HOWARD BROWN HEALTH CENTER
(A NOT-FOR-PROFIT CORPORATION)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS REPORTS REQUIRED BY GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133

June 30, 2012 and 2011

HOWARD BROWN HEALTH CENTER
(A NOT-FOR-PROFIT CORPORATION)
Chicago, Illinois

FINANCIAL STATEMENTS
June 30, 2012 and 2011

CONTENTS

Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Howard Brown Health Center
Chicago, Illinois

We have audited the accompanying statements of financial position of Howard Brown Health Center (the "Center") as of June 30, 2012 and 2011, and the related statements of activities, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 the 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 Howard Brown Health Center as of June 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated January 29, 2013 on our consideration of Howard Brown Health Center'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 is presented for purposes 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 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 subject to the auditing procedures applied in the audit of the financial statements and certain other 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 schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Crowe Horwath LLP

Crowe Horwath LLP

Chicago, Illinois
January 29, 2013

HOWARD BROWN HEALTH CENTER
STATEMENTS OF FINANCIAL POSITION
June 30, 2012 and 2011

	2012	2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 636,012	$ 415,114
Accounts receivable, net of allowance for doubtful accounts of $489,947 and $531,407	2,716,706	1,943,237
Pledges receivable, net of allowance for doubtful accounts of $99,637 and $46,716	263,133	697,260
Inventories	656,172	688,876
Prepaid expenses	149,772	147,470
Total current assets	4,421,795	3,891,957
Property and equipment, net	2,663,055	2,626,415
Investment in Alliance	456,069	464,798
Other assets, primarily works of art	365,492	308,767
	$ 7,906,411	$ 7,291,937
LIABILITIES AND NET ASSETS		
Current liabilities		
Line of credit, current	$ 666,667	$ 814,299
Current maturities of long-term debt	81,684	1,959,239
Accounts payable	2,883,337	2,975,088
Accrued expenses	434,605	410,589
Due to the federal government	191,667	721,842
Total current liabilities	4,257,960	6,881,057
Due to the federal government	383,333	-
Long-term debt, less current maturities	1,951,049	41,684
Total liabilities	6,592,342	6,922,741
Net assets		
Unrestricted	915,163	(435,971)
Temporarily restricted	398,906	805,167
Total net assets	1,314,069	369,196
	$ 7,906,411	$ 7,291,937

See accompanying notes to financial statements

HOWARD BROWN HEALTH CENTER
STATEMENTS OF ACTIVITIES
Years ended June 30, 2012 and 2011

	Unrestricted	Temporarily Restricted	2012 Total
Revenues, Gains and Other Support			
Gross patient revenue	$ 4,003,681	$ -	$ 4,003,681
Less: contractual adjustments	(865,913)	-	(865,913)
Less: charitable care	(1,061,099)	-	(1,061,099)
Net patient revenue	2,076,669	-	2,076,669
Government contracts	4,350,686	-	4,350,686
Direct public support	4,180,246	663,600	4,843,846
Donated services	562,382	-	562,382
Interest	45	39	84
Net assets released from restriction	1,069,900	(1,069,900)	-
340B pharmacy revenue	7,208,781	-	7,208,781
Other, including Alliance income (loss)	172,528	-	172,528
Total revenues, gains and other support	19,621,237	(406,261)	19,214,976
Expenses			
Medical	7,750,024	-	7,750,024
Youth services	881,960	-	881,960
Behavioral health	734,093	-	734,093
Research	933,700	-	933,700
Prevention	1,102,285	-	1,102,285
Total program expenses	11,402,062	-	11,402,062
Development	821,974	-	821,974
Public relations	195,982	-	195,982
Brown elephant	2,160,511	-	2,160,511
Total expenses by function	14,580,529	-	14,580,529
General and administrative	3,689,574	-	3,689,574
Total expenses	18,270,103	-	18,270,103
Increase (decrease) in net assets	1,351,134	(406,261)	944,873
Net assets (deficit) at beginning of year	(435,971)	805,167	369,196
Net assets at end of year	$ 915,163	$ 398,906	$ 1,314,069

(Continued)

HOWARD BROWN HEALTH CENTER
STATEMENTS OF ACTIVITIES
Years ended June 30, 2012 and 2011

	Unrestricted	Temporarily Restricted	2011 Total
Revenues, Gains and Other Support			
Gross patient revenue	$ 3,911,377	$ -	$ 3,911,377
Less: contractual adjustments	(1,065,605)	-	(1,065,605)
Less: charitable care	(928,376)	-	(928,376)
Net patient revenue	1,917,396	-	1,917,396
Government contracts	5,796,415	-	5,796,415
Direct public support	4,123,810	929,054	5,052,864
Donated services	1,041,847	-	1,041,847
Interest	452	166	618
Net assets released from restriction	758,378	(758,378)	-
340B pharmacy revenue	2,133,552	-	2,133,552
Other, including Alliance income (loss)	229,280	-	229,280
Total revenues, gains and other support	16,001,130	170,842	16,171,972
Expenses			
Medical	3,840,930	-	3,840,930
Youth services	1,405,565	-	1,405,565
Behavioral health	643,552	-	643,552
Research	1,350,340	-	1,350,340
Prevention	1,070,006	-	1,070,006
Total program expenses	8,310,393	-	8,310,393
Development	660,581	-	660,581
Public relations	86,159	-	86,159
Brown elephant	2,175,846	-	2,175,846
Total expenses by function	11,232,979	-	11,232,979
General and administrative	3,748,620	-	3,748,620
Total expenses	14,981,599	-	14,981,599
Increase in net assets	1,019,531	170,842	1,190,373
Net assets (deficit) at beginning of year	(1,455,502)	634,325	(821,177)
Net assets (deficit) at end of year	$ (435,971)	$ 805,167	$ 369,196

See accompanying notes to financial statements

HOWARD BROWN HEALTH CENTER
STATEMENT OF FUNCTIONAL EXPENSES
Year ended June 30, 2012

	Program Services									
	Medical	Youth Services	Behavioral Health	Research	Prevention	Development	Public Relations	Brown Elephant	General and Administrative	2012 Total
Salaries	$ 2,119,319	$ 534,745	$ 583,041	$ 711,859	$ 766,384	$ 498,014	$ 56,798	$ 856,755	$ 1,431,680	$ 7,558,595
Fringe benefits	215,888	70,793	51,533	59,171	98,175	21,072	7,933	68,630	91,350	684,545
Payroll taxes	162,490	40,478	45,225	52,077	58,462	32,193	5,005	75,788	98,516	570,234
Accounting and legal fees	-	-	-	-	-	-	-	-	566,679	566,679
Supplies	80,051	72,466	7,419	11,923	30,183	9,795	1,232	19,639	166,001	398,709
Telephone	28,746	18,532	-	2,410	2,306	648	419	22,690	76,366	152,117
Postage and shipping	4,871	266	205	8,735	127	2,461	2	766	4,344	21,777
Occupancy and utilities	110,736	66,442	-	-	-	-	-	897,318	131,505	1,206,001
Repairs and maintenance	9,912	25,860	-	-	-	-	-	44,765	86,912	167,449
Printing	8,600	5	2,624	9,182	10,184	18,058	67	3,346	6,937	59,003
Travel	14,173	4,306	111	2,517	23,894	4,952	-	992	6,705	57,650
Seminars and meetings	8,768	1,638	-	1,256	4,622	1,460	-	-	5,410	23,154
Depreciation and amortization	-	-	-	-	-	-	-	7,604	136,945	144,549
Outside services	257,770	7,532	3,708	8,309	53,257	100,399	(2,383)	36,189	386,374	851,155
Staff services	31,145	2,703	6,395	1,774	4,740	4,032	115	1,119	34,252	86,275
Pharmaceuticals, outside labs and medical supplies	4,547,184	7,400	370	17,523	7,040	802	-	-	-	4,580,319
Client assistance	16,157	9,401	3,046	-	-	-	-	-	-	28,604
Licenses and fees	3,843	200	200	329	-	100	200	570	218	5,660
Dues and subscriptions	1,170	110	-	2,505	443	2,241	-	347	33,095	39,911
Advertising	3,530	-	15,755	250	2,100	4,494	3,808	11,070	1,239	42,246
Client development	-	9,997	-	30,967	(1,323)	-	-	-	-	39,641
Public relations	4,188	-	-	-	-	48,083	120,589	-	-	172,860
Leases and equipment	410	-	-	3,943	-	-	-	-	-	4,353
Other	15,391	9,086	-	-	12	14,615	1,547	34,343	33,519	108,513
Benefit expense	-	-	-	-	-	55,409	650	-	-	56,059
Bank fees	10,005	-	-	-	-	1,987	-	38,935	94,669	145,596
Interest expense	-	-	-	-	-	-	-	-	170,608	170,608
Insurance expense	36,777	-	6,469	8,970	4,257	1,159	-	39,645	36,119	133,396
Bad debt expense (recoveries)	57,900	-	7,992	-	-	-	-	-	90,131	156,023
Subcontractor expense	1,000	-	-	-	37,422	-	-	-	-	38,422
Total expense	$ 7,750,024	$ 881,960	$ 734,093	$ 933,700	$ 1,102,285	$ 821,974	$ 195,982	$ 2,160,511	$ 3,689,574	$ 18,270,103

(Continued)

HOWARD BROWN HEALTH CENTER
STATEMENT OF FUNCTIONAL EXPENSES
Year ended June 30, 2011

	Program Services									
	Medical	Youth Services	Behavioral Health	Research	Prevention	Development	Public Relations	Brown Elephant	General and Administrative	2011 Total
Salaries	$ 1,592,865	$ 774,171	$ 479,699	$ 967,102	$ 704,429	$ 317,737	$ 62,678	$ 1,022,016	$ 1,334,855	$ 7,255,552
Fringe benefits	144,715	71,883	40,281	108,315	93,841	9,010	1,536	47,959	39,475	557,015
Payroll taxes	138,452	71,143	43,440	79,114	62,129	24,384	6,077	104,753	112,365	641,857
Accounting and legal fees	-	-	-	-	-	-	-	-	1,087,751	1,087,751
Supplies	17,823	52,867	30,954	23,032	29,791	7,170	1,320	17,685	42,215	222,857
Telephone	24,156	23,734	77	2,182	1,439	-	-	16,690	71,699	139,977
Postage and shipping	3,308	250	244	11,412	67	4,680	19	-	9,422	29,402
Occupancy and utilities	104,060	77,212	-	-	-	-	-	777,768	143,246	1,102,286
Repairs and maintenance	4,458	26,100	-	-	-	-	-	61,123	66,502	158,183
Printing	23,046	1,374	4,760	6,737	900	7,995	1,441	1,459	1,949	49,661
Travel	8,668	13,735	4,054	7,158	47,295	2,771	26	300	2,856	86,863
Seminars and meetings	11,897	938	-	2,781	75	3	-	-	6,338	22,032
Depreciation and amortization	-	-	-	-	-	-	-	7,604	135,050	142,654
Outside services	42,111	22,343	37	13,151	4,015	36,135	10,557	9,348	189,943	327,640
Staff services	14,298	1,643	12,368	1,126	1,298	13,357	-	110	13,278	57,478
Pharmaceuticals, outside labs and medical supplies	1,638,994	52,798	1,701	19,573	7,897	-	-	-	-	1,720,963
Client assistance	16,474	6,048	5,327	-	201	-	-	-	-	28,050
Licenses and fees	500	200	613	-	-	-	-	95	31	1,439
Dues and subscriptions	7,521	965	430	3,675	655	540	420	290	35,003	49,499
Advertising	3,613	375	9,342	(3,350)	-	600	938	1,381	4,130	17,029
Client development	1,317	29,399	-	75,782	-	-	-	-	-	106,498
Public relations	-	-	-	-	-	126,737	972	-	400	128,109
Leases and equipment	-	-	-	3,409	-	-	-	818	-	4,227
Other	16,751	10,203	-	-	6,657	2,043	175	33,760	17,501	87,090
Benefit expense	-	-	-	-	-	92,399	-	-	-	92,399
Bank fees	9,432	-	-	-	-	13,730	-	50,003	40,366	113,531
Interest expense	-	-	-	-	-	-	-	34	187,640	187,674
Insurance expense	124,577	3,539	14,882	17,628	-	1,290	-	22,650	16,673	201,239
Bad debt expense (recoveries)	(108,904)	1,674	(4,657)	10,280	2,430	-	-	-	178,137	78,960
Subcontractor expense	798	162,971	-	1,233	106,887	-	-	-	11,795	283,684
Total expense	$ 3,840,930	$ 1,405,565	$ 643,552	$ 1,350,340	$ 1,070,006	$ 660,581	$ 86,159	$ 2,175,846	$ 3,748,620	$ 14,981,599

See accompanying notes to financial statements

HOWARD BROWN HEALTH CENTER
STATEMENTS OF CASH FLOW
Years ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Increase in net assets	$ 944,873	$ 1,190,373
Adjustments to reconcile increase in net assets to net cash from operating activities		
Bad debt (recoveries) expense	156,023	78,960
Depreciation and amortization	144,549	142,654
Loss on disposal of equipment	4,200	-
Equity share of Alliance (income) loss	28,729	(88,111)
Changes in assets and liabilities		
Accounts receivable	(898,391)	(709,447)
Pledges receivable	403,026	(473,506)
Inventories	32,704	362,498
Prepaid expenses and other assets	(59,027)	(51,059)
Accounts payable	(91,751)	(3,249)
Accrued expenses	24,016	(94,569)
Due to federal government	(146,842)	(383,629)
Net cash from operating activities	542,109	(29,085)
Cash flows from investing activities		
Purchase of property and equipment	(185,389)	-
Investment in Alliance	(20,000)	(20,000)
Net cash from investing activities	(205,389)	(20,000)
Cash flows from financing activities		
Principal payments on notes payable	(90,429)	(91,508)
Net payments on line of credit	(25,393)	(634)
Net cash from financing activities	(115,822)	(92,142)
Net change in cash and cash equivalents	220,898	(141,227)
Cash and cash equivalents at beginning of year	415,114	556,341
Cash and cash equivalents at end of year	$ 636,012	$ 415,114
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	$ 170,608	$ 192,481

See accompanying notes to financial statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization, Nature of Business and Income Tax Status: Howard Brown Health Center (the "Center") is incorporated under the laws of the State of Illinois as a not-for-profit organization. The Center provides a comprehensive array of healthcare and social services to a broad community with a focus on lesbian, gay, bi-sexual and transgender ("LGBT") communities. In addition to healthcare services, the Center also conducts behavioral and clinical research in a variety of areas that impact wellness in the LGBT community.

Basis of Accounting: The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Center's financial statements are presented in conformity with the AICPA Audit and Accounting Guide for Not-For-Profit Organizations.

On March 29, 2012, the Center negotiated a final Settlement Agreement with a federal agency regarding the previous administration's mismanagement of grant funds (see Notes 7 and 10). In addition, the Center is in default of its debt terms and requirements (see Notes 6 and 10 regarding forbearance terms of debt). The Center's ability to continue as a going concern will depend upon its ability to continue to obtain forbearance extensions on debt in default, finalize a long-term repayment schedule for obligations due to Northwestern (see Note 10) and continued expansion of the Center's 340B pharmacy program.

The Center has taken substantial steps to address these concerns, and has shown significant improvement in the fiscal years ended June 30, 2012 and 2011, respectively. In addition to a complete change of management, and reconstitution of the Board of Directors in January 2011, the Center has made significant progress in each area which gave rise to the doubts that existed in 2010. The Center's performance in each of the last two fiscal years ended June 30, 2012 and 2011, respectively, reflects the Center's ability to continue operations and resolve doubts about its ability to continue as a going concern in the next fiscal period. At the conclusion of the fiscal year ended June 30, 2011, the Center no longer had a deficit in net assets and, instead, increased net assets by over $1,000,000. This positive financial progress continued in the fiscal year ended June 30, 2012, as the net assets position increased by almost an additional $1,000,000. With respect to the bank debt, the Center has successfully obtained six consecutive forbearance agreements (see Note 10) from its bank lender. The lender has continued to work cooperatively with the Center as it pursues options to either resolve the debt due to the lender or refinance it with another lending institution. There are no indications that the Center's relationship with the lender will change in a manner that will have a material adverse effect on the Center's ability to continue to improve its financial performance. Additionally, the Center has concluded its investigation and has been advised by the U.S. Office of Inspector General ("OIG") that the findings have been validated, as have the changes the Center made in response. As evidenced by the Settlement Agreement, the OIG responded favorably to the Center's proactive steps to resolve the liabilities as a result of past mismanagement (see Note 10).

The Center's management team has worked diligently in responding to the concerns identified in the 2010 audit. The outcome of these steps has been positive and demonstrable of the Center's capacity to fulfill its recovery plan. The Center's efforts increased net assets by over $1,000,000 for the fiscal year ended June 30, 2011, and almost by $1,000,000 for the fiscal year ended June 30, 2012. This positive financial progress restored the Center's net assets to a positive position, in the first year alone of the Center's three-year recovery plan. The Center's three-year recovery plan continues to include, but is not limited to, the following:

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Substantial reduction of the Center's expenses through an improved three-year strategic budget plan, including for example:
    - Reducing unfunded and unnecessary payroll expenses, without material adverse impact on services;
    - Restructuring and reducing certain fixed expenses, such as occupancy and other operational costs;
    - Collaborating with other agencies and community partners where opportunities for gains in efficiency or sharing of expenses exist;
    - Strategically partnering with vendors to obtain more favorable pricing commitments on short and long term supply and service contracts; and
    - Reducing expenditures of resources in unfunded or non-revenue generating divisions or programs.
- Substantial increase of the Center's revenue through:
    - Implementation of an enhanced 340B pharmacy program, which has a demonstrated ability to earn revenue in excess of expenses by approximately 40-50%;
    - Improving efficiency in the Center's promotion and provision of medical and behavioral health services;
    - Strategic advertising and promotion of existing, new and improved services designed for and targeted at insured patients;
    - Raising substantial additional unrestricted capital through special fundraising campaigns, major gifts and, also raising additional long-term equity capital for future strategic capital improvements or expenditures to expand capacity and promote strategic growth;
    - Substantially increasing sales in retail operations (the Brown Elephant Resale Shops) to convert inventory to cash through sales, promotions and liquidation efforts;
    - Strategic partnerships, joint ventures and mergers/acquisitions with complimentary agencies or community partners; and
    - Identifying, seeking and obtaining additional research and other program grants; including several pending applications.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Improved cash flow management including:
  - Renewing existing lending facilities or entering into new lending arrangements;
  - More effectively managing and collecting receivables due for the Center's medical and behavioral health services, and also from the Center's commercial and program vendors and subcontractors;
  - Reducing unnecessary spending; and increasing revenue opportunities through strategic avenues such as expanding hours for patient service, and enhanced patient billing processes;
  - Strategically monitoring and managing its cash flow on a weekly basis.

The Center cannot provide assurance that it will be able to successfully execute all of the actions in its final business plan; however the Center has made demonstrable progress on several of these initiatives during 2012 and 2011, including:

- Successful completion of the Lifeline Appeal, which the Center launched in November 2010, seeking to raise $500,000 in 50 days in order to overcome cash shortfalls which threatened the continued operations of the Center. As shown in the financial statements, the Lifeline Appeal raised in excess of $1,000,000 during 2011, while incurring direct expenses of less than 1% of total revenue from the Lifeline Appeal.
- Successful implementation of an improved 340B Pharmacy Program, which earned $7,208,781 and $2,133,552 in revenue during 2012 and 2011, respectively, while incurring $4,161,885 and $1,298,225 in direct expenses for a contribution margin of over $3,046,000 and $835,000, for the years ending June 30, 2012 and 2011, respectively. The pharmacy program's current performance in 2013 is trending toward substantially exceeding 2012 performance and the 2013 budgeted contribution margin of $4,100,000.
- Obtaining several new sources of private grant funds, including a $250,000 grant from the GE Foundation which is being used to develop new sustainable and revenue-generating models of health care.
- Obtaining five six-month forbearance agreements and most recently a nine-month forbearance agreement from its primary bank lender BMO Harris Bank (note holder on mortgage and line of credit discussed above) during 2011 and 2012, the latest of which is through July 31, 2013. The lender continues to work cooperatively and favorably with the Center and there are no indications that a material adverse change in the parties relationships will occur in the foreseeable future.
- Obtaining an agreement in principle with Northwestern University ("NU"), to convert the $1,728,182 accounts payable due to NU as a result of past mismanagement of the MACS Grant, into a note payable with a minimum forbearance period through June 30, 2012. The final agreement is still being memorialized by the parties and has not yet been executed. However, the parties conduct during 2011 and 2012 is consistent with this agreement and there have been no indications that Northwestern will demand repayment in any amount after that period that is inconsistent with the Center's ability to repay at that time.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 revenue and expense during the reporting period. Areas where significant estimates that are sensitive to change in the near term are used in the accompanying financial statements include allowances for contractual adjustments and doubtful accounts, useful lives of fixed assets, incurred but not reported self-funded health insurance liability, net realizable value of pledge receivables, fair value of inventory, real and property taxes, and due to federal government. Actual results may differ from these estimates.

Concentrations: At June 30, 2012 and 2011, substantially all of the Center's cash and cash equivalents were with two financial institutions. At times amounts on deposit may exceed federally insured limits, which represents a concentration of credit risk; however, management monitors this risk and believes the likelihood of loss to be remote.

Cash and Cash Equivalents: Cash and cash equivalents consist of demand deposits in accounts that are either interest-bearing or federally insured up to $250,000, or non-interest bearing and fully guaranteed by the federal government. The Center considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Endowment: The Center's Board-designated endowment ("Endowment") consists of cash and cash equivalents. As required by applicable standards, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Endowment net asset composition consists of all temporarily restricted net assets, as restricted by the Board.

Changes in Endowment net assets for 2012 and 2011 are as follows:

	Total	Unrestricted	Temporarily Restricted	Permanently Restricted
Endowment net assets, July 1, 2010	$ 400,571	$ -	$ 400,571	$ -
Interest income	166	-	166	-
Board-approved draw	(290,000)	-	(290,000)	-
Endowment net assets, June 30, 2011	110,737	-	110,737	-
Interest income	39	-	39	-
Board-approved addition	25,000	-	25,000	-
Endowment net assets, June 30, 2012	$ 135,776	$ -	$ 135,776	$ -

Interpretation of UPMIFA: The Center's Board of Directors has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the Endowment funds absent explicit donor stipulations to the contrary.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Return Objectives and Risk Parameters: The Center has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include board restricted funds that the Center must hold for a board specific purpose. Under this policy, as prescribed by the board, the endowment assets are to be invested in a prudent manner where the primary objective is the preservation of principal in an attempt to provide a predictable stream of funding to programs supported by the endowment.

Strategies Employed for Achieving Objectives: The purpose of the endowment fund is to provide funds for professional development for gay and lesbian providers and fellowships for medical staff. To satisfy its objectives, the Center has elected to invest in a money market bank account to preserve principle and provide interest income to provide professional development and fellowships for medical staff.

Spending Policy and How the Investment Objectives Relate to Spending Policy: The Board of Directors of the Center has established an endowment fund spending policy, which utilizes the interest income to provide funds for professional development and fellowships for medical staff. The amount of the funding is determined by the Board of Directors and upon specific events, may exceed interest income. It is expected that only the interest income of the endowment will be utilized in support of the Center's activities, but in the event that the Center's Board of Directors determines that there is a critical need in providing medical services which could not otherwise be met through funds available to the Center, the Board can utilize endowment principal for such purposes upon approval by a two-thirds vote of the Board of Directors.

Patient Accounts Receivable and Allowances: Accounts receivable represents charges to patients, primarily on open account. Past due receivables are determined based on contractual terms. The Center does not accrue interest on any of its accounts receivable. Adjustments to patient accounts are made in amounts estimated to maintain allowances to cover estimated contractual allowances and anticipated losses from patients, third-party payers and others. The allowance is determined by management based on the Center's historical net collection percentages, specific patient circumstances and general economic conditions. As payments are received, specific contractual adjustments detailed in the explanation of benefits are charged against the patient's account and the allowance. At the Center's sole discretion, and with consideration given to specific grant requirements, as applicable, patient accounts are turned over to external collections. Accounts receivable is shown net of allowances on the statement of financial position. Gross patient accounts receivable greater than 90 days outstanding at June 30, 2012 and 2011 were $375,748 and $374,388.

Pledges Receivable: Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Amounts that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using interest rates applicable to the years in which the pledges are received. Amortization of the discounts is included in direct public support. There were no long-term pledge receivables at June 30, 2012. There was one long-term pledge at June 30, 2011 in the amount of $250,000 of which $150,000 was collected during fiscal year 2012 and $100,000 collected during fiscal year 2013. Conditional promises to give are not included as support until the conditions are substantially met.

Inventories: Inventories consist of items donated to the resale shop which are valued at estimated fair value, and pharmaceutical drug supplies which are value at the lower of cost or fair value.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment and Related Depreciation and Amortization: Property and equipment are stated at cost or, if donated, at estimated fair value upon donation, and are depreciated using the straight-line method over the assets' estimated useful lives ranging from 3 to 25 years. All productive assets with a cost when purchased, or fair value when donated, of over $5,000 are capitalized, with the exception of computer hardware and software. The capitalization threshold was changed to $1,000 effective July 1, 2011 for computer hardware and software. When assets are sold or otherwise disposed of, the assets and related accumulated depreciation are removed from the accounts, and the remaining gain or loss is included in operations. Repairs and maintenance costs are charged to expense as incurred. Capitalized works of art are not depreciated since they are expected to maintain their value.

Equity Method Investment: The Center accounts for its 25% investment in the Alliance of Chicago Community Health Services, LLC ("the Alliance") under the equity method of accounting. The Alliance was created to coordinate the sharing of resources and the development and integration of IT systems between and among its members. The Center and the other member agencies are each required to contribute $20,000 annually to the Alliance. The Alliance also receives grants from government and private foundations. The Center's share of equity in gain (loss) of the Alliance (unconsolidated affiliate) was $(28,352) and $85,530 for 2012 and 2011, and is included in the statements of activities in other revenues.

Summarized unaudited financial information for the Alliance at June 30, 2012 and 2011 is as follows:

	2012	2011
Assets	$ 5,235,887	$ 5,310,721
Liabilities	3,421,435	3,461,856
Equity	1,814,452	1,848,865

Donated Long-Lived Assets: The Center reports gifts of property and equipment and works of art as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used are reported as restricted support.

Impairment of Long-Lived Assets: On an ongoing basis, the Center reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying amounts may be overstated. The Center recognizes impairment losses if the undiscounted cash flows expected to be generated by the asset are less than the carrying value of the related asset. The impairment loss adjusts the assets to fair value. As of June 30, 2012 and 2011, management believes that no impairment existed.

Due to Federal Government: Due to federal government represents the Center's estimated liability resulting from the events described earlier in Note 1 and in Note 7.

Net Assets and Contributions: The Center reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Unrestricted net assets include resources which are not subject to donor-imposed restrictions plus those resources for which donor-imposed restrictions have been satisfied. Contributions are reported as increases in the appropriate category of net assets. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported in the statement of activities as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Satisfaction of temporarily restricted net assets (i.e., the donor-stipulated purpose has been fulfilled or the stipulated time period has elapsed) is reported as reclassification from temporarily restricted net assets to unrestricted net assets. Where the stipulation of the temporarily restricted net assets is fulfilled in the same year as the original contribution, the contribution is recorded as unrestricted revenue. Permanently restricted net assets are subject to donor-imposed restrictions which will never lapse, thus requiring that the funds be retained permanently. At June 30, 2012 and 2011, temporarily restricted net assets were related to amounts received from a foundation to be used to support the mission of the Center and uncollected pledges. Amounts are released from restriction as the funds are spent toward the specific restricted purposes or the time period has elapsed. The Center does not have any permanently restricted net assets.

Revenue Recognition: Patient revenue is recognized as revenue when the services are performed and is reported at the estimated net realizable amounts from patients, third-party payers and others. Provisions for estimated third-party payer settlements and adjustments are made in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Revenue related to the sale of prescription drugs in the Center's health centers consists of the amount paid by third-party payers and patients, net of the amount the Center has contracted to pay the pharmacy for the dispensing of such drugs together with any associated administrative fees. Revenue is recognized when prescription drugs are dispensed, and is recorded in Other Revenue on the statement of activities.

Charity Care: The Center provides charity care (care for which the Center receives no payment, revenue or grant reimbursement) to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because collection of amounts determined to qualify as charity care is not pursued, such amounts are not reported as revenue. Records are maintained to identify and monitor the level of charity care provided including the amount of charges foregone for services and supplies furnished.

In August 2010, the FASB (“Financial Accounting Standards Board”) issued ASU (“Accounting Standards Update”) No. 2010-23, which requires the Center to use its direct and indirect costs of providing charity care as the measurement basis for charity care disclosures. This ASU also requires additional disclosures of the method used to determine such costs. The Center adopted this update on July 1, 2011. The estimated costs incurred by the Center to provide these services to patients who are unable to pay was approximately $3,537,591 and $2,632,124 for 2012 and 2011, respectively. The estimated costs of these charity care services was determined using a ratio of certain costs to gross charges and applying that ratio to the gross charges associated with providing care to charity patients for the period. Gross charges associated with providing care to charity patients includes only the related charges for those patients who are financially unable to pay and qualify under the Center’s charity care policy and that do not otherwise qualify for reimbursement from a government program. During 2012 and 2011, the Center received grants revenue of $287,299 and $258,483, from the Heartland International Health Center (subaward) to help defray the costs of indigent care.

Government Grants and Contracts: Government grants and contracts are recognized as income in the period in which services are provided. Subcontractor expense results from certain contracts passed through to sub-recipients.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Resale Shop: The Center operates three resale shops supported solely by donations of second-hand goods. Revenue from sales of donated goods at the date of sale, as well as net increases or decreases of inventory, are recorded as direct public support in the statement of activities. The net increase (decrease) in inventories was ($16,087) and ($420,052), and donations of second-hand goods was $3,225,025 and $2,820,615 for 2012 and 2011, respectively.

Donated Services: Various services and support (primarily professional fees) for the Center's operations and staff members have been provided by volunteers with specialized skills. The Center recognizes the estimated fair value of the donated services as a contribution when such services are rendered. Included in the financial statements are contributions from such donated services and the corresponding expenses of $562,382 and $1,041,847 for 2012 and 2011.

Incentive Program Revenue: The Patient Protection and Affordable Care Act of 2010 (PPACA), the American Recovery and Reinvestment Act of 2009 (ARRA) and the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA) all include provisions for incentive revenue to be provided to physicians who participate in providing data on quality measures or utilize electronic prescription, or demonstrate meaningful use of certified electronic health records technology, within their practice of medicine. The Center follows the gain contingency method of revenue recognition with regard to these types of incentive programs, whereby revenue is recognized under notification from governmental authorities that incentive program revenue has been earned and/or actual payment has been received. Total incentive program revenue recognized in 2012 and 2011 is $31,875 and $0, respectively. Such incentive revenue is included in other revenues in the statements of activities.

Functional Allocation of Expenses: The costs of providing various programs and supporting activities are presented on the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

The Center's activities are reported in the following nine functional expense categories: medical, youth services, behavioral health, research, and prevention, all of which are program services; public relations, which includes marketing; development, which includes general fundraising/benefits and grant writings; Brown Elephant, which are the resale shop operations; and general and administrative, which includes all other types of expenses.

Allocation of Expenses: Expenses that are common to program services, development and general and administrative expenses are allocated based on estimates of management.

Income Taxes: The Center is exempt from federal income tax under Section 501 (c)(3) of the Internal Revenue Code. Accordingly, no provision has been made for federal or state income taxes. The exemption for the State of Illinois expires on July 1, 2017, unless properly renewed three months prior to the expiration.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Due to its tax-exempt status, the Center is not subject to U.S. federal or state income tax. The Center's Form 990 is no longer subject to examination by the Internal Revenue Service or the state of Illinois for the years prior to June 30, 2009. The Center does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months. The Center recognizes interest and/or penalties related to income tax matters in income tax expense. The Center did not have any amounts accrued for interest and penalties at June 30, 2012 and 2011.

Reclassifications: Certain prior year amounts have been reclassified to conform with the current year presentation. These reclassifications had no effect on net assets or the change in net assets.

Adoption of New Accounting Standards: ASU No. 2011-07 *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts* requires the accounting for patient accounts receivable and associated revenues be updated to require all healthcare organizations that perform services for patients for which the ultimate collection of all or a portion of the amounts billable or balance cannot be determined at the time services are rendered to present all bad debt expense associated with patient service revenue as an offset to the patient service revenue line item in the statement of operations. The update also requires qualitative disclosures about the Center's policy for recognizing revenue and bad debt expense for patient service transactions and qualitative information about the effects of changes in the assessment of collectability of patient service revenue. This update is effective for fiscal years beginning after December 15, 2011. This update is not expected to have an impact on the Center's change in net assets, but will increase the current disclosures.

NOTE 2 - CONTRACTUAL AGREEMENTS

The Center's principal contractual agreements are as follows:

Health Resources and Services Administration (Ryan White Part A): Funded by HRSA HIV/AIDS Bureau, the Center sub-contracted with CDPH to provide Ambulatory Outpatient Medical Care, Behavioral Health Services, Substance Abuse Treatment, Early Intervention Services, and Psychosocial Support Services to individuals living with HIV.

Health Resources and Services Administration (Ryan White Part C): The Center contracted with HRSA's HIV/AIDS Bureau to conduct Outpatient Early Intervention and Primary Care Services to HIV-infected individuals.

Health Resources and Services Administration (Ryan White Part D): The Center contracted with HRSA's HIV/AIDS Bureau to provide Medical Services, Mental Health Services, and Case Management to HIV-positive women, infants, children and youth.

Health Resources and Services Administration (Comprehensive Geriatric Education Program): The Center was awarded a multi-year contract to support the training and education of individuals in providing care for the elderly and to develop and disseminate a replicable cultural competency program. The Center is partnering with two nursing colleges on this project.

The Center also has numerous federal, state and local grants for the purpose of providing medical services, research, case management services, as well as prevention and education programs, to the gay, lesbian, bisexual and transgender community.

(Continued)

NOTE 2 - CONTRACTUAL AGREEMENTS (Continued)

As described above, the Center receives a significant amount of its funding from federal government agencies, though grants. Accordingly, the Center's management is responsible for administering and managing these funds in accordance with the specific terms and provisions of the underlying grants or contracts as well as the general compliance and administrative rules to which any recipient of federal funds must adhere.

NOTE 3 - PROPERTY AND EQUIPMENT

At June 30, property and equipment consist of:

	2012	2011
Land	$ 343,421	$ 343,421
Buildings	3,047,383	3,047,383
Leasehold improvements	116,652	116,653
Furniture and fixtures	137,267	257,607
Office equipment	298,504	432,603
Software	228,533	166,127
Medical equipment	51,449	51,449
Vehicles	102,990	139,864
	4,326,199	4,555,107
Less accumulated depreciation and amortization	1,663,144	1,928,692
	$ 2,663,055	$ 2,626,415

NOTE 4 - PRETAX SAVINGS PLAN

The Center maintains a 401(k) savings plan covering substantially all employees with three months of service. Employees can contribute up to 90% of their compensation, subject to Internal Revenue Code limits. The Center made no contributions to the Plan in 2012 or 2011.

On January 1, 2008, the Center offered certain employees an unqualified deferred compensation plan created in accordance with IRC Section 457. The Plan is available for a select group of management or highly compensated employees as defined in Sections 201, 301, and 401 of the Employee Retirement Income Security Act of 1974 (ERISA). The deferred compensation is not available to the employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights are, until made available to the employee or other beneficiary, solely the property and rights of the Center without being restricted to the provision of benefits under the Plan and are thus subject to the claims of the Center's general creditors. Participants' rights created under the Plan are equivalent to those of general creditors of the Center.

The Center's liability to each participant is equal to the amount of the participant's deferred compensation adjusted by an amount equal to the investment performance in a related asset account. The related asset accounts are recorded at fair value, which is equal to the liability to plan participants. The Center has not matched any participant's contributions since inception.

(Continued)

NOTE 5 - LEASES

At June 30, 2012 and 2011, the Center was obligated for future rentals under various non-cancelable operating leases for their operating facilities. Monthly payments range from $1,213 to $31,293 through 2019, and various leases include escalation clauses and renewal options. Future minimum lease payments are as follows:

2013	$ 856,670
2014	769,908
2015	407,299
2016	253,242
2017	137,868
Thereafter	212,850
Total	$ 2,637,837

Rent expense for 2012 and 2011 was $935,158 and $877,393, which is included in occupancy and utilities expense in the statement of functional expenses.

NOTE 6 - NOTES PAYABLE

A summary of notes payable at June 30 is as follows:

	2012	2011
Mortgage note secured by real estate with monthly payments of $4,138, including interest at 4.64%, through March 1, 2013.	$ 36,536	$ 83,317
Bank mortgage note secured by real estate with monthly payments of $13,504, including interest at 6.50%, through August 29, 2013. The bank mortgage note is in forbearance through July 31, 2013 (see Note 10).	1,868,810	1,905,998
Note payable of $29,765 collateralized by a truck, with monthly payments of $589, including interest at 6.95%, through February 15, 2013.	5,148	11,608
Bank operating line of credit, collateralized by accounts receivable, with interest at the prime rate plus the default rate of 3.00% (6.25% at June 30, 2012 and 2011). The line of credit is in forbearance through July 31, 2013 (see Note 10).	788,906	814,299
Total notes payable	2,699,400	2,815,222
Less current portion of line of credit	666,667	814,299
Less current maturities	81,684	1,959,239
Total long-term notes payable	$ 1,951,049	$ 41,684

(Continued)

NOTE 6 - NOTES PAYABLE (Continued)

The bank mortgage note and line of credit contain, among other things, financial requirements regarding the Center's maintenance of minimum earnings before interest, taxes, depreciation and amortization ("EBITDA") to debt service and liabilities to taxable net worth ratios and certain other provisions limiting the incurrence of additional debt.

The Center is in default of the aforementioned loan arrangements. On October 31, 2012, the Bank lender agreed to forbear, for the sixth consecutive time, from exercising their rights and remedies under the loan arrangement through July 31, 2013 (see Note 10). The forbearance agreement requires periodic payments, totaling $266,667 on the line of credit prior to June 30, 2013. Upon expiration of the forbearance period, the Center shall pay the remaining balance of the line of credit. A previous forbearance agreement required the payment of $400,000 on the outstanding line of credit in August 2012. The forbearance agreement requires the regular monthly payments on the bank mortgage note, based upon a 19-year amortization schedule, through July 31, 2013. The Center's management is working cooperatively with the Center's lender to improve the Center's banking relationship. As a result of recent efforts and communications, the Center anticipates that such cooperation will continue.

Scheduled principal payments over the next two years ending June 30 are as follows. The schedule reflects the bank mortgage note as a 2014 payment due to the default noted above.

2013	$ 748,351
2014	1,951,049

Interest expense was $170,608 and $187,674 for the years ended December 31, 2012 and 2011, respectively.

NOTE 7 – DUE TO FEDERAL GOVERNMENT

The Center finalized an agreement with OIG to settle the allegations of mismanagement of funds from January 1, 2006 through December 31, 2010. The agreement calls for repayment of $715,000 through September 30, 2014. As of June 30, 2012, the Center owed the Federal Government $575,000, allocated between current liabilities and long-term liabilities.

NOTE 8 – RELATED PARTY TRANSACTIONS

The Center purchases ongoing information technology services from the Alliance, a related party through equity ownership. The services include discounted licensing and maintenance fees for the Centricity electronic health records system (which includes a patient accounts receivable system), hosting and technical support. Annual fees of $45,440 and $43,264 were incurred during 2012 and 2011. At June 30, 2012 and 2011, the Center had accounts payable due to the Alliance of $3,540 and $5,432 (this balance was in dispute).

(Continued)

NOTE 9 – EMPLOYEE HEALTH BENEFIT PLAN

The Center participates in a self-funded health insurance plan covering substantially all employees. Covered services include medical benefits and prescription drugs. The plan has annual reinsurance covered for a maximum eligible claim expense per covered person in excess of $50,000, and a maximum aggregate per covered person in excess of $1,950,000. The Center recorded a provision for claims incurred but not reported, which amounted to $47,563 and $41,344 at June 30, 2012 and 2011 respectively, and is included in accrued expenses. Expenses of the plan for 2012 and 2011 were $606,727 and $473,503, respectively. The plan had no claimants who exceeded the stop-loss during 2012 or 2011.

NOTE 10 - SUBSEQUENT EVENTS

Management has performed an analysis of the activities and transactions subsequent to June 30, 2012 to determine the need for any adjustments to and/or disclosures within the audited financial statements for the year ended June 30, 2012. Management has performed their analysis through January 29, 2013, the date the financial statements were available to be issued.

Management obtained a fifth forbearance agreement to the debt in default. Under the forbearance agreement, the Center was required to make a $400,000 payment on the line of credit, in consideration for the waiver of the forbearance fee. The Center made this payment on August 29, 2012.

Management obtained a sixth forbearance agreement to the debt in default. Under the sixth forbearance agreement, the Center is required to make monthly payments totaling $266,667 over the period of November 1, 2012 through June 30, 2013 on the outstanding line of credit. Subsequent to the execution of the sixth forbearance agreement, the Center made a $100,000 payment on the line of credit during January 2013. The Center has agreed to pay in full, the remaining balance of the line of credit on or before July 31, 2013, in consideration for the waiver of the forbearance fee. The forbearance agreement continues to require regular monthly payments on the bank mortgage note, based upon a 19-year amortization schedule. The forbearance extends to July 31, 2013, and all other terms of the forbearance remain substantially the same.

The Center made a payment of $191,667 to the Federal Government, in accordance with the Settlement Agreement discussed in Note 1 and 7, on September 30, 2012.

Management is in the process of negotiating a long-term repayment plan for the $1,728,182 in obligations due at June 30, 2012 to Northwestern University.

SUPPLEMENTAL SCHEDULES

HOWARD BROWN HEALTH CENTER
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2012

Federal Grantor/Pass-Through Grantor/ Program Title for Year ended June 30, 2012	Federal CFDA Number	Agency or Pass-Through Number	Grant Period	Program or Award Amount	Federal Expenditure
Major Programs					
Department of Health and Human Services					
R&D Cluster					
National Institutes of Health, National Institute of Allergy and Infectious Diseases, Multi-center AIDS cohort Study	93.855	2 U01 A1035039-19	04/01/11-03/31/12	$ 546,119	$ 382,755
Health Resources and Services Administration, Special Project of National Significance (ARRA)	93.701	3 U01 A1069918-04S1	09/22/09-08/31/11	17,842	797
National Institutes of Health, University of Illinois at Chicago, “Patient Navigator Study” (ARRA)	93.701	1R21NR010754-01A1	07/01/10-08/31/11	147,289	41,201
Department of Health and Human Services, Children’s Memorial Hospital, Multi-System Evaluation of Massage Therapy and Touch Healing on HIV+ Adolescents	93.213	K23 AT003807	08/01/10-07/31/11	11,000	201
Health Resources and Services Administration Erie Family Health Center, Community Health Applied Research Network (ARRA)	93.420	1UB2HA20234	09/01/11-08/31/12	7,740	4,828
Centers for Disease Control and Prevention University of Kentucky Research Foundation, RCPC Core Research Project	93.135	5U48DP001932-03	09/30/11-09/29/12	56,566	8,925
Centers for Disease Control and Prevention Chicago Department of Public Health, STD Syphilis Surveillance Network (SSuN)	93.977	25330	09/30/11-09/30/12	50,832	25,423
National Institutes of Health, University of Illinois at Chicago Targeted Smoking Cessation	93.279	1R01DA023935-01A2	08/01/11-07/31/12	322,103	172,688
Total R&D Cluster					**636,818**
Health Resources and Services Administration,	93.153	6 H12 HA 23053-09-03	09/01/10-08/31/11	356,372	59,638
HIV/AIDS Bureau, Ryan White Part D	93.153	6 H12 HA 23053-11-02	09/01/11-08/31/12	374,900	252,153
					311,791
Health Resources and Services Administration	93.914	AFC CCRAO-FY11	03/01/11-02/28/12	185,405	139,972
AIDS Foundation of Chicago/HRSA, Ryan White Part A	93.914	AFC CCRAO-FY12	03/01/12-02/28/13	186,973	70,536
Medical Care and Case Management					210,508
Health Resources and Services Administration	93.914	P.O. #17142	03/01/11-02/28/12	556,725	409,717
Chicago Department of Public Health - Ryan White Part A	93.914	P.O. #23755	03/01/12-02/28/13	504,312	199,637
Primary Care/Behavioral Science/Substance Abuse					609,354
Health Resources and Services Administration	93.918	6 H76 HA 00184-15-02	01/01/11-12/31/11	697,486	360,674
HIV/AIDS Bureau, Ryan White Part C	93.918	6 H76 HA 00184-16-03	01/01/12-12/31/12	843,424	241,811
					602,485

(Continued)

HOWARD BROWN HEALTH CENTER
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2012

Federal Grantor/Pass-Through Grantor/ Program Title for Year ended June 30, 2012	Federal CFDA Number	Agency or Pass-Through Number	Grant Period	Program or Award Amount	Federal Expenditure
Non-Major Programs					
Department of Health and Human Services					
Center for Disease Control and Prevention,	93.939	5U22PS000486-05	09/30/10-09/29/11	$ 316,375	$ 66,004
HIV Prevention for Young Transgender Persons of Color	93.939	5U22PS000486-06	09/30/11-12/31/11	24,661	27,792
					93,796
National Institutes of Health, Children's Memorial Hospital, Adolescent Trials Network	93.279	U01 HD040474-08	03/01/11-02/28/12	33,619	11,782
Health Resources and Services Administrations,	93.224	6 H80 CS 00215-03-01	12/01/10-11/30/11	258,785	138,930
Heartland International Health Center, 330 Funding	93.224	6 H80 CS 00215-03-01	12/01/11-11/30/12	258,785	148,370
					287,300
Health Resources and Services Administration,	93.917	AFC CCRAO-FY11	04/01/11-03/31/12	41,000	29,764
AIDS Foundation of Chicago, Ryan White Part B	93.917	AFC CCRAO-FY12	04/01/12-03/31/13	41,000	13,147
					42,911
Health Resources and Services Administration	93.917	70007-324-HBHC-PC	04/01/11-03/31/12	151,729	20,118
AIDS Foundation of Chicago, Ryan White Part B (Case Management)	93.917	70007-324-HBHC-PC	04/01/12-03/31/13	41,769	14,297
					34,415
Center for Disease Control and Prevention,	93.977	PO # 17071	01/01/11-12/31/11	186,848	80,073
Chicago Department of Public Health, Syphilis Elimination	93.977	PO # 17071	01/01/12-12/31/12	55,477	1,103
					81,176
Center for Disease Control and Prevention	93.940	14366-1	01/01/11-12/31/11	130,500	53,129
Chicago Department of Public Health, HIV Prevention - MSM Adult	93.940	14366-1	01/01/12-12/31/12	97,500	41,338
					94,467
Center for Disease Control and Prevention					
Chicago Department of Public Health, HIV Prevention - Transgender	93.940	14366-1	01/01/11-12/31/11	130,500	64,697
Center for Disease Control and Prevention	93.940	14366-1	01/01/11-12/31/11	87,000	25,974
Chicago Department of Public Health, HIV Prevention - Youth	93.940	14366-1	01/01/12-12/31/12	100,000	45,360
					71,334
Center for Disease Control and Prevention	93.944	1175808	01/01/11-12/31/11	62,300	27,527
Cook County Department of Public Health, HIV/AIDS Prevention Education	93.944	1275809	01/01/12-06/30/12	31,150	31,499
Illinois Dept. of Public Health/Illinois Public Health Assoc., HIV Prevention					59,026
Department of Health and Human Services					
Illinois Department of Human Services - Domestic Violence	93.667	11GQ00694	07/01/11-06-30/12	39,070	36,254
Department of Health and Human Services, OMH/TA-CD	93.006	5 TACMP080035-02-00	09/01/10-08/31/11	225,000	19,170
	93.006	5 TACMP080035-02-00	09/01/11-08/31/12	225,000	103,965
					123,135

(Continued)

HOWARD BROWN HEALTH CENTER
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2012

Federal Grantor/Pass-Through Grantor/ Program Title for Year ended June 30, 2012	Federal CFDA Number	Agency or Pass-Through Number	Grant Period	Program or Award Amount	Federal Expenditure
Non-Major Programs (Continued)					
Health Resources and Services Administration Comprehensive Geriatric Education ATN 093 - Linkage to Care	93.265	1 D62HP15057-01-00	07/01/11-06/30/12	$ 238,870	$ 187,383
Department of Health and Human Services Illinois Department of Public Health - Illinois Breast and Cervical Cancer Program	93.283	16180013	07/01/11-06/30/12	162,888	162,888
Health Resources and Services Administration Hepatitis C Expansion	93.928	H97HA22725	09/01/11-08/31/12	76,749	41,587
Centers for Disease Control	93.268	23671-1	01/01/11-12/31/11	109,406	51,810
Chicago Department of Public Health, Substance Abuse Treatment	93.268	23671-1	01/01/12-12/31/12	70,020	34,123
					85,933
Health Resources and Services Administration	93.557		09/30/10-09/29/11	50,000	12,494
The Night Ministry, Street Outreach Program	93.557		09/30/11-09/29/12	50,000	37,503
					49,997
Department of Health and Human Services	93.977	15180123	01/01/11-12/31/11	43,849	17,213
Illinois Department of Public Health – Syphilis Elimination Initiative	93.977	15180123	01/01/12-12/31/12	46,103	44,634
					61,847
Health Resources and Services Administration AIDS Foundation of Chicago, Crystal Meth Project	93.940		01/01/11-12/31/11	35,850	15,096
Health Resources and Services Administration Chicago Department of Public Health, CDBG – LGBT Homeless Youth	93.940	25370	01/01/12-12/31/12	67,500	26,209
Total Department of Health and Human Services					$ 4,002,189

See notes to Schedule of Expenditures of Federal Awards.

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of the Center and is presented on the accrual basis of accounting. For the purpose of the Schedule, federal awards include pass-through funds from grants and contracts entered into directly between the Center and state or local agencies and departments of the federal government. The federal expenditures are primarily related to research and development projects. There were no noncash federal awards during the fiscal year ended June 30, 2012. No federal loan guarantees or federal insurance were in effect during fiscal 2012. The information in the 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 financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES FOR FEDERAL AWARD EXPENDITURES

Expenditures consist of direct and indirect costs. Direct costs are those that can be readily identified with an individual federally sponsored project. The salary of a principal researcher of a sponsored research project and the materials consumed by the project are examples of direct costs.

Unlike direct costs, indirect costs cannot be readily identified with an individually sponsored project. Indirect costs are the costs of services and resources that benefit many projects as well as non-sponsored projects and activities. Indirect costs primarily consist of expenses incurred for administration, payroll taxes and fringe benefits.

The Center and federal agencies use an indirect cost rate to charge indirect costs to individual sponsored projects. The rate is the result of a number of cost allocation procedures that the Center uses to allocate its indirect costs to both sponsored and non-sponsored activities. The indirect costs allocated to sponsored projects are divided by the direct costs of sponsored projects to arrive at a rate. The U.S. Department of Health and Human Services ("DHHS") must approve the rate before the Center can use it to charge indirect costs to federally sponsored projects.

During fiscal year 2012, the Center charged indirect costs at rates which DHHS has approved as provisional rates.

NOTE 3 – NON-CASH ASSISTANCE, LOANS OR LOAN GUARANTEES, AND FEDERAL INSURANCE

No federal awards were expended in the form of non-cash assistance, loans or loan guarantees during the fiscal year. There was no federal insurance in effect from a federal insurance program during the fiscal year.

(Continued)

NOTE 4 - SUB-RECIPIENTS

Of the federal expenditures presented in the Schedule, the Center provided federal awards to sub-recipients as follows:

Federal Grantor/Pass-Through Grantor/ Program Title for Year ended June 30, 2012	Federal CFDA Number	Agency or Pass-Through Number	Grant Period	Federal Expenditure
Department of Health and Human Services , OMH/TA-CD	93.006	1 TACMP080035-02-00	09/01/10-08/31/11	$ -
	93.006	1 TACMP080035-02-00	09/01/11-08/31/12	66,967
Total sub-recipient expenditures				$ 66,967

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
Howard Brown Health Center
Chicago, Illinois

We have audited the financial statements of Howard Brown Health Center (the "Center") as of and for the year ended June 30, 2012, and have issued our report thereon dated January 29, 2013. 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.

Internal Control Over Financial Reporting

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

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2012-a through 2012-d to be material weaknesses.

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2012-e to be a significant deficiency.

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*.

We noted certain matters that we reported to management of the Center in a separate letter dated January 29, 2013.

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

This report is intended solely for the information and use of the Board of Directors, management, others within the Center, the Department of Health and Human Services, 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.

Crowe Horwath LLP

Crowe Horwath LLP

Chicago, Illinois
January 29, 2013

INDEPENDENT AUDITOR'S 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
Howard Brown Health Center
Chicago, Illinois

Compliance

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

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

As described in items 2012-1 through 2012-2 in the accompanying schedule of findings and questioned costs, the Center did not comply with requirements regarding: eligibility and program income that is applicable to CFDA Numbers 93.918 and 93.914; SEFA preparation which is applicable to all major programs. Compliance with such requirements is necessary, in our opinion, for the Center to comply with the requirements applicable to those programs.

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

Internal Control Over Compliance

Management of the Center is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Center's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance 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 Center's internal control over compliance.

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2012-1 through 2012-2 to be material weaknesses.

We noted certain matters that we reported to management of the Center in a separate letter dated January 29, 2013.

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

The purpose of this report is solely to describe the scope of our testing over compliance and internal controls over compliance with the requirements that could have a direct and material effect on each major program and the results of that testing, and not to provide a legal determination of compliance with those requirements or an opinion on the effectiveness of internal control over compliance. Accordingly, this report is not suitable for any other purpose.

Crowe Horwath LLP

Crowe Horwath LLP

Chicago, Illinois
January 29, 2013

SECTION I - SUMMARY OF AUDITORS RESULTS

Financial Statements	
Type of auditors report issued:	*Unqualified*
Internal control over financial reporting:	
• Material weakness(es) identified?	X Yes ___ No
• Significant deficiencies identified that are not considered to be material weakness(es)?	X Yes ___ No
Noncompliance material to financial statements noted?	___ Yes X No
Federal Awards	
Internal control over major programs:	
• Material weakness(es) identified?	X Yes ___ No
• Significant deficiencies identified that are not considered to be material weakness(es)?	___ Yes X No
Type of auditors report issued on compliance for major programs:	*Qualified*
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	X Yes ___ No

(Continued)

SECTION I - SUMMARY OF AUDITORS RESULTS (Continued)

Identification of major programs:

CFDA or identifying number	Name of federal program or cluster
93.855, 93.701, 93.213, 93.420, 93.135 93.977, and 93.279	R&D Cluster (ARRA)
93.153	Department of Health and Human Services Health Resources and Services Administration HIV/AIDS Bureau – Ryan White Part D
93.914	Department of Health and Human Services Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A
93.918	Health Resources and Services Administration HIV/AIDS Bureau - Ryan White Part C

Dollar threshold used to distinguish between type A and type B programs: $300,000

Auditee qualified as low-risk auditee? ______ Yes ___X___ No

(Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS

Finding 2012-a – Segregation of Duties - Journal Entries – Material Weakness

Criteria: Segregation of duties is critical to effective internal control because it reduces the risk of mistakes and inappropriate actions.

Condition: The controller and several accounting staff have access to post journal entries.

Cause: Ineffective control design due to limited staffing.

Effect: The lack of segregation provides the opportunity for misstatements by error or fraud that would not be detected in a timely manner.

Recommendation: We recommend all journal entries be created / posted and reviewed by independent individuals. We recommend that the individuals with access to post journal entries be monitored, and that the number of individuals with this access level be limited.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and proposes to ensure that all journal entries greater than an established materiality threshold will be reviewed by a qualified, independent member of the accounting team before the entries are posted to the general ledger. In addition, we will review the team members who have access to post journal entries and if practical, limit the number of individuals with this access level; however, a mitigating circumstance will be the independent review of material journal entries. These changes will occur during the third or fourth quarter of 2013.

Finding 2012-b - Controls over Financial Reporting – Material Weakness

Criteria: Reconciliations, if effectively carried out, constitute an internal check of receipts, disbursements, as well as revenue and expense.

Condition: We were unable to corroborate independent review of reconciliations. Additionally, we noted that many accounts had not been consistently reconciled throughout the year.

Cause: Reconciliations were not independently reviewed, due to working through transition of responsibilities within the accounting department and development of specific account reconciliation procedures.

Effect: The reconciliations, if effectively carried out, constitute an internal check of receipts, disbursements, as well as revenue and expense, and therefore, because they were not properly documented as having been reviewed, could result in missed reviews, resulting in errors or potential undetected fraud.

Recommendation: Accounting staff, with the ability to devote the time and who possess the necessary experience and knowledge, should be recruited to ensure that accurate financial statements are prepared within a reasonable time after month-end. Internal controls should be put in place to ensure all balance sheet and income statement accounts are reconciled within a reasonable time after month-end.

(Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS (Continued)

Finding 2012-b - Controls over Financial Reporting – Material Weakness (Continued)

Reconciliations should be prepared on a monthly basis, and should be agreed to the general ledger. Preparation and review responsibilities should be segregated. The policies and procedures for account reconciliations should be formally documented to ensure consistency in application of the controls in the event of turnover. Proper monitoring will assist with identification and correction of misstatements in a timely manner, and segregation of preparation and review responsibilities will reduce the opportunity for misappropriation of assets and the likelihood of misstatements caused by error.

Management's Response and Corrective Action Plan: We agree. During 2012, the following processes and controls were maintained: trend analysis and budget to actual analysis, standardized monthly financial reporting to the President and Chief Executive Officer and Board of Directors, divisional performance analysis, improvement in the timeliness of the monthly close process and the hiring of an experienced contract, grant and budget manager. During the third and fourth quarters of 2013, a standardized monthly close package which includes all recurring journal entries will be finalized, and additional experienced accounting staff will be added to meet the needs of the agency.

Finding 2012-c – Controls over Petty Cash – Material Weakness

Criteria: The responsibility for the physical security (custody) of assets should be separated from the related record-keeping (accounting) for those assets. Unauthorized access to assets and accounting records should be prevented.

Condition: Petty cash is replenished by the directors at the various Center locations. The directors submit expense reimbursement claims for payment in the amount needed to replenish petty cash. We noted that these expense reimbursements include receipts to support the replenishment of petty cash. The receipts are attached to the petty cash paystub and the receipts are approved by an individual in the finance department. We noted that these checks were written to the directors individually and for total expense reimbursement (travel, miscellaneous expenditures, and petty cash on same request and check). Furthermore, petty cash reconciliations are not completed regularly, nor is a consistent tracking mechanism in place to track petty cash payments.

Cause: The control in place during the fiscal year was ineffectively designed and implemented.

Effect: There were misstatements detected during the financial audit as result of the control deficiencies.

Recommendation: We recommend that petty cash be replenished directly, not via a check paid to the director. Furthermore, we recommend implementation of a monthly tracking mechanism to track petty cash payments / reimbursements. Additionally, monthly reconciliations should be prepared for all petty cash accounts.

Management's Response and Corrective Action Plan: We agree. A petty cash custodian, when possible, separate from the director has been identified at each agency location. Requests for replenishment are completed by the custodian and authorized by the manager/supervisor prior to submission to accounting. A petty cash reconciliation is prepared with each reimbursement request. All petty cash replenishments will be issued separate from any other employee-related expense reimbursement. During the third and fourth quarters of 2013, accounting will periodically audit petty cash funds at each location consistent with policy and procedure.

(Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS (Continued)

Finding 2012-d – Estimated Accounts Receivable Reserves – Material Weakness

Criteria: Information must be identified, captured and analyzed to ensure that accounts receivable are properly valued, and should be maintained to support the adequacy of management's estimates and judgment.

Condition: The allowance for uncollectible accounts was calculated based on zero balance claims, regardless of financial class or insurance payer, and applied to gross accounts receivable, regardless of financial class or insurance payer. Industry best practice is to calculate reserves at the financial class or insurance payer level, as the payer mix can have a significant impact on the reserve estimate.

In addition, a standard procedure for analyzing and adjusting uncollectible accounts is not in place.

Cause: There has been turnover of employees and systems, as well as a lack of defined policies and procedures, which has resulted in inconsistent and incomplete implementation of internal controls.

Effect: There were misstatements detected during the financial audit as result of the control deficiencies. Because there is not a standard procedure in place to adjust uncollectible accounts, it is possible that additional balances in accounts receivable, in excess of the established reserves, are not realizable.

Recommendation: Management should generate accounts receivable detail at the financial class or insurance payer level, and estimate the reserve at a more granular level. Accounts receivable balances should be investigated for collectability by financial services staff. Accounts deemed uncollectible should be approved for adjustment by a supervisor. Financial accounting staff should trend bad debt write-offs to get a better understanding of historical activity, which can be used to estimate uncollectible accounts at a point in time.

Management's Response and Corrective Action Plan: We agree. The accounting staff will work with the patient billing services staff to generate accounts receivable detail reports at the financial class or insurance payer level. This will allow us to estimate the reserve at a more granular level, including both bad debt and contractual allowance reserve components.

The accounting staff, in conjunction with the patient billing services staff, will establish a plan to collect current outstanding patient balances and write-off uncollected amounts from that effort. Additionally, the accounting staff will ensure there is a reconciliation of the Centricity Electronic Health Records subledger to the general ledger on a monthly basis.

In collaboration with the patient billing services staff, the accounting staff, will work to formulate and establish a collections policy that supports both the Center's mission as well as its financial stability.

The accounting staff will trend bad debt write-offs and contractual adjustments so that we obtain a better understanding of historical activity, which can be used to estimate uncollectible accounts at a point in time. In conjunction with trending bad debts, accounting staff, in collaboration with patient billing service staff, will work to establish a monthly patient bad debt write-off process and work to activate a monthly insurance bad debt write-off process. These changes will occur during the third or fourth quarter of 2013.

(Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS (Continued)

Finding 2012-e – Clinical Trial Revenue Recognition – Significant Deficiency

Criteria: Pertinent information must be identified, captured and communicated in a form and timeframe that enables a manager and staff to carry out their responsibilities efficiently. Information systems must be capable of producing reports containing operational, financial and compliance-related information that make it possible to monitor and report on activities. Effective communication must also occur in a broader sense, flowing down, across and up the unit. All staff must understand their own role in the internal control system, as well as how individual activities relate to the work of others.

Condition: The Center participates in numerous clinical trials. There is no system in place to track progress of the clinical trials relative to how much has been earned in a given period, making it difficult to record a receivable. Therefore, the Center records clinical trial revenue on the cash basis.

Cause: There has been turnover of employees, as well as a lack of defined policies and procedures.

Effect: It is possible revenues may not be recorded in the same period as the related expenses.

Recommendation: We recommend the Center implement a system to monitor and track progress of each clinical trial in order to properly match revenue with related expenses.

Management's Response and Corrective Action Plan: We agree. There have been meetings between the clinical trial staff and accounting staff so that the clinical trial revenue can be recognized on an accrual basis. During the third quarter of 2013 management plans to implement a system to monitor and track the progress of each clinical trial in order to properly match revenue and related expenses. This system, once implemented, will track the progress of clinical trials thereby ensuring proper revenue recognition and cut-off.

(Continued)

SECTION III - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Finding 2012 – 1 – SEFA Preparation – Material Weakness

Major Programs Impacted:

CFDA or Identifying Number	Name of Federal Program or Cluster
93.855, 93.701, 93.213, 93.420, 93.135 93.977, and 93.279	R&D Cluster (ARRA)
93.153	Department of Health and Human Services Health Resources and Services Administration HIV/AIDS Bureau – Ryan White Part D
93.914	Department of Health and Human Services Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A
93.918	Health Resources and Services Administration HIV/AIDS Bureau – Ryan White Part C

Criteria: The Center is responsible for documenting policies and procedures necessary to prepare the Schedule of Expenditures of Federal Awards (SEFA) and to ensure that preparation of the SEFA is adequately monitored by responsible personnel with proper training in SEFA preparation to ensure that the SEFA is presented free of material error.

Condition: The Center does not have policies and procedures documented for SEFA preparation and review and the manager of grants and budgets has relied on guidance provided by the auditors.

Context: While we noted that the SEFA was prepared using an appropriate methodology at June 30, 2012, we noted policies and procedures related to SEFA preparation have not yet been documented.

Cause: The Center focused on preparing the SEFA appropriately at June 30, 2012, and did not have the resources available to prepare policies and procedures or to perform adequate supervisory review.

Effect: Lack of policies and procedures puts the Center at risk in the event the individual preparing the SEFA becomes incapacitated.

Recommendation: We recommend that the Center document policies and procedures to ensure adequate preparation and review of the SEFA, in the event the individual preparing the SEFA becomes incapacitated. Furthermore, we recommend that the SEFA be reviewed and approved by an individual with proper training in SEFA preparation.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and intends to implement this recommendation to the best of its ability. During 2012, the manager of contracts, grants and budgets ensured that the SEFA reconciled to the general ledger. During the third and fourth quarters of 2013, the Center will ensure that the policies and procedures relevant to the preparation and review of the SEFA are created and maintained. In addition, the agency will ensure that the SEFA is reviewed and approved by an individual with proper training in SEFA preparation as evidenced by the review of the 2012 SEFA by the Senior Director of Accounting and Finance and Controller. Lowell B. Raven, CPA is the person responsible for corrective action, and correction is anticipated by June 30, 2013.

(Continued)

SECTION III - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (Continued)

Finding 2012 – 2 – Application of Sliding Fee Schedule – Material Weakness

Major Programs Impacted:

CFDA or Identifying Number	Name of Federal Program or Cluster
93.918	Health Resources and Services Administration HIV/AIDS Bureau - Ryan White Part C
93.914	Department of Health and Human Services Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A

Criteria: The Center is required to implement and enforce a sliding fee scale policy for patients in the Ryan White Part A and C programs.

Condition: There is inconsistent application of the Center's sliding fee scale policy.

Context: Out of sixty (60) Ryan White Part A & C sliding fee scale patients, we noted:

- Eighteen (18) instances in which appropriate proof of income was unavailable
- Two (2) instances of patients being assigned to the incorrect sliding fee scale category
- Fifteen (15) instances of the sliding fee charge being greater than the allowed amount based upon the compliance supplement

Cause: The Center does not monitor sliding fee scale and admission policies and procedures.

Effect: The Center is not in compliance with the sliding fee scale application requirements, additionally, the Center may have improperly charged Ryan White Part A and C patients, as the sliding fee scale was improperly applied to patients. Because the monitoring process in place is not operating effectively, it is possible that patients could have been charged amounts greater than allowed by the grants, that program income is not properly reported, and that these activities would not be detected and corrected in a timely manner.

Recommendation: We recommend that management implement monitoring procedures related to the sliding fee scale application process. Monitoring procedures should include review and approval of all sliding fee scale applications, and periodic internal audits to ensure that the process properly identifies patients that qualify for the sliding fee scale. Management should implement a mandatory training program on the sliding fee scale for all employees involved in the admissions process. We did note that management implemented a new sliding fee scale policy and series of procedures during May 2012. Of the six (6) patients examined subsequent to the implementation, no issues were noted.

Questioned Cost: $360

Management's Response and Corrective Action Plan: We agree. The Center has created and implemented a new policy for all Ryan White clients, which became effective on May 5, 2012. As a result of establishing this policy the Center has hired a Ryan White Coordinator to ensure that the Center's policy is being followed and that HRSA updates are being complied with in a timely manner. The Ryan White Coordinator works closely with the Billing Manager and PSR team to ensure that the Ryan White clients are not being overcharged and that these clients are meeting the income percentages as outlined by HRSA. This process is monitored on a monthly basis by both the Ryan White Coordinator and Billing Manager. Lowell B. Raven, CPA is the person responsible for corrective action, and correction is anticipated by June 30, 2013.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

Financial Statement Findings

Finding 2011-a – Segregation of Duties - Journal Entries – Material Weakness

Criteria: Segregation of duties is critical to effective internal control because it reduces the risk of mistakes and inappropriate actions.

Condition: The controller and several accounting staff have access to post journal entries

Cause: Ineffective control design due to limited staffing.

Effect: The lack of segregation provides the opportunity for misstatements by error or fraud that would not be detected in a timely manner.

Recommendation: We recommend all journal entries by created / posted and reviewed by independent individuals. We recommend that the individuals with access to post journal entries be monitored, and that the number of individuals with this access level be limited.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and proposes to ensure that all journal entries greater that an established threshold, complex journal entries, as defined, all journal entries posted by staff accountants, and journal entries posted by the controller will be reviewed by a qualified member of the accounting team before the entries are posted.

Status: This condition still existed during 2012.

Finding 2011-b – Control over Patient Revenue Cycle – Material Weakness

Criteria: Internal control is necessary ensure the effectiveness and efficiency of operations and the validity, accuracy and reliability of accounting records and financial reports.

Condition: There are deficiencies in the controls over the patient revenue cycle. Deficiencies relate to Center policies and procedures (adopted and/or needed), information technology (actual systems and fragmentation of those systems), business design (process flow of revenue, utilizing policies/procedures/systems), and contractual relationships with payers (in force and/or needed).

Cause: There has been turnover of employees and systems, as well as a lack of defined policies and procedures, which has resulted in inconsistent and incomplete implementation of internal controls.

Effect: Potential misstatement of the net realizable value of accounts receivables and leakage of otherwise collectible accounts.

Recommendation: We suggest the following areas be reviewed and assessed for improvement:

- Revenue policy and procedures: in-network/out-of-network cost/benefit analysis; self-pay approach and patient communications; expected collection rates by payer and business office criteria to determine when an account is fully realized.
- Revenue process flow including information systems: front-end data collection and input (including interrelated insurer/patient information noted above); flow of patient information through systems; management reporting systems interrelated to process flow.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

- Business office operations: policies and procedures to determine fully realizable claims; claim write-off procedures to match full realization policies (which will include more timely removal of claims from the system); biller/collector roles and responsibilities; workflow management tools consistent with all other considerations.

- Financial reporting: based upon all changes from the front-end to back-end of the revenue cycle, re-assess financial reporting risks/challenges, inputs/outputs, and related reserve methodologies.

In summary, revenue cycle operations and financial reporting can be significantly improved (and simplified) to produce greater overall results. One potential solution to consider is outsourcing of most, to all, stages of this process to an organization specializing in outpatient/ancillary healthcare business operations.

Management's Response and Corrective Action Plan: We agree. During the third and fourth quarters of 2012, the Center's Patient Billing Services Department, in conjunction with the Accounting Department, with review and assess the following areas for improvement:

1. Revenue policy and procedures: in-network/out-of-network cost/benefit analysis; self-pay approach and patient communications; expected collection rates by payer and business office criteria to determine when an account is fully realized.

2. Revenue process flow including information systems: front-end data collection and input (including interrelated insurer/patient information noted above); flow of patient information through systems; management reporting systems interrelated to process flow.

3. Business office operations: policies and procedures to determine fully realizable claims; claim write-off procedures to match full realization policies (which will include more timely removal of claims from the system); biller/collector roles and responsibilities; workflow management tools consistent with all other considerations.

4. Financial reporting: based upon all changes from the front-end to back-end of the revenue cycle, re-assess financial reporting risks/challenges, inputs/outputs, and related reserve methodologies.

Status: Corrective action was taken during 2012 and management adopted policies and processes which improved the control over the patient revenue cycle.

<u>Finding 2011-c - Controls over Financial Reporting – Material Weakness</u>

Criteria: Reconciliations, if effectively carried out, constitute an internal check of receipts, disbursements, as well as revenue and expense.

Condition: We were unable to corroborate independent review of reconciliations, several reconciliations were not prepared and available during the audit or did not agree to the general ledger, and many accruals were not properly reversed as expenditures were paid.

Cause: Reconciliations were not prepared timely, or independently reviewed, due to turnover in employees, and lack of qualified accounting staff during a substantial portion of the fiscal year.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Effect: Because the financial statements were not completed monthly on a timely basis, errors or fraud could occur. There were adjustments made during our audit, however, there were significantly fewer adjustments than for 2010, for identified errors.

Recommendation: Accounting staff, with the ability to devote the time and who possess the necessary experienced and knowledge, should be recruited to ensure that accurate financial statements are prepared within a reasonable time after month-end. Internal controls should be put in place to ensure all balance sheet and income statement accounts are reconciled within a reasonable time after month-end. Reconciliations should be prepared on a monthly basis, and should be agreed to the general ledger. Preparation and review responsibilities should be segregated. The policies and procedures for account reconciliations should be formerly documented to ensure consistency in application of the controls in the event of turnover. Proper monitoring will assist with identification and correction of misstatements in a timely manner, and segregation of preparation and review responsibilities will reduce the opportunity for misappropriation of assets and the likelihood of misstatements caused by error.

Management's Response and Corrective Action Plan: We agree. During the fourth quarter of 2011, several new processes and controls were implemented:

- Recurring journal entry checklist
- Trend analysis and budget to actual analysis and narrative
- Standardized monthly financial reporting to the Chief Executive Officer and Board of Directors

Management is in the process of developing a monthly close package, which includes a reconciliation checklist. Furthermore, experienced accounting staff with significant not-for-profit accounting experience has been hired, which is expected to improve the monthly close process and control structure.

Status: This condition still existed during 2012.

<u>Finding 2011-d – CAO Segregation of Duties – Material Weakness</u>

Criteria: Segregation of duties is critical to effective internal control because it reduces the risk of mistakes and inappropriate actions.

Condition: The controller has the ability to sign checks, as well as the ability to prepare, post, and review journal entries. This individual also has access to enter accounts payable for which payment would be included in a check run.

The chief administrative officer ("CAO") is an authorized check signer, in-charge of oversight of compliance and billing functions, as well as has access to various financial reporting systems.

Cause: Ineffective control design due to limited staffing.

Effect: The lack of segregation provides the opportunity for misstatements by error or fraud that would not be detected in a timely manner.

Recommendation: All payments posted in the accounts payable ledger and all journal entries created or posted by the controller should be reviewed by another individual.

Preventative controls should be put in place to either limit the CAOs access to systems for which the CAO provides direct oversight, or the CAOs oversight responsibilities should be segregated and transferred to another individual at the Center who does not have transaction initiation or editing rights.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Management's Response and Corrective Action Plan: We agree. The Financial Accounting Manager will review all journal entries created and posted by the controller. Management intends to implement the remainder of this recommendation to the best of its ability during the third or fourth quarter of 2012.

Status: Due to turnover, management was able to eliminate the CAO segregation of duties concerns.

<u>Finding 2011-e – Monitoring of Third-party Service Provider Controls – Material Weakness</u>

Criteria: Internal control systems need to be monitored to assess the quality of the system's performance over time. Ongoing monitoring occurs in the course of normal operations and includes regular management and supervisory activities, including over outsourced functions.

Condition: The Center utilizes the services of third-party vendors to perform such functions as patient billing (CPS) and payroll processing (ADP). Management relies on the internal controls of these third-party administrators to ensure the accuracy of financial reporting related to revenue and payroll and related liabilities; however, management does not obtain and review SAS 70 reports for these vendors.

Cause: Controls to monitor obtain and review SAS 70 reports for third-party service providers did not exist for the entire fiscal year.

Effect: There is a risk that a deficiency in the third-party vendors' internal controls could lead to a material misstatement on the Center's financial statements.

Recommendation: Management should obtain, review and document the review of the SAS 70 reports received from critical vendors when such reports become available during the year. Specifically, this process should include a review of the various sections of a standard SAS 70 report including the timeframe, type of report (Type I or Type II), opinion, tests of controls, including a description of the control environment, objectives, and testing performed of the operating effectiveness of the key controls in place to achieve those objectives, and user control considerations (for the clients of the service organizations).

A strong SAS 70 review should encompass the following areas:

- <u>Timeframe</u> – Management should determine whether the timeframe of the SAS 70 covers the Clinic's entire fiscal year, keeping in mind that if it does not, for certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support for control risk reduction the test may provide.
- <u>Type</u> – There are two types of SAS 70 reports:
    - Type I report - the service auditor will express an opinion on (1) whether the service organization's description of its controls presents fairly, in all material respects, the relevant aspects of the service organization's controls that had been placed in operation as of a specific date, and (2) whether the controls were suitably designed to achieve specified control objectives.
    - Type II report - the service auditor will express an opinion on the same items noted above in a Type I report, and whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.
- <u>Opinion</u> – Management should review the opinion included in the SAS 70 report. This review should verify that controls in place at the vendor are designed and operating effectively.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

- Test of Controls – Management should review the tests of controls performed by the service auditor to identify any significant exceptions with the operation of controls. If significant exceptions are noted, or the opinion with respect to operating effectiveness is other than unqualified, management should take appropriate actions to ensure that the Clinic's transactions are being processed in accordance with its expectations, which may include contacting the vender to discuss their planned responses to the noted exceptions.
- User Control Considerations - Management should review and document how the Clinic has addressed controls outlined in the user control consideration section of the report.

Management's Response and Corrective Action Plan: We agree. The Chief Administrative Officer obtained the SAS 70 reports for ADP, Stratex, Alliance and Allied, and reviewed these reports, as suggested, in the second quarter of 2012. We will continue to update our review of these reports as they become available.

Status: Management was able to implement necessary controls required to obtain and review the service auditor's reports for applicable third-party service providers.

Finding 2011-f – Controls over Petty Cash – Material Weakness

Criteria: The responsibility for the physical security (custody) of assets should be separated from the related record-keeping (accounting) for those assets. Unauthorized access to assets and accounting records should be prevented.

Condition: Petty cash is replenished by the directors at the various Center locations. The directors submit expense reimbursement claims for payment in the amount needed to replenish petty cash. We noted that these expense reimbursements include receipts to support the replenishment of petty cash. The receipts are attached to the petty cash paystub and the receipts are approved by an individual in the finance department. We noted that these checks were written to the directors individually and for total expense reimbursement (travel, miscellaneous expenditures, and petty cash on same request and check). Furthermore, petty cash reconciliations are not completed regularly, nor is a consistent tracking mechanism in place to track petty cash payments.

Cause: The control in place during the fiscal year was ineffectively designed and implemented.

Effect: There were misstatements detected during the financial audit as a result of the control deficiencies.

Recommendation: We recommend that petty cash be replenished directly, not via a check paid to the director. Furthermore, we recommend implementation of a monthly tracking mechanism to track petty cash payments / reimbursements. Additionally, monthly reconciliations should be prepared for all petty cash accounts.

Management's Response and Corrective Action Plan: We agree. We will identify a petty cash custodian at each location separate from the director and issue replenishments to that individual. We will implement a monthly tracking mechanism to track petty cash payments / reimbursements, and will prepare monthly reconciliations for all petty cash accounts. These changes will occur during the third or fourth quarter of 2012.

Status: This condition still existed during 2012.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Finding 2011-g – Controls over Donated Goods – Material Weakness

Criteria: Controls over goods at the time of donation at the Brown Elephant stores are not sufficiently designed to ensure that donated goods are not misappropriated by store employees. Donated goods are not tracked and/or logged upon receipt. Additionally, the stores do not have security cameras or other means to prevent theft.

Management did inform us that, in many cases, when donated goods are received, there are many individuals within the donation area, and employees have been instructed to bring high dollar and/or difficult to value items to the attention of a manager. Goods determined to be of seemingly high value are kept in a designated room, the safe, or locked in a case on the storeroom floor. However, given the volume of items donated, sorted, priced, and sold at the Brown Elephant stores on a daily basis, items could be stolen by an employee prior to bringing the item to the attention of a manager.

Cause: Ineffective control design due to limited staffing and inadequate systems.

Effect: Donated goods could be misappropriated by store employees.

Recommendation: We recommend that the Center implement a system whereby donated goods are logged, valued, and a two-way, sequenced receipt issued to the donor upon receipt of the good. A highly visible sign should be placed in the donor area to inform donors that a receipt should always be issued, and if a receipt is not provided that a manager should be informed. The receipt book should be periodically reviewed to ensure that the sequence is complete. The receipt book could also be utilized to support the valuation of donated goods during the inventory process.

Management's Response and Corrective Action Plan: We agree. While management does not believe security cameras are a cost efficient way to deter theft, the Center intends to implement the following:

1. POS / inventory system to track donated items from the point of donation through the point of sale and or destruction of items

2. A system to track all Items that pass directly through to salvage

3. A form, created collaboratively by human resources and management, for employees and volunteers to sign declaring their understanding that of the importance of integrity and responsibility to ensure that donated assets are not misappropriated

4. Signs will be posted that encourage customers to fill out tax forms

Status: Management has implemented certain processes and policies which have provided significant additional control over the donated goods function.

Finding 2011-h – Control over Fixed Assets – Material Weakness

Criteria: Physical assets must be periodically compared to accounting records to verify existence.

Condition: The Center has not performed a physical inventory of fixed assets.

Cause: Ineffective control design due to limited staffing.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Effect: Fully depreciated assets that are not in use may be included in the fixed asset report resulting in the cost and accumulated depreciation to be overstated.

Recommendation: We suggest that the Center perform a physical inventory of fixed assets on a periodic basis, and dispose of any assets that are no longer in use. In addition, the fixed asset sub ledger should be adjusted based on the results of the observation.

Management's Response and Corrective Action Plan: We agree. Management plans to perform a physical inventory of fixed assets during 2012, and adjust the agencies' records as appropriate.

Status: Management was able to perform a fixed asset survey during 2012, which was then compared to the underlying accounting records.

Finding 2011-i – Estimated Accounts Receivable Reserves – Material Weakness

Criteria: Information must be identified, captured and analyzed to ensure that accounts receivable are properly valued, and should be maintained to support the adequacy of management's estimates and judgment.

Condition: The allowance for uncollectible accounts was calculated based on zero balance claims, regardless of financial class or insurance payer, and applied to gross accounts receivable, regardless of financial class or insurance payer. Industry best practice is to calculate reserves at the financial class or insurance payer level, as the payer mix can have a significant impact on the reserve estimate.

In addition, a standard procedure for analyzing and adjusting uncollectible accounts is not in place.

Cause: There has been turnover of employees and systems, as well as a lack of defined policies and procedures, which has resulted in inconsistent and incomplete implementation of internal controls.

Effect: There were misstatements detected during the financial audit as a result of the control deficiencies. Because there is not a standard procedure in place to adjust uncollectible accounts, it is possible that additional balances in accounts receivable, in excess of the established reserves, are not realizable.

Recommendation: Management should generate accounts receivable detail at the financial class or insurance payer level, and estimate the reserve at a more granular level. Accounts receivable balances should be investigated for collectability by financial services staff. Accounts deemed uncollectible should be approved for adjustment by a supervisor. Financial accounting staff should trend bad debt write-offs to get a better understanding of historical activity, which can be used to estimate uncollectible accounts at a point in time.

Management's Response and Corrective Action Plan: We agree. The accounting staff will work with the patient billing services staff to generate accounts receivable detail reports at the financial class or insurance payer level. This will allow us to estimate the reserve at a more granular level, including both bad debt and contractual allowance reserve components.

The accounting staff, in conjunction with the patient billing services staff, will investigate the collectability of the accounts receivable balances on a more regular basis. The patient billing services staff has been working with GIS billing on this endeavor since August 2011. As uncollectible accounts are identified, they will be brought to the attention of the billing supervisor for approval for adjustment.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

The accounting staff will trend bad debt write-offs and contractual adjustments so that we obtain a better understanding of historical activity, which can be used to estimate uncollectible accounts at a point in time. These changes will occur during the third or fourth quarter of 2012.

Status: This condition still existed during 2012.

Finding 2011-j – Controls over Reporting of Net Asset Classifications – Significant Deficiency

Criteria: Pertinent information must be identified, captured and communicated in a form and timeframe that enables a manager and staff to carry out their responsibilities efficiently. Information systems must be capable of producing reports containing operational, financial and compliance-related information that make it possible to monitor and report on activities.

Condition: The Center does not use the net assets / contributions tracking system (Raisor’s Edge) to identify restricted versus unrestricted net assets and contributions. The Center also does not have proper controls in place to prevent the use of restricted funds for a use other than intended.

Cause: Raisor’s Edge was not properly utilized due to turnover in employees and improper / inconsistent application of controls.

Effect: Net assets may not be properly reflected in the financial statements, or utilized for their intended purpose.

Recommendation: We recommend that management utilize Raisor’s Edge to track net assets and contributions (unrestricted versus restricted). Additionally, supporting documentation for the release from restriction should be maintained, including that the use was as intended by the donor.

Furthermore, to improve the Center’s controls over net asset restrictions, we recommend management perform a periodic internal audit of funds used versus their intended purpose.

Management’s Response and Corrective Action Plan: We agree. The development staff who utilize the Raisor’s Edge software will work in collaboration with the accounting staff who utilize the Financial Edge software to ensure that contributions are properly tracked and reported as unrestricted versus temporarily restricted, including tracking of net assets released from restriction once the restriction is met either due to the passage of time or the occurrence of an event. Management hopes to have a process in place in the third or fourth quarter of 2012.

Status: Corrective action was taken during 2012 which improved the consistency in reporting of net asset classification and accounting.

Finding 2011-k – Clinical Trial Revenue Recognition – Significant Deficiency

Criteria: Pertinent information must be identified, captured and communicated in a form and timeframe that enables a manager and staff to carry out their responsibilities efficiently. Information systems must be capable of producing reports containing operational, financial and compliance-related information that make it possible to monitor and report on activities. Effective communication must also occur in a broader sense, flowing down, across and up the unit. All staff must understand their own role in the internal control system, as well as how individual activities relate to the work of others.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Condition: The Center participates in numerous clinical trials. There is no system in place to track progress of the clinical trials relative to how much has been earned in a given period, making it difficult to record a receivable. Therefore, the Center records clinical trial revenue on the cash basis.

Cause: There has been turnover of employees, as well as a lack of defined policies and procedures.

Effect: It is possible revenues may not be recorded in the same period as the related expenses.

Recommendation: We recommend the Center implement a system to monitor and track progress of each clinical trial in order to properly match revenue with related expenses.

Management's Response and Corrective Action Plan: We agree. Management plans to implement a system to monitor and track the progress of each clinical trial in order to properly match revenue with related expenses. This system, once implemented, will track the progress of clinical trials thereby ensuring proper revenue recognition and cut-off.

Study Manager was launched during 2011, and all research clinical staff trained, however, there was 100% turnover in this department. The CAO plans to re-launch, with the assistance of the accounting department, Study Manager during 2012. Research and accounting department resource availability will be reviewed to determine that adequate resources exist to properly implement and maintain Study Manager.

Status: This condition still existed during 2012.

<u>Finding 2011-I – Capital versus Operating Lease Analysis – Significant Deficiency</u>
Criteria: Lease analyses must be prepared to ensure proper accounting treatment of leases.

Condition: The Center does not have monitoring controls in place to ensure that a capital versus operating lease analysis is prepared for all new lease arrangements.

Cause: A proper control to analyze leases does not exist due to turnover in employees, and lack of qualified accounting staff during a substantial portion of the fiscal year.

Effect: Leases could be accounted for improperly.

Recommendation: A system should be developed for management to inform the accounting department whenever a new lease is entered into. An individual in the accounting department should be assigned the responsibility of preparing all capital lease analyses. A separate individual should be responsible for review and approval of the analysis. Review should be documented and maintained with the lease agreement.

Management's Response and Corrective Action Plan: We agree. The Center will implement controls to ensure that all new leases are analyzed for capital versus operating lease treatment. Management will ensure that someone on that the accounting department is informed of all new leases. The lease analysis will be reviewed and approved by either the financial accounting manager and or the controller. This review will be documented. The documentation of the review will be maintained with the lease agreement. These changes will occur during the third or fourth quarter of 2012.

Status: Management implemented controls which ensure that any new leases are properly analyzed for capital versus operating lease treatment.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Federal Awards Findings and Questioned Costs

Finding 2011 – 1 – Grant Disbursement Controls – Material Weakness

Major Programs Impacted: All

Criteria: The Center is responsible for ensuring costs charged to Federal grants conform to the allowability of costs provisions of A-133, or limitations in the program agreement, program regulations, or program statute.

Condition: Non-payroll disbursements were not reviewed and approved by both the grant project manager and the Controller.

Context: During our testing of controls over non-payroll related grant disbursements, we noted that control procedures were lacking for certain disbursements. Of our sample of 102 disbursements, we noted six (6) instances in which a program manager did not properly sign-off or formerly approve the expenditure.

Cause: The Center does not have or did not have control procedures in place to review and approve certain disbursements.

Effect: It is possible that noncompliance with allowable costs requirements would not be detected and corrected in a timely manner.

Recommendation: We recommend that the Center require that each disbursement be reviewed and physically approved by both the appropriate grant project manager and the Controller.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and intends to implement this recommendation to the best of its ability during 2012, and will report on its specific implementation and compliance in the 2012 audit report. For example, during 2011 management began requiring that each disbursement be reviewed and physically approved by both the appropriate grant project manager and the Controller.

Status: Management has implemented controls during 2012 which remediated this finding.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Finding 2011 – 2 – Preparation of Billings to Flow-Through Entities – Material Weakness

Major Programs Impacted:

CFDA or Identifying Number	Name of Federal Program or Cluster
93.279	National Institutes of Health – Drug Abuse and Addictions Research Programs
93.914	Department of Health and Human Services Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A

Criteria: The Center is responsible for ensuring billings to flow through entities comply with award provisions and represent allowable costs.

Condition: Billings to flow through entities were not consistently signed by the preparer, evidence of review and approval of the billing by the project manager was not documented, and none of the reconciliations of subsequent cash receipts to the billing were reviewed by someone other than the preparer.

Context:

- Of six (6) billing to flow through entities tested for the 93.279 grant, we noted two (2) were not signed by the preparer
- Of seven (7) billings to flow through entities tested for the 93.914 grant, we noted that all seven (7) were not reviewed, approved and signed by the project manager

Cause: The Center does not enforce the control requiring the preparer to sign-off on the billing.

Effect: There is not an audit trail for the Center to follow in the event that a billing is inappropriate.

Recommendation: The Center should implement a control to ensure that a billing to a flow through entity cannot be processed without the signature of the preparer. The project manager, during their review, should ensure that this control has been completed. We recommend that the Center implement the review controls utilized for the NIH AIDS Cohort Study (CFDA 93.855 and 93.701) and Drug Abuse and Addiction (CFDA 93.279) programs on all programs that have flow through billings. The Center should require maintenance of electronic approval of the review / approval of the flow through billing by the project manager.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and intends to implement this recommendation to the best of its ability during 2012, and will report on its specific implementation and compliance in the 2012 audit report.

Status: Management has implemented controls during 2012 which remediated this finding.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Finding 2011 – 3 – SEFA Preparation – Material Weakness

Major Programs Impacted: All

Criteria: The Center is responsible for maintaining policies and procedures, and hiring adequate qualified resources, necessary for preparing the Schedule of Expenditures of Federal Awards (SEFA) free of material misstatement.

Condition: The Center did not have policies and procedures implemented for SEFA preparation, or adequate qualified resources for SEFA review.

Context: We noted that the SEFA, as originally reported, was misstated at June 30, 2011, and was restated to appropriately report R&D Cluster grants, as well as certain grants that were erroneously omitted from the SEFA.

Cause: The Center did not have adequate qualified resources available to prepare policies and procedures or to ensure adequate independent review of the SEFA preparation at June 30, 2011.

Effect: Lack of policies and procedures, and adequate qualified resources, lead to the SEFA, as originally reported at June 30, 2011 being misstated and requiring restatement.

Recommendation: We recommend that the Center document and procedures to ensure adequate preparation and review of the SEFA, in the event the individual preparing the SEFA becomes incapacitated. Furthermore, we recommend that the SEFA be reviewed and approved by an individual with proper training in SEFA preparation.

Management's Response and Corrective Action Plan: We agree. Management has reviewed this recommendation and intends to implement this recommendation to the best of its ability. For example, during 2011 management has been working to implement policies and procedures to ensure the SEFA reconciles to the general ledger. Jamal Edwards will be the person responsible for corrective action, and correction is anticipated by June 30, 2012.

Status: This condition still existed during 2012.

Finding 2011 – 4 – Application of Sliding Fee Schedule Part 1 – Material Weakness

Major Programs Impacted:

CFDA or Identifying Number	Name of Federal Program or Cluster
93.918	Health Resources and Services Administration HIV / AIDS Bureau – Ryan White Part C
93.914	Department of Health and Human Services, Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A

Criteria: The Center is required to implement and enforce a sliding fee scale policy for patients in the Ryan White Part A and C programs.

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Condition: There is inconsistent application of the Center's sliding fee scale policy.

Context: Out of sixty (60) Ryan White Part A & C sliding scale patients, we noted:

- One (1) instance where approval of the sliding fee scale application was unavailable;
- Eleven (11) instances in which appropriate proof of income was unavailable;
- Fifteen (15) instances of patients being assigned to the incorrect sliding fee scale category;
- Seven (7) instances of a sliding fee scale applicable patient having not been properly and timely updated in the billing system;
- Thirty-three (33) instances of the sliding fee charge being greater than the allowed amount based upon the compliance supplement

Cause: The Center does not monitor sliding fee scale and admission policies and procedures.

Effect: The Center is not in compliance with the sliding fee scale application requirements, additionally, the Center may have improperly charged Ryan White Part A and C patients, as the sliding fee scale was improperly applied to patients. Because the monitoring process in place is not operating effectively, it is possible that patients could have been charged amounts greater than allowed by the grants, that program income is not properly reported, and that these activities would not be detected and corrected in a timely manner.

Recommendation: We recommend that management implement monitoring procedures related to the sliding fee scale application process. Monitoring procedures should include review and approval of all sliding fee scale applications, and periodic internal audits to ensure that the process properly identified patients that qualify for the sliding fee scale. Management should implement a mandatory training program on the sliding fee scale for all employees involved in the admissions process.

Questioned Costs: = $555

Management's Response and Corrective Action Plan: We agree. The Center has created and implemented a new policy for all Ryan White clients. The policy includes a sliding fee scale update once a year on the client's birthday, caps of 5%, 7% and 10%, and other items that may need attention or updating. Our PSR team is currently going over the manual excel spreadsheet, which details all Ryan White patients' payments, dates of visits, charges, and other information. This is to ensure that clients are not being charged more than what is allowable by the grants. This process could result in refund due to clients. Jamal Edwards will be the person responsible for corrective action, and correction is anticipated by June 30, 2012.

Status: This condition still existed during 2012.

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Finding 2011 – 5 – Application of Sliding Fee Schedule Part 2 – Material Weakness

Major Programs Impacted:

CFDA or Identifying Number	Name of Federal Program or Cluster
93.918	Health Resources and Services Administration HIV / AIDS Bureau – Ryan White Part C
93.914	Department of Health and Human Services Health Resources and Services Administration Chicago Department of Public Health – Ryan White Part A

Criteria: The Center is required to ensure that the Center's sliding fee scale policy is in line with the grant requirements.

Condition: There are portions of the Center's sliding fee scale policy which are inconsistent with the requirements of the compliance supplement for the Ryan White Part A and C grants.

Context: During our review of the sliding fee scale policy, we noted the following: (1) the policy allows for the charging of a $10 or $20 minimum fee for all Ryan White patients (depending on the service provided), including unemployed patients and patients for which an income level of zero has been indicated, (2) the policy does not explicitly note that charges to an individual patient are not to exceed a certain percentage of the patient's income level for a calendar year. The compliance supplement for both the Ryan White Part A and C grants indicates that no amount is to be charged to any patient with an income level below 100% of the federally determined poverty level. Additionally, the compliance supplement indicates that amounts charged to patients for a calendar year are limited to an identified percentage of their income level (such as 5% or 7% of total income).

Cause: The Center has not properly identified or implemented the specific requirements associated with the sliding fee scale policies of the Ryan White Part A and C grants, as outlined within the respective compliance supplements.

Effect: The Center is not in compliance with the sliding fee scale requirements, as outlined within the grant compliance supplements. Because the policy in place is not in compliance with the grant requirements, it is possible that patients could have been charged amounts greater than allowed by the grants, that program income is not properly reported, and that these activities would not be detected and corrected in a timely manner.

Recommendation: We recommend that management revisit the current sliding fee scale policy to be in compliance with grant requirements. Training sessions should be held to educate staff on the proper application of the policy, and a system should be developed to capture and report program income..

(Continued)

SECTION IV - SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (Continued)

Management's Response and Corrective Action Plan: We agree. The Center has created and implemented a new policy for all Ryan White clients. The policy includes a sliding fee scale update once a year on the client's birthday, caps of 5%, 7%, and 10%, and other items that may need attention of updating. Our PSR team is currently going over the manual excel spreadsheet, which details all Ryan White patients' payments, dates of visits, charges, and other information. This is to ensure that clients are not being charged more than what is allowable by the grants. This process could result in refund due to clients. Jamal Edwards will be the person responsible for corrective action, and correction is anticipated by June 30, 2012.

Status: Corrective action was taken and management adopted a new sliding fee scale policy, which utilizes the appropriate requirements.