

EL RIO SANTA CRUZ NEIGHBORHOOD HEALTH CENTER, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND
OTHER FINANCIAL INFORMATION

December 31, 2017 and 2016

El Rio Santa Cruz Neighborhood Health Center, Inc.

Consolidated Financial Statements and
Other Financial Information

December 31, 2017 and 2016

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Independent Auditors' Report

The Board of Directors
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center, a nonprofit organization), which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of El Rio Santa Cruz Neighborhood Health Center, Inc. as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying other financial information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 4, 2018, on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Center's internal control over financial reporting and compliance.

Fester & Chapman, PLLC

May 4, 2018

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Statements of Financial Position
December 31,

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 14,988,156	\$ 12,787,972
Investments	5,618,738	4,980,577
Accounts receivable, net	23,834,727	16,340,392
Grants and other receivables	1,538,605	1,695,400
Other current assets	2,266,487	2,271,740
Total current assets	48,246,713	38,076,081
Assets limited as to use	6,361,893	6,832,943
Other noncurrent assets	76,723	92,176
Land, buildings and equipment:		
Land	4,124,971	3,801,376
Buildings and improvements	48,981,455	47,847,364
Construction in progress	1,900,996	
Equipment	24,871,352	23,768,374
	79,878,774	75,417,114
Less accumulated depreciation	(36,545,635)	(33,250,077)
	43,333,139	42,167,037
Total assets	\$ 98,018,468	\$ 87,168,237
Liabilities and Net Assets		
Current liabilities:		
Accrued employee compensation and benefits	\$ 11,597,187	\$ 8,767,425
Accounts payable and accrued expenses	3,081,738	2,054,185
Contingency and risk pool reserves	3,201,845	2,703,877
Current portion of long-term debt	1,018,996	980,144
Other current liabilities	158,822	639,951
Total current liabilities	19,058,588	15,145,582
Long-term debt, less current portion	2,899,894	3,915,686
Other noncurrent liabilities	93,567	168,426
Total liabilities	22,052,049	19,229,694
Net assets:		
Unrestricted net assets:		
Undesignated	72,835,415	65,158,252
Board designated	236,931	236,931
	73,072,346	65,395,183
Temporarily restricted	2,870,155	2,519,442
Permanently restricted	23,918	23,918
Total net assets	75,966,419	67,938,543
Total liabilities and net assets	\$ 98,018,468	\$ 87,168,237

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Consolidated Statements of Activities

Years Ended December 31,

	<u>2017</u>	<u>2016</u>
Revenue and public support:		
Patient service fees, net	\$ 120,104,068	\$ 106,624,757
Public support - Department of Health and Human Services	10,495,929	10,730,950
Public support - Medicaid EHR Incentive Program	1,389,750	403,750
Public support - other	2,634,983	2,641,605
Other	2,717,184	5,844,778
In-kind contributions	<u>2,823,116</u>	<u>3,539,645</u>
Total revenue and public support	140,165,030	129,785,485
Expenses:		
Salaries and wages	72,340,118	66,996,174
Employee benefits	15,374,367	16,035,213
Medical services	6,382,809	4,705,198
Supplies	21,129,481	19,743,988
General and administrative	12,450,367	11,372,468
Depreciation	3,762,852	3,522,028
Interest	179,850	213,716
In-kind expenses	<u>2,823,116</u>	<u>3,539,645</u>
Total expenses	<u>134,442,960</u>	<u>126,128,430</u>
Changes in net assets from operations	5,722,070	3,657,055
Changes in fair value of interest rate swaps	74,859	77,346
Investment income	1,355,234	588,426
Capital grants	<u>525,000</u>	
Increase in unrestricted net assets	<u><u>\$ 7,677,163</u></u>	<u><u>\$ 4,322,827</u></u>

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Statements of Changes in Net Assets
Years Ended December 31,

	2017	2016
Unrestricted net assets:		
Changes in net assets from operations	\$ 5,722,070	\$ 3,657,055
Changes in fair value of interest rate swaps	74,859	77,346
Investment income	1,355,234	588,426
Capital grants	525,000	
Increase in unrestricted net assets	7,677,163	4,322,827
Temporarily restricted net assets:		
Contributions	1,237,030	1,329,773
Net assets released from restrictions	(886,317)	(873,551)
Increase in temporarily restricted net assets	350,713	456,222
Increase in net assets	8,027,876	4,779,049
Net assets, beginning of the year	67,938,543	63,159,494
Net assets, end of the year	\$ 75,966,419	\$ 67,938,543

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Statements of Cash Flows
Years Ended December 31,

	2017	2016
Operating activities		
Increase in net assets	\$ 8,027,876	\$ 4,779,049
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	3,762,852	3,522,028
Capital grants	(525,000)	
Amortization of deferred financing costs	15,453	15,453
Realized and unrealized gains on investments and assets limited as to use	(977,567)	(294,910)
Changes in fair value of interest rate swaps	(74,859)	(77,346)
Changes in operating assets and liabilities:		
Accounts receivable, net	(7,494,335)	(7,103,615)
Grants and other receivables	156,795	(725,651)
Other current assets	5,253	(590,543)
Assets limited as to use, current portion		25,053,964
Accrued employee compensation and benefits	2,829,762	2,108,536
Accounts payable and accrued expenses, excluding construction-related liabilities	436,342	1,094,880
Contingency and risk pool reserves	497,968	941,312
Due to Medicare		(26,060,460)
Other current liabilities	(498,253)	(575,512)
Net cash provided by operating activities	6,162,287	2,087,185
Investing activities		
Purchases of land, buildings and improvements and equipment	(4,320,619)	(6,397,536)
Purchases of investments	(85,040)	(101,995)
Proceeds from maturities of assets limited as to use	6,645,122	1,334,694
Purchases of assets limited as to use	(5,749,626)	(3,456,836)
Net cash used by investing activities	(3,510,163)	(8,621,673)
Financing activities		
Repayment of bonds and notes payable	(976,940)	(940,353)
Proceeds from capital grants	525,000	
Net cash used by financing activities	(451,940)	(940,353)
Increase (decrease) in cash and cash equivalents	2,200,184	(7,474,841)
Cash and cash equivalents, beginning of the year	12,787,972	20,262,813
Cash and cash equivalents, end of the year	\$ 14,988,156	\$ 12,787,972
<u>Supplemental Disclosures:</u>		
Cash paid during the year for interest	\$ 179,850	\$ 213,716

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

1. Summary of Significant Accounting Policies

Organization

El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center) is a Federally Qualified Health Center (FQHC) that provides health care and related services to the indigent and low-income population of Tucson, Arizona. The Center is an Arizona nonprofit corporation and is exempt from state and federal income taxes as an organization described under Section 501(c)(3) of the Internal Revenue Code.

The Center established the El Rio Foundation, Inc. (the Foundation), whose sole purpose is to solicit, receive gifts, money and property and to distribute the same to the Center to support the charitable, scientific and educational activities related to the Center and its health care mission. The balances and transactions of the Foundation are included in the accompanying financial statements.

In September 2016 the Center entered into a joint venture agreement with Tucson Medical Center to form Health on Tucson LLC. In conjunction with forming the joint venture, the Center also entered into a professional and management services agreement to manage the facility and provide all personnel, accounting, and billing services in exchange for an administrative fee. The balances and transactions of Health on Tucson LLC are included in the accompanying financial statements.

Significant intercompany accounts and transactions have been eliminated in these consolidated financial statements.

Basis of Presentation

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) topic of *Not-for-Profit Entities*. The Center and the Foundation are required to report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid instruments with initial maturities of three months or less.

Investments

Investments primarily consist of corporate bond funds, equity securities and shares in mutual funds, and are stated at fair value. Unrealized gains and losses are accounted for as other income. See Note 4.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

1. Summary of Significant Accounting Policies (continued)

Inventory

Inventory is included in other current assets and is comprised of pharmaceutical and medical supplies. Inventory is stated at the lower of cost or market, using the first-in, first-out method. Donated pharmaceuticals are stated at estimated fair value at the date of donation, which approximates cost.

Assets Limited as to Use

Assets limited as to use consist of funds from nonpublic sources set aside by the Center's Board of Directors. The Board retains control of these funds and may, at its discretion, direct the use of these funds in future periods. The investments included in assets limited as to use are carried at fair value based on quoted market prices. Realized and unrealized gains and losses are accounted for as other income.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at historical cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings and improvements are depreciated over 10 to 40 years and equipment is depreciated over 3 to 20 years. Computer equipment costing \$1,500 or more, and land, buildings, and other equipment costing \$5,000 or more are capitalized.

United States Department of Health and Human Services (DHHS) retains a reversionary interest in property and equipment purchased with its funds, as well as proceeds from the sale of such assets.

Contingency and risk pool reserves

Contingency and risk pool reserves consist of management's estimate of uncollectible amounts related to denied claims from Medicare and Arizona Health Care Cost Containment System (AHCCCS).

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Center has been limited by donors to a specific time period or purpose. Unconditional promises to give cash and other assets are reported at estimated fair value at the date the promise is received. The gifts are reported as temporarily restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and recognized as a component of other revenue. Donor-restricted contributions whose restrictions are met within the same year as received are considered unrestricted contributions and presented as other revenue in the consolidated statements of activities.

Permanently restricted net assets have been restricted by donors to be maintained by the Center in perpetuity.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

1. Summary of Significant Accounting Policies (continued)

Patient Service Fees, Net

The Center has agreements with third-party payors that provide for payments to the Center at amounts different from their established rates. Payment arrangements include prospectively determined rates, reimbursed costs and discounted charges. Patient service fees are reported at the estimated net realizable amounts from patients, third-party payors, and for other services rendered including retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Annually, Medicare cost reports are filed with the intermediary and are subject to audit and adjustments prior to final settlement. Estimates of final settlements for the 2017 and 2016 cost reports have been recognized in these consolidated financial statements.

The Center also has agreements with various health maintenance organizations (HMOs) and AHCCCS to provide medical services to subscribing participants. Under these agreements, the Center receives monthly capitation payments based on the number of participants, regardless of services actually performed by the Center.

Changes in Net Assets from Operations

The consolidated statement of activities includes a measurement for changes in net assets from operations. Components of changes in net assets from operations include changes in the fair value of the interest rate swaps, investment income and capital grants, consistent with industry practice.

Public Support Revenue

The Center receives annual grants awarded by DHHS which are primarily to subsidize care provided to the indigent population of the community and to provide prevention and primary health care services to persons with HIV infection and/or AIDS. These grants are subject to renewal periodically. The Center also receives grants awarded by the State of Arizona and other entities for specific public health care purposes. The Center recognizes grants as support when eligible costs are incurred or services are provided. Grants receivable are recorded when grant expenses are incurred or contracted services have been provided, but reimbursement has not been received by the Center.

Uncompensated Care

The Center provides health care and other related services to patients who meet certain criteria under its charity care policy. Because the Center does not pursue collection of amounts which qualify as charity care, they are not reported as net patient service fees. Uncompensated care provided by the Center under its policy amounted to \$10,630,289 and \$10,323,909 in 2017 and 2016, respectively.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

1. Summary of Significant Accounting Policies (continued)

Derivative and Hedging Instruments

The Center recognizes all derivatives in the consolidated statements of financial position at fair value. Derivatives that are not hedges must be adjusted to fair value through the consolidated statement of activities. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair values of the derivative are offset against one of the following: the change in fair value of assets, liabilities, or firm commitments through the consolidated statement of activities. The ineffective portion of a derivative's change in fair value, if any, is immediately recognized in the excess of revenue over expenses. The Center has interest rate swaps to manage the cost of borrowing its outstanding debt. The interest rate swaps converted the interest on the Center's long-term debt from floating rates to fixed rates.

Income Taxes

The Center and the Foundation are exempt from federal and state income taxes as organizations other than private foundations under Section 501(c)(3) of the Internal Revenue Code and similar state provisions. Health on Tucson LLC is considered a disregarded entity for tax purposes, as each of its members are nonprofit organizations.

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in Note 10. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

In-Kind Contributions

Donated goods or services are recorded at their estimated fair value at the date of the donation, and presented as revenues and expenses in the consolidated financial statements.

Reclassifications

Certain reclassifications were made to the 2016 financial statements in order to conform to the 2017 presentation.

Subsequent Events

The Center evaluated all events or transactions that occurred after December 31, 2017 through May 4, 2018, the date the Center issued these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

2. Concentration of Risk

The Center received payment for services rendered to patients under payment arrangements with payors which include third-party payors contracting with the Center to provide services under capitated arrangements, DHHS and other federally funded programs, and others. The following table summarizes the percentages of net revenues from each of these payors for the years ended December 31:

	<u>2017</u>	<u>2016</u>
	<u>Percent (%)</u>	<u>Percent (%)</u>
Department of Health and Human Services	8%	9%
Patient service fees:		
AHCCCS insurance plans	50	48
Other fee-for-service insurance plans	37	37
Other	<u>5</u>	<u>6</u>
	<u>100%</u>	<u>100%</u>

Collective Bargaining Agreement

Certain of the Center's employees, including its physicians and nonmanagerial employees, are covered by a collective bargaining agreement. At December 31, 2017 and 2016, 18 percent and 21 percent, respectively, of the Center's employees were participating under this agreement.

Credit Risk

The Center and the Foundation maintain cash and cash equivalents and investment balances at several financial institutions. Bank and investment accounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC) and the Securities Investor Protection Corporation (SIPC). Additionally, the Center maintains investments in money market funds that are secured by United States Treasury Securities and are considered to be fully backed by the United States federal government. Balances may at times exceed insured amounts; however, the Center and the Foundation manage the concentration of credit risk by maintaining deposits in multiple financial institutions. The Center and the Foundation have not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk.

3. Accounts Receivable, Net

Accounts receivable consists of charges to patients for services provided to them. Settled patient charges have been adjusted by a sliding fee schedule based on each patient's ability to pay. Allowances for doubtful accounts and contractual allowances have been provided to cover receivable amounts management estimates will not be collected.

The amount due from AHCCCS is included in accounts receivable, net, and it represents amounts due to the Center for the unreimbursed cost of providing primary health care to AHCCCS members. The Center completes annual reconciliations between actual costs of providing healthcare services to AHCCCS members and the payments received for those encounters. As of April 1, 2015, AHCCCS replaced the Prospective Payment System, and now FQHCs receive the majority of their all-inclusive per visit cost for each AHCCCS encounter by directly billing the contracted third party AHCCCS insurance plans.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

3. Accounts Receivable, Net (continued)

The following is a summary at December 31:

	<u>2017</u>	<u>2016</u>
Accounts receivable	\$ 15,529,779	\$ 13,043,061
Allowance for doubtful accounts and contractual allowances	<u>5,693,881</u>	<u>3,782,549</u>
Net accounts receivable	9,835,898	9,260,512
Due from AHCCCS	<u>13,998,829</u>	<u>7,079,880</u>
	<u>\$ 23,834,727</u>	<u>\$ 16,340,392</u>

4. Investments, Assets Limited as to Use, and Fair Value Measurements

Accounting principles generally accepted in the United States of America (GAAP) establish a framework for measuring fair value and expand disclosures about fair value measurements, which are determined based on assumptions that market participants would use in pricing assets and liabilities. GAAP establishes a fair value hierarchy that distinguishes between market participant assumptions and the Center's own assumptions about market participant assumptions.

Observable inputs are assumptions based on market data obtained from independent sources; while unobservable inputs are the Center's own assumptions about what market participants would assume based on the best information available in the circumstance.

Level 1 inputs - A quoted price in the active market for an identical asset or liability is considered to be the most reliable evidence of fair value. The Center's assets limited as to use and investments are valued using Level 1 inputs.

Level 2 inputs - These are observable inputs, either directly or indirectly, other than quoted prices included within Level 1. The Center estimates the fair value of its interest rate swap hedge liabilities described in Note 6 based on level 2 inputs.

Level 3 inputs - These inputs are unobservable and are used to measure fair value only when observable inputs are not available. The Center does not have any financial instruments valued using level 3 inputs.

As of December 2017 and 2016, the fair value of the Center's other financial instruments approximates their carrying amounts, either because the expected collection or payment period is relatively short or because the terms are similar to market terms.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Investments, Assets Limited as to Use, and Fair Value Measurements (continued)

Fair value of assets measured on a recurring basis at December 31, 2017 was as follows:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Assets limited as to use:			
Cash equivalents	\$ 28,348	\$ 28,348	
Fixed income mutual funds	260,590	260,590	
Equity securities	<u>6,072,955</u>	<u>6,072,955</u>	
Total assets limited as to use	6,361,893	6,361,893	
Investments:			
Fixed income mutual funds	2,161,441	2,161,441	
Equity securities and mutual funds	3,162,743	3,162,743	
Other	<u>294,554</u>	<u>294,554</u>	
Total investments	5,618,738	5,618,738	
Interest rate swap hedge	<u>(93,567)</u>		\$ (93,567)
	<u>\$ 11,887,064</u>	<u>\$ 11,980,631</u>	<u>\$ (93,567)</u>

Fair value of assets measured on a recurring basis at December 31, 2016 was as follows:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Assets limited as to use:			
Cash equivalents	\$ 1,003,657	\$ 1,003,657	
Fixed income mutual funds	1,011,710	1,011,710	
Equity securities	<u>4,817,576</u>	<u>4,817,576</u>	
Total assets limited as to use	6,832,943	6,832,943	
Investments:			
Fixed income mutual funds	1,993,803	1,993,803	
Equity securities and mutual funds	2,692,220	2,692,220	
Other	<u>294,554</u>	<u>294,554</u>	
Total investments	4,980,577	4,980,577	
Interest rate swap hedge	<u>(168,426)</u>		\$ (168,426)
	<u>\$ 11,645,094</u>	<u>\$ 11,813,520</u>	<u>\$ (168,426)</u>

Income earned from investments and assets limited as to use is included in other income on the consolidated statements of activities, and it is comprised of the following for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Unrealized and realized gains	\$ 977,567	\$ 294,910
Dividends	252,613	168,769
Interest	<u>125,054</u>	<u>124,747</u>
	<u>\$ 1,355,234</u>	<u>\$ 588,426</u>

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

5. Long-Term Debt

Long-term debt was comprised of the following at December 31:

	2017	2016
Series 2010 Healthcare Revenue Bonds (Pima County, Arizona - see below)	\$ 1,785,983	\$ 2,043,974
\$5,000,000 note payable to financial institution (see below)	2,132,907	2,851,856
	3,918,890	4,895,830
Less current portion	(1,018,996)	(980,144)
	\$ 2,899,894	\$ 3,915,686

In June 2010, the Center issued \$4,000,000 Series 2010 Healthcare Revenue Bonds through the Industrial Development Authority of Pima County, Arizona (Series 2010 Bonds). The proceeds of the Series 2010 Bonds were used for construction, acquisition and development of medical facilities and to pay the cost of issuance. Under the terms of the Series 2010 Bonds, one financial institution agreed to purchase all of the bonds. Repayment on the bonds is due in monthly installments of approximately \$21,000 including principal and interest at 3.85 percent according to the terms of an interest rate swap agreement (Note 6). The bonds are secured by a deed of trust on the constructed building and mature in June 2025.

In August 2013, the Center signed a \$5,000,000 note payable to a financial institution. Repayment on the note is due in monthly installments of approximately \$68,000, including principal and interest at 3.84 percent according to the terms of an interest rate swap agreement (Note 6). The note is secured by a deed of trust on real property and matures in August 2020.

Future principal payments on long-term debt are as follows at December 31, 2017:

2018	\$ 1,018,996
2019	1,018,996
2020	859,480
2021	261,690
2022	272,022
Thereafter	487,706
Total	\$ 3,918,890

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

6. Interest Rate Swaps

In June 2010, the Center entered into an interest rate swap agreement that hedges an initial notional amount of \$4,000,000 at a fixed rate of 3.85 percent against 65 percent of 1 month LIBOR plus 1.3 percent. The notional amount will decrease over the term of the agreement as principal payments are made on the underlying debt. The interest rate swap agreement will terminate in June 2025.

In August 2013, the Center entered into an interest rate swap agreement that hedges an initial notional amount of \$5,000,000 at a fixed rate of 3.84 percent against 1 month LIBOR plus 1.85 percent. The notional amount will decrease over the term of the agreement as principal payments are made on the underlying debt. The interest rate swap agreement will terminate in August 2020.

Changes in the fair value of the interest rate swap agreements resulted in increases in net assets of \$74,859 and \$77,346 during the years ended December 31, 2017 and 2016, respectively.

7. Operating Leases

The Center rents certain facilities and telephone, medical and other equipment under noncancelable operating leases. Future minimum rents under these leases are as follows:

Year ending December 31,		
2018	\$	1,511,743
2019		896,871
2020		454,869
2021		232,307
2022		239,276
Thereafter		985,074
Total minimum lease payments	\$	<u>4,320,140</u>

Rental expense totaled \$2,461,196 and \$2,535,857 in 2017 and 2016, respectively.

8. Retirement Plans

The Center has a 403(b) Tax Deferred Annuity Plan (TDA) for the benefit of its employees, which is administered by a pension plan administrator. The Center contributes 1.5 percent of qualifying gross salaries and wages to the TDA and matches employees' contributions up to three percent of qualifying salaries and wages. The Center made contributions to the TDA of \$2,753,089 and \$2,465,973 in 2017 and 2016, respectively.

9. In-kind Contributions

In-kind contributions are measured at estimated fair value at the date of donation and consisted of the following at December 31:

	<u>2017</u>	<u>2016</u>
Immunizations and HIV pharmaceuticals received from the State of Arizona	\$ 2,762,239	\$ 3,466,376
Other	<u>60,877</u>	<u>73,269</u>
	<u>\$ 2,823,116</u>	<u>\$ 3,539,645</u>

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

10. Functional Expense Classification

General and administrative expenses exclusively supported primary healthcare activities. The following is a summary of the Center's expenses by function for the years ended December 31:

	2017	2016
Program activities - primary healthcare	\$ 119,479,738	\$ 113,521,044
General and administrative	13,482,271	11,183,604
Fundraising	<u>1,480,951</u>	<u>1,423,782</u>
	<u>\$ 134,442,960</u>	<u>\$ 126,128,430</u>

11. Commitments and Contingencies

Healthcare regulations: The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Center is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) broadened the scope of certain fraud and abuse laws by adding several criminal provisions for fraud offenses that apply to all healthcare benefit programs. HIPAA also added a prohibition against incentives intended to influence decisions by Medicare beneficiaries as to the provider from which they receive services. HIPAA requirements were updated by the Health Information Technology for Economic and Clinical Health Act (HITECH Act). Under the HITECH Act, violations of HIPAA requirements could now result in civil penalties of up to \$50,000 per incident, and up to \$1.5 million in total for each type of violation in a calendar year.

Professional liability insurance: The Federally Supported Health Centers Assistance Act of 1992 authorizes the Public Health Service to assume responsibility for medical malpractice claims involving approved grantees and certain other health care providers under the Federal Tort Claim Act (FTCA). The Center is currently covered under the FTCA. In addition, the Center has general liability and umbrella coverage.

Litigation: Periodically, the Center is involved in litigation and claims arising in the normal course of operations. In the opinion of management, based on consultation with legal counsel, losses, if any, from these matters are covered by insurance or are immaterial.

Construction commitment: As of December 31, 2017, the Center had entered into an agreement with a general contractor for \$11.7 million to construct a clinic, which is expected to be completed in 2018. The Center plans to finance a portion of the project costs prior to its completion. At December 31, 2017, the Center had paid \$806,108 to the general contractor.

OTHER FINANCIAL INFORMATION



Independent Auditors' Report on Other Financial Information

The Board of Directors of
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

Our audits were conducted for the purpose of forming an opinion on the 2017 and 2016 consolidated financial statements taken as a whole. The details of the 2017 and 2016 consolidated statements of financial position and the related details of the consolidated statements of activities and changes in net assets of El Rio Santa Cruz Neighborhood Health Center, Inc., and the 2017 statements of financial position and activities and changes in net assets of El Rio Foundation, Inc. (other financial information) are presented for purposes of additional analysis and are not a required part of the basic consolidated 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 basic consolidated financial statements. The other financial information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other financial information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Fester & Chapman, PLLC

May 4, 2018

El Rio Santa Cruz Neighborhood Health Center, Inc.
Details of Consolidated Statement of Financial Position
December 31, 2017

	The Center						Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	Health on Tucson LLC	Foundation	Eliminations	
Assets							
Current assets:							
Cash and cash equivalents	\$ 13,951,618	\$ 121,304	\$ 148,300		\$ 766,934		\$ 14,988,156
Investments	5,618,738						5,618,738
Accounts receivable, net	23,834,727						23,834,727
Grants and other receivables	1,308,542				230,063		1,538,605
Due from other funds	960,708			\$ 231,349	25,362	\$ (1,217,419)	
Other current assets	<u>2,266,487</u>						<u>2,266,487</u>
Total current assets	<u>47,940,820</u>	<u>121,304</u>	<u>148,300</u>	<u>231,349</u>	<u>1,022,359</u>	<u>(1,217,419)</u>	<u>48,246,713</u>
Assets limited as to use			3,657		6,358,236		6,361,893
Other noncurrent assets	76,723						76,723
Land, buildings and equipment:							
Land	4,124,971						4,124,971
Building and improvements	48,981,455			700,324		(700,324)	48,981,455
Construction in progress	1,900,996						1,900,996
Equipment	<u>24,844,543</u>	<u>2,083</u>	<u>24,726</u>	<u>96,837</u>		<u>(96,837)</u>	<u>24,871,352</u>
	79,851,965	2,083	24,726	797,161		(797,161)	79,878,774
Less accumulated depreciation	<u>(36,518,826)</u>	<u>(2,083)</u>	<u>(24,726)</u>	<u>(46,577)</u>		<u>46,577</u>	<u>(36,545,635)</u>
	43,333,139			750,584		(750,584)	43,333,139
Total assets	<u>\$ 91,350,682</u>	<u>\$ 121,304</u>	<u>\$ 151,957</u>	<u>\$ 981,933</u>	<u>\$ 7,380,595</u>	<u>\$ (1,968,003)</u>	<u>\$ 98,018,468</u>
Liabilities and Net Assets							
Current liabilities:							
Accrued employee compensation and benefits	\$ 11,597,187						\$ 11,597,187
Accounts payable and accrued expenses	3,081,738						3,081,738
Contingency and risk pool reserves	3,201,845						3,201,845
Current portion of long-term debt	1,018,996						1,018,996
Due to other funds	256,712	\$ 121,304	\$ 165,755	\$ 546,940	\$ 126,708	\$ (1,217,419)	
Other current liabilities	<u>172,620</u>		<u>(13,798)</u>				<u>158,822</u>
Total current liabilities	<u>19,329,098</u>	<u>121,304</u>	<u>151,957</u>	<u>546,940</u>	<u>126,708</u>	<u>(1,217,419)</u>	<u>19,058,588</u>
Long-term debt, less current portion	2,899,894						2,899,894
Other noncurrent liabilities	<u>93,567</u>						<u>93,567</u>
Total liabilities	<u>22,322,559</u>	<u>121,304</u>	<u>151,957</u>	<u>546,940</u>	<u>126,708</u>	<u>(1,217,419)</u>	<u>22,052,049</u>
Net assets:							
Unrestricted	69,028,123			434,993	4,359,814	(750,584)	73,072,346
Temporarily restricted					2,870,155		2,870,155
Permanently restricted					<u>23,918</u>		<u>23,918</u>
Total net assets	<u>69,028,123</u>			<u>434,993</u>	<u>7,253,887</u>	<u>(750,584)</u>	<u>75,966,419</u>
Total liabilities and net assets	<u>\$ 91,350,682</u>	<u>\$ 121,304</u>	<u>\$ 151,957</u>	<u>\$ 981,933</u>	<u>\$ 7,380,595</u>	<u>\$ (1,968,003)</u>	<u>\$ 98,018,468</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Details of Consolidated Statement of Financial Position
December 31, 2016

	The Center						Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	Health on Tucson LLC	Foundation	Eliminations	
Assets							
Current assets:							
Cash and cash equivalents	\$ 11,761,988	\$ 392	\$ 301,480		\$ 724,112		\$ 12,787,972
Investments	4,980,577						4,980,577
Accounts receivable, net	16,340,392						16,340,392
Grants and other receivables	1,660,394		2,736		109,311	\$ (77,041)	1,695,400
Due from other funds	170,750					(170,750)	
Other current assets	<u>2,269,740</u>				<u>2,000</u>		<u>2,271,740</u>
Total current assets	<u>37,183,841</u>	<u>392</u>	<u>304,216</u>		<u>835,423</u>	<u>(247,791)</u>	<u>38,076,081</u>
Assets limited as to use	500,000		3,657	\$ 1,000,000	5,829,286	(500,000)	6,832,943
Other noncurrent assets	92,176						92,176
Land, buildings and equipment:							
Land	3,801,376						3,801,376
Building and improvements	47,847,364			51,218		(51,218)	47,847,364
Equipment	<u>23,741,565</u>	<u>2,083</u>	<u>24,726</u>				<u>23,768,374</u>
	75,390,305	2,083	24,726	51,218		(51,218)	75,417,114
Less accumulated depreciation	<u>(33,223,268)</u>	<u>(2,083)</u>	<u>(24,726)</u>				<u>(33,250,077)</u>
	42,167,037			51,218		(51,218)	42,167,037
Total assets	<u>\$ 79,943,054</u>	<u>\$ 392</u>	<u>\$ 307,873</u>	<u>\$ 1,051,218</u>	<u>\$ 6,664,709</u>	<u>\$ (799,009)</u>	<u>\$ 87,168,237</u>
Liabilities and Net Assets							
Current liabilities:							
Accrued employee compensation and benefits	\$ 8,767,425						\$ 8,767,425
Accounts payable and accrued expenses	2,049,531				4,654		2,054,185
Contingency and risk pool reserves	2,703,877						2,703,877
Current portion of long-term debt	980,144						980,144
Due to other funds	67,567	\$ 392	\$ 4,737	\$ 77,275	\$ 97,820	\$ (247,791)	
Other current liabilities	<u>336,815</u>		<u>303,136</u>				<u>639,951</u>
Total current liabilities	<u>14,905,359</u>	<u>392</u>	<u>307,873</u>	<u>77,275</u>	<u>102,474</u>	<u>(247,791)</u>	<u>15,145,582</u>
Long-term debt, less current portion	3,915,686						3,915,686
Other noncurrent liabilities	<u>168,426</u>						<u>168,426</u>
Total liabilities	<u>18,989,471</u>	<u>392</u>	<u>307,873</u>	<u>77,275</u>	<u>102,474</u>	<u>(247,791)</u>	<u>19,229,694</u>
Net assets:							
Unrestricted	60,953,583			973,943	4,018,875	(551,218)	65,395,183
Temporarily restricted					2,519,442		2,519,442
Permanently restricted					<u>23,918</u>		<u>23,918</u>
Total net assets	<u>60,953,583</u>			<u>973,943</u>	<u>6,562,235</u>	<u>(551,218)</u>	<u>67,938,543</u>
Total liabilities and net assets	<u>\$ 79,943,054</u>	<u>\$ 392</u>	<u>\$ 307,873</u>	<u>\$ 1,051,218</u>	<u>\$ 6,664,709</u>	<u>\$ (799,009)</u>	<u>\$ 87,168,237</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Details of Consolidated Statement of Activities and Changes in Net Assets
December 31, 2017

	The Center						Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	Health on Tucson LLC	Foundation	Eliminations	
Unrestricted net assets:							
Revenue and public support:							
Patient service fees, net	\$ 120,104,067	\$ 408,303	\$ 1,599,686	\$ 871,853		\$ (2,879,841)	\$ 120,104,068
Public support - Department of Health and Human Services	10,495,929	1,360,565	960,524	72,221		(2,393,310)	10,495,929
Public Support - Medicaid EHR Incentive Program	1,389,750						1,389,750
Public support - other	2,634,983						2,634,983
Other	3,412,349	261,723	3,066		\$ 1,110,170	(2,070,124)	2,717,184
In-kind contributions	2,762,239				60,877		2,823,116
Total revenue and public support	<u>140,799,317</u>	<u>2,030,591</u>	<u>2,563,276</u>	<u>944,074</u>	<u>1,171,047</u>	<u>(7,343,275)</u>	<u>140,165,030</u>
Expenses:							
Salaries and wages	72,340,120	1,279,431	1,104,252	547,121		(2,930,806)	72,340,118
Employee benefits	15,374,364	285,879	122,884	145,490		(554,250)	15,374,367
Medical services	6,288,868	76,522	309,614	216,815	93,940	(602,950)	6,382,809
Supplies	21,106,332	113,549	340,967	258,935	23,150	(713,452)	21,129,481
General and administrative	12,214,403	275,210	685,559	270,873	1,302,984	(2,298,662)	12,450,367
Depreciation	3,762,851			43,790		(43,789)	3,762,852
Interest	179,850						179,850
In-kind expenses	2,762,239				60,877		2,823,116
Total expenses	<u>134,029,027</u>	<u>2,030,591</u>	<u>2,563,276</u>	<u>1,483,024</u>	<u>1,480,951</u>	<u>(7,143,909)</u>	<u>134,442,960</u>
Changes in net assets from operations	6,770,290			(538,950)	(309,904)	(199,366)	5,722,070
Change in fair value of interest rate swaps	74,859						74,859
Investment income	704,391				650,843		1,355,234
Capital grants	525,000						525,000
Increase (decrease) in unrestricted net assets	8,074,540			(538,950)	340,939	(199,366)	7,677,163
Temporarily restricted net assets:							
Contributions					1,237,030		1,237,030
Net assets released from restrictions					(886,317)		(886,317)
Increase in temporarily restricted net assets					<u>350,713</u>		<u>350,713</u>
Increase (decrease) in net assets	<u>\$ 8,074,540</u>	<u>\$</u>	<u>\$</u>	<u>\$ (538,950)</u>	<u>\$ 691,652</u>	<u>\$ (199,366)</u>	<u>\$ 8,027,876</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
 Details of Consolidated Statement of Activities and Changes in Net Assets
 December 31, 2016

	The Center						Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	Health on Tucson LLC	Foundation	Eliminations	
Unrestricted net assets:							
Revenue and public support:							
Patient service fees, net	\$ 106,624,757	\$ 109,595	\$ 927,895			\$ (1,037,490)	\$ 106,624,757
Public support - Department of Health and Human Services	10,730,950	1,297,610	984,142			(2,281,752)	10,730,950
Public support - Medicaid EHR Incentive Program	403,750						403,750
Public support - other	2,641,605						2,641,605
Other	3,933,365	1,016,170	5,472	\$ 1,000,000	\$ 926,565	(1,036,794)	5,844,778
In-kind contributions	<u>3,466,376</u>				<u>73,269</u>		<u>3,539,645</u>
Total revenue and public support	<u>127,800,803</u>	<u>2,423,375</u>	<u>1,917,509</u>	<u>1,000,000</u>	<u>999,834</u>	<u>(4,356,036)</u>	<u>129,785,485</u>
Expenses:							
Salaries and wages	65,355,889	1,574,796	1,233,375	6,199		(1,174,085)	66,996,174
Employee benefits	16,035,215	364,494	320,758	3,893		(689,147)	16,035,213
Medical services	4,606,850	64,208	193,112	8,071	98,348	(265,391)	4,705,198
Supplies	19,726,139	157,971	101,854	7,894	17,848	(267,718)	19,743,988
General and administrative	11,216,312	261,906	68,410		1,234,317	(1,408,477)	11,372,468
Depreciation	3,522,028						3,522,028
Interest	213,716						213,716
In-kind expenses	<u>3,466,376</u>				<u>73,269</u>		<u>3,539,645</u>
Total expenses	<u>124,142,525</u>	<u>2,423,375</u>	<u>1,917,509</u>	<u>26,057</u>	<u>1,423,782</u>	<u>(3,804,818)</u>	<u>126,128,430</u>
Changes in net assets from operations	3,658,278			973,943	(423,948)	(551,218)	3,657,055
Change in fair value of interest rate swaps	77,346						77,346
Investment income	<u>348,123</u>				<u>240,303</u>		<u>588,426</u>
Increase (decrease) in unrestricted net assets	4,083,747			973,943	(183,645)	(551,218)	4,322,827
Temporarily restricted net assets:							
Contributions					1,329,773		1,329,773
Net assets released from restrictions					<u>(873,551)</u>		<u>(873,551)</u>
Increase in temporarily restricted net assets					<u>456,222</u>		<u>456,222</u>
Increase (decrease) in net assets	<u>\$ 4,083,747</u>	<u>\$</u>	<u>\$</u>	<u>\$ 973,943</u>	<u>\$ 272,577</u>	<u>\$ (551,218)</u>	<u>\$ 4,779,049</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Note to Other Financial Information
December 31, 2017 and 2016

1. Summary of Significant Accounting Policies

Fund Accounting

The following funds are maintained by the Center:

- *General Fund* - represents funds used for program activities allowed by the Department of Health and Human Services (DHHS) under a Section 330 grant and for activities related to the provision of health care and related services to patients.
- *Homeless Fund* - represents funds under a DHHS grant to be used to provide general care for the homeless population.
- *HIV Early Intervention Fund* - represents funds under a DHHS grant to be used in prevention and delivery of primary healthcare services to persons with the HIV infection and/or AIDS.
- *Health on Tucson LLC* - represents the balances and transactions of a joint venture with the Center and Tucson Medical Center.

El Rio Foundation, Inc.
Statement of Financial Position
December 31, 2017

Assets	
Cash and cash equivalents	\$ 766,934
Contributions and other receivables:	
Unrestricted	40,301
Temporarily restricted	215,124
Assets limited as to use:	
Unrestricted	6,334,318
Permanently restricted	<u>23,918</u>
	<u>6,358,236</u>
Total assets	<u><u>\$ 7,380,595</u></u>
 Liabilities and Net Assets	
Liabilities:	
Due to the Center	<u>\$ 126,708</u>
Total liabilities	126,708
 Net assets:	
Unrestricted net assets:	
Undesignated	4,122,883
Board designated	<u>236,931</u>
	4,359,814
Temporarily restricted net assets	2,870,155
Permanently restricted net assets	<u>23,918</u>
Total net assets	<u>7,253,887</u>
Total liabilities and net assets	<u><u>\$ 7,380,595</u></u>

El Rio Foundation, Inc.
Statement of Activities and Changes in Net Assets
Year Ended December 31, 2017

	<u>Unrestricted Net Assets</u>	<u>Temporarily Restricted Net Assets</u>	<u>Permanently Restricted Net Assets</u>	<u>Total</u>
Revenues and support:				
Grants and contributions	\$ 223,853	\$ 740,240		\$ 964,093
Special events revenue		496,790		496,790
Net investment income	650,843			650,843
In-kind contributions	<u>60,877</u>			<u>60,877</u>
	935,573	1,237,030		2,172,603
Net assets released from restrictions	<u>886,317</u>	<u>(886,317)</u>		
Total revenues and support	1,821,890	350,713		2,172,603
Expenses:				
Program services	1,012,009			1,012,009
Management and general	247,500			247,500
Special events and fundraising	160,565			160,565
In-kind expenses	<u>60,877</u>			<u>60,877</u>
Total expenses	<u>1,480,951</u>			<u>1,480,951</u>
Increase in net assets	340,939	350,713		691,652
Net assets, beginning of year	<u>4,018,875</u>	<u>2,519,442</u>	\$ 23,918	<u>6,562,235</u>
Net assets, end of year	<u>\$ 4,359,814</u>	<u>\$ 2,870,155</u>	<u>\$ 23,918</u>	<u>\$ 7,253,887</u>