El Centro de Corazón

Independent Auditor's Reports and Financial Statements

October 31, 2018 and 2017

BKD
CPAs & Advisors

El Centro de Corazón
October 31, 2018 and 2017

Contents

BKD
CPAs & Advisors

14241 Dallas Parkway, Suite 1100 | Dallas, TX 75254-2961
972.702.8262 | Fax 972.702.0673 | bkd.com

Independent Auditor's Report

Board of Directors
El Centro de Corazón
Houston, Texas

We have audited the accompanying financial statements of El Centro de Corazón (Organization), which comprise the balance sheets as of October 31, 2018 and 2017, and the related statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of El Centro de Corazón as of October 31, 2018 and 2017, and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Dallas, Texas
April 8, 2019

El Centro de Corazón

Balance Sheets

October 31, 2018 and 2017

Assets

	2018	2017
Current Assets		
Cash	$ 3,787,608	$ 3,540,476
Patient accounts receivable, net of allowance; 2018 – $324,878, 2017 – $72,732	498,040	724,640
Grants and other receivables	116,959	90,127
Contributions receivable	85,442	118,226
Supplies	129,958	125,899
Prepaid expenses and other	79,376	106,623
Total current assets	4,697,383	4,705,991
Property and Equipment, At Cost		
Land and land improvements	356,393	356,394
Buildings and leasehold improvements	2,127,584	2,134,205
Equipment	1,103,489	1,075,174
Furniture and fixtures	83,917	83,918
Construction in progress	1,161,014	226,467
	4,832,397	3,876,158
Less accumulated depreciation	1,707,580	1,476,502
	3,124,817	2,399,656
Total assets	$ 7,822,200	$ 7,105,647

Liabilities and Net Assets

	2018	2017
Current Liabilities		
Accounts payable	$ 319,071	$ 247,909
Accrued expenses	522,235	511,346
Current maturities of long-term debt	2,793	-
Total current liabilities	844,099	759,255
Long-term Debt	256,319	-
Total liabilities	1,100,418	759,255
Net Assets		
Unrestricted	6,226,050	5,760,281
Temporarily restricted	495,732	586,111
Total net assets	6,721,782	6,346,392
Total liabilities and net assets	$ 7,822,200	$ 7,105,647

El Centro de Corazón

Statements of Operations and Changes in Net Assets

Years Ended October 31, 2018 and 2017

	2018	2017
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowance)	$ 6,870,481	$ 6,974,659
Provision for uncollectible accounts	(348,390)	(112,534)
Net patient service revenue less provision for uncollectible accounts	6,522,091	6,862,125
Grant revenue	2,754,984	2,791,875
Contributions	699,134	743,547
Other	212,689	7,822
Net assets released from restrictions used for operations	1,352,029	1,141,453
Total unrestricted revenues, gains and other support	11,540,927	11,546,822
Expenses and Losses		
Salaries and wages	6,204,056	6,143,505
Employee benefits	966,742	948,949
Purchased services and professional fees	885,096	794,357
Supplies and other	2,814,673	2,486,760
Rent	313,916	313,918
Depreciation	235,085	228,416
Loss on disposition of property and equipment	7,362	1,437
Total expenses and losses	11,426,930	10,917,342
Excess of Revenues over Expenses	113,997	629,480
Contributions and grants of or for acquisition of property and equipment	351,772	30,816
Net assets released from restriction used for purchase of property and equipment	-	25,000
Increase in unrestricted net assets	465,769	685,296
Temporarily Restricted Net Assets		
Contributions	1,261,650	1,383,441
Net assets released from restriction	(1,352,029)	(1,166,453)
Increase (decrease) in temporarily restricted net assets	(90,379)	216,988
Change in Net Assets	375,390	902,284
Net Assets, Beginning of Year	6,346,392	5,444,108
Net Assets, End of Year	$ 6,721,782	$ 6,346,392

El Centro de Corazón

Statements of Cash Flows

Years Ended October 31, 2018 and 2017

	2018	2017
Operating Activities		
Change in net assets	$ 375,390	$ 902,284
Items not requiring (providing) operating cash flow		
Loss on disposition of property and equipment	7,362	1,437
Depreciation	235,085	228,416
Provision for uncollectible accounts	348,390	112,534
Contributions and grants of or for acquisition of property and equipment	(351,772)	(80,816)
Changes in		
Patient accounts receivable, net	(121,790)	(310,020)
Grants and other receivables	10,589	168,721
Contributions receivable	32,784	(18,569)
Prepaid expenses and other	27,247	(26,848)
Supplies	(4,059)	19,504
Accounts payable and accrued expenses	(64,311)	102,420
Net cash provided by operating activities	494,915	1,099,063
Investing Activities		
Purchase of property and equipment	(821,246)	(294,633)
Proceeds from sale of property and equipment	-	27,165
Net cash used in investing activities	(821,246)	(267,468)
Financing Activities		
Proceeds from contributions and grants for acquisition of property and equipment	314,351	50,000
Proceeds from issuance of long-term debt	259,112	-
Net cash provided by financing activities	573,463	50,000
Increase in Cash	247,132	881,595
Cash, Beginning of Year	3,540,476	2,658,881
Cash, End of Year	$ 3,787,608	$ 3,540,476
Supplemental Cash Flows Information		
Accounts payable incurred for property and equipment	$ 171,337	$ 24,975
Property and equipment acquired through noncash contributions	$ -	$ 30,816

El Centro de Corazón

Notes to Financial Statements

October 31, 2018 and 2017

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

Nature of Operations

El Centro de Corazón (Organization) primarily earns revenues by providing primary health services to indigent and low-income patients in the East End of Houston, Texas. The Organization is recognized as a Federally Qualified Health Center (FQHC) by the U.S. Department of Health and Human Services and the state of Texas and is subject to established regulations. The Organization is governed by a Board of Directors of no less than nine members, of which 51% or more must be health care service users of the Organization.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash

At October 31, 2018, the Organization’s cash accounts exceeded federally insured limits by approximately $3,185,000.

Patient Accounts Receivable

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of accounts receivable, the Organization analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

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

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

The Organization's allowance for uncollectible accounts for self-pay patients increased from 52% of self-pay accounts receivable at October 31, 2017 to 59% of self-pay accounts receivable at October 31, 2018. In addition, the Organization's write-offs increased approximately $37,000 from $59,000 for the year ended October 31, 2017, to approximately $96,000 for the year ended October 31, 2018. The increase in write-offs was due to a change in the way the Medicaid managed care claims were required to be billed at the end of 2017 that resulted in some claims not being paid.

Supplies

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

Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated using the straight-line method over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

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

Buildings and improvements	15 – 20 years
Equipment	3 – 15 years
Furniture and fixtures	5 – 7 years

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Certain property and equipment have been purchased with grant funds received from the U.S. Department of Health and Human Services. Such items may be reclaimed by the federal government if not used to further the grant's objectives.

Long-lived Asset Impairment

The Organization evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended October 31, 2018 and 2017.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Organization has been limited by donors to a specific time period or purpose.

Net Patient Service Revenue

The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

In accordance with grant requirements, the Organization provides care at amounts less than its established rates using sliding fee scale adjustments to patients who meet certain criteria. These adjustments are a component of net patient service revenue.

Government Grant Revenue

Support funded by grants is recognized as the Organization performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be required.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted and then released from restriction. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

In-kind Contributions

In addition to receiving cash contributions, the Organization receives in-kind contributions of laboratory services, rent, and other supplies from various donors. It is the policy of the Organization to record the estimated fair value of certain in-kind donations as inventory or expense in its financial statements and similarly increase contribution revenue by a like amount. For the years ended October 31, 2018 and 2017, $586,064 and $614,228, respectively, was received in in-kind contributions.

Professional Liability Claims

The Organization recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in *Note 6*.

Income Taxes

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

Excess of Revenues Over Expenses

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

Subsequent Events

Subsequent events have been evaluated through April 8, 2019, which is the date the financial statements were available to be issued.

Note 2: Grant Revenue

The Organization is the recipient of a Health Center Program (HCP) grant from the U.S. Department of Health and Human Services (HHS). The general purpose of the grant is to provide expanded health care services in Houston, Texas. Terms of the grant generally provide for funding of the Organization's operations based on an approved budget. Grant revenue is recognized as qualifying expenditures are incurred over the grant period.

During the years ended October 31, 2018 and 2017, the Organization earned $2,311,610 and $2,346,926, respectively, in HCP grant funds. Funding for the grant budget period ending January 31, 2020, is authorized at $2,218,144.

In 2016, the Organization was awarded a $1,000,000 Health Infrastructure Investment Program grant from HHS to be used for expansion of one of its facilities. During the years ended October 31, 2018 and 2017, $351,772 and $53,239, respectively, was recognized in grant revenue for this grant.

The Organization also receives additional financial support from other federal, state and private sources. Generally, such support requires compliance with terms and conditions specified in grant agreements.

Note 3: Net Patient Service Revenue

The Organization recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for the sliding fee program, the Organization recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Organization's uninsured patients who do not qualify for the sliding fee program will be unable to pay for the services provided. Thus, the Organization records a significant provision for uncollectible accounts related to uninsured patients who do not qualify for the sliding fee program in the period the services are provided. This provision for uncollectible accounts is presented on the statements of operations and changes in net assets as a component of net patient service revenue.

The Organization is approved as a FQHC for both Medicare and Medicaid reimbursement purposes. The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates. These payment arrangements include:

Medicare. Covered FQHC services rendered to Medicare program beneficiaries are paid in accordance with provisions of Medicare's Prospective Payment System (PPS) for FQHCs. Medicare payments, including patient coinsurance, are now paid on the lesser of the Organization's actual charge or the applicable PPS rate. Services not covered under the FQHC benefit are paid based on established fee schedules.

Medicaid. Covered FQHC services rendered to Medicaid program beneficiaries are paid based on a prospective reimbursement methodology. The Organization is reimbursed a set encounter rate for all services provided under the plan. The encounter rate is updated annually based on the Medicare Economic Index (MEI).

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Organization has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Organization under these agreements includes prospectively determined rates per unit of service and discounts from established charges.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended October 31, 2018 and 2017, respectively, was approximately:

	2018	2017
Medicare	$ 91,210	$ 31,050
Medicaid	5,017,158	5,227,388
Other third-party payers	1,302,258	1,188,456
Patient responsibility	459,855	527,765
Total	$ 6,870,481	$ 6,974,659

Note 4: Concentration of Credit Risk

The Organization grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at October 31, 2018 and 2017, is:

	2018	2017
Medicare	3%	2%
Medicaid	85%	87%
Other third-party payers	10%	10%
Patient responsibility	2%	1%
	100%	100%

Note 5: Contributions Receivable

Contributions receivable consisted of temporarily restricted contributions due within one year of $85,442 and $118,226 at October 31, 2018 and 2017, respectively. No discount or allowance was provided for the contributions, as they are expected to be fully collected within one year from the time of the pledge.

Note 6: Medical Malpractice Claims

The U.S. Department of Health and Human Services has deemed the Organization and its participating providers covered under the Federal Tort Claims Act (FTCA) for damage and personal injury, including death, resulting from the performance of medical, surgical, dental, and related functions. FTCA coverage is comparable to an occurrence policy without a monetary cap.

Claim liabilities are determined without consideration of insurance recoveries. Expected recoveries are presented separately. Based on the Organization's claim experience, no such accrual has been made for the Organization's medical malpractice cost for the years ended October 31, 2018 and 2017. However, because of the risk in providing health care services, it is possible that an event has occurred which will be the basis for a future claim.

Note 7: Lines of Credit

The Organization has a $300,000 revolving line of credit that matures in November 2019. The line is unsecured and bears interest at a variable rate equal the prime rate plus 1.00%, with a floor of 4.50% (6.5% and 5.25% at October 31, 2018 and 2017, respectively). At October 31, 2018 and 2017, there was $0 borrowed against this line.

The Organization has a $100,000 revolving line of credit secured by certain real estate and bearing interest at a variable rate equal to the prime rate plus 1.50% (6.75% and 5.75% at October 31, 2018 and 2017, respectively). At October 31, 2018 and 2017, there was $0 borrowed against this line. This line matures in March 2025.

Note 8: Long-term Debt

	2018	2017
Note payable, Bank (A)	$ 259,112	$ -
Less current maturities	2,793	-
	$ 256,319	$ -

(A) Organization can draw up to the maximum amount of $1,450,000 to fund construction of improvements at the Organization's Dunn Clinic through July 1, 2019. Monthly interest payments at a fixed interest rate of 4.15% are due through August 1, 2018 until and including June 1, 2019, then principal payments will be calculated on the basis of an amortization of the principal balance over 240 months and will be payable beginning July 1, 2019. The note has a maturity date of June 29, 2028. The note payable is secured by certain real estate.

Aggregate annual maturities of long-term debt at October 31, 2018, are:

2019	$ 2,793
2020	8,614
2021	8,978
2022	9,358
2023	9,754
Thereafter	219,615
	$ 259,112

Note 9: Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods:

	2018	2017
Purchase of equipment	$ 50,000	$ 50,000
Behavioral health services	85,577	24,770
Primary health care services	182,621	186,463
Women's health care services	417	24,000
Dental care services	32,917	52,917
Prescription assistance	12,500	12,500
Future periods	53,959	76,818
Pediatric obesity prevention	26,667	112,500
Community services	-	7,350
Emergency relief	51,074	38,793
	$ 495,732	$ 586,111

During the years ended October 31, 2018 and 2017, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes of various health care services, in the amounts of $1,352,029 and $1,141,453, respectively. During 2017, $25,000 was released for the purchase of property and equipment.

Note 10: Functional Expenses

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

	2018	2017
Health care services	$ 8,808,039	$ 8,399,514
General and administrative	2,373,421	2,281,502
Fundraising	245,470	236,326
	$ 11,426,930	$ 10,917,342

Note 11: Operating Leases

The Organization has an operating lease for a facility which expired in October 2018 and automatically renewed for a period of one year through October 2019. Rent is $26,160 per month, of which $13,080 is donated as an in-kind contribution. Future minimum lease payments under this agreement are $143,878 for 2019.

Note 12: Pension Plan

The Organization has a defined contribution pension plan covering substantially all employees. The Organization matches contributions made by each qualifying participant up to 3% of that participant's annual compensation. Total employer expenses under the plan during the years ended October 31, 2018 and 2017, were $86,497 and $73,148, respectively.

Note 13: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

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

Grant Revenues

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

Litigation

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

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Notes 1* and *6*.

Note 14: Construction in Progress

The Organization began renovation and expansion of the John S. Dunn Health Center during 2016. When complete, the facility will continue to provide behavioral health, dental, pediatric and family practice services. The Organization has incurred project costs of approximately $1,160,000 through October 31, 2018. Total project costs are estimated at $2.3 million with a projected completion date in mid-2019. The project is expected to be funded using federal grant funds received from the U.S. Department of Health and Human Services under the Health Infrastructure Investment Program (HIIP) grant, restricted contributions, cash on hand and a note payable.

Note 15: Future Change in Accounting Principle

Revenue Recognition

The Financial Accounting Standards Board amended its standards related to revenue recognition. This amendment replaces all existing revenue recognition guidance and provides a single, comprehensive revenue recognition model for all contracts with customers. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of the time value of money in the transaction price and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendment also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in those judgments and assets recognized from costs incurred to fulfill a contract. The standard allows either full or modified retrospective adoption effective for annual periods beginning after December 15, 2018. The Organization is in the process of evaluating the impact the amendment will have on the financial statements.