*Report of Independent Auditors and*
*Financial Statements with*
*Supplementary Information*

# Community Medical Centers, Inc.

*June 30, 2019 and 2018*

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# Report of Independent Auditors

To the Board of Directors
Community Medical Centers, Inc.

## Report on the Financial Statements

We have audited the accompanying financial statements of Community Medical Centers, Inc. (the Organization), which comprise the balance sheets as of June 30, 2019 and 2018, 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 and the standards applicable to financial audits contained in *Governmental Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 Community Medical Centers, Inc., as of June 30, 2019 and 2018, and the results of its operations and 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.

### *Emphasis of Matter*

As discussed in Note 1 to the financial statements, the Organization adopted Financial Accounting Standard Update (FASB) Accounting Standard Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses information about liquidity and availability of resources and methods used to allocated costs to programmatic and other support information. The ASU has been applied retrospectively to all periods presented with the exception of the omission of certain information as permitted by the ASU. Our opinion is not modified with respect to this matter.

Also, as discussed in Note 1 of the financial statement, the Organization adopted FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* The ASU has been applied using the modified retrospective method applied to all contracts. Our opinion is not modified with respect to this matter.

## Other Matter

*Supplementary Information*

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, as required by Title 2 U.S. *Code of Federal Regulations* Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated January 15, 2020, on our consideration of the Organization's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is solely 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 effectiveness of the Organization's 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 Community Medical Centers, Inc.'s internal control over financial reporting and compliance.

Moss Adams LLP

Sacramento, California
January 15, 2020

# Financial Statements

# Community Medical Centers, Inc.
## Balance Sheets
## June 30, 2019 and 2018

| | 2019 | 2018 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 1,389,347 | $ 343,352 |
| Short-term investments | 1,630,000 | 1,933,000 |
| Assets limited as to use, current | 156,941 | 145,858 |
| Patient accounts receivable, net | 6,691,495 | 2,884,779 |
| Grants and other receivables | 2,583,388 | 2,532,442 |
| Estimated amounts due from third-party payers, current | 301,658 | 3,784,550 |
| Prepaid expenses and others | 1,309,136 | 718,912 |
| Total current assets | 14,061,965 | 12,342,893 |
| ASSETS LIMITED AS TO USE | 6,141,153 | 5,005,694 |
| Less amount required to meet current obligations | (156,941) | (145,858) |
| Total assets limited as to use | 5,984,212 | 4,859,836 |
| ESTIMATED AMOUNTS DUE FROM THIRD-PARTY PAYERS, net of current portion | 2,725,838 | 7,971,901 |
| PROPERTY AND EQUIPMENT, at cost | | |
| Land and land improvements | 5,150,426 | 1,069,758 |
| Buildings and leasehold improvements | 17,524,180 | 11,442,334 |
| Equipment and software | 13,080,858 | 9,917,686 |
| Construction in progress | 492,603 | 2,626,170 |
| | 36,248,067 | 25,055,948 |
| Less accumulated depreciation | (11,705,771) | (8,761,567) |
| Total property and equipment, net | 24,542,296 | 16,294,381 |
| Intangibles | 1,000,000 | - |
| Less accumulated amortization | (27,777) | - |
| Total intangibles, net | 972,223 | - |
| Total assets | $ 48,286,534 | $ 41,469,011 |


See notes to financial statements.

# Community Medical Centers, Inc.
## Balance Sheets
## June 30, 2019 and 2018

| | 2019 | 2018 |
|---|---|---|
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES | | |
| Long-term debt, current | $ 5,396,803 | $ 3,234,844 |
| Accounts payable | 3,038,859 | 4,290,524 |
| Accrued expenses | 4,215,216 | 3,641,530 |
| Total current liabilities | 12,650,878 | 11,166,898 |
| DEFERRED COMPENSATION | 5,922,677 | 4,728,084 |
| ESTIMATED AMOUNTS DUE TO THIRD-PARTY PAYERS | 1,194,562 | 2,136,456 |
| LONG-TERM DEBT, net of current portion | 5,934,613 | 3,307,666 |
| Total liabilities | 25,702,730 | 21,339,104 |
| NET ASSETS WITHOUT DONOR RESTRICTIONS | 22,583,804 | 20,129,907 |
| Total liabilities and net assets | $ 48,286,534 | $ 41,469,011 |

# Community Medical Centers, Inc.
## Statements of Operations and Changes in Net Assets
## Years Ended June 30, 2019 and 2018

| | 2019 | 2018 |
|---|---|---|
| REVENUES AND OTHER SUPPORT | | |
| Net patient service revenue | $ 28,037,225 | $ 28,440,964 |
| Capitation revenue | 31,357,976 | 23,354,347 |
| Grant revenue | 12,464,631 | 10,689,557 |
| Contributions revenue | 1,455,299 | 897,252 |
| Other support | 2,971,148 | 3,525,514 |
| Total revenues and other support | 76,286,279 | 66,907,634 |
| EXPENSES | | |
| Salaries and wages | 42,860,775 | 36,140,199 |
| Employee benefits | 7,589,539 | 6,795,373 |
| Purchased services and professional fees | 5,429,109 | 4,484,808 |
| Pharmacy inventory, supplies, and other | 12,232,917 | 10,477,368 |
| Rent | 2,293,318 | 2,055,534 |
| Depreciation and amortization | 3,000,876 | 1,828,674 |
| Interest | 497,838 | 239,076 |
| Total expenses | 73,904,372 | 62,021,032 |
| OPERATING GAIN | 2,381,907 | 4,886,602 |
| OTHER INCOME | | |
| Investment return | 71,990 | 43,875 |
| Gain on asset disposal | - | 550 |
| Total other income | 71,990 | 44,425 |
| CHANGE IN NET ASSETS | 2,453,897 | 4,931,027 |
| NET ASSETS WITHOUT DONOR RESTRICTIONS, beginning of year | 20,129,907 | 15,198,880 |
| NET ASSETS WITHOUT DONOR RESTRICTIONS, end of year | $ 22,583,804 | $ 20,129,907 |


See notes to financial statements.

# Community Medical Centers, Inc.
## Statements of Cash Flows
## Years Ended June 30, 2019 and 2018

| | 2019 | 2018 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Change in net assets | $ 2,453,897 | $ 4,931,027 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities | | |
| Depreciation and amortization | 3,000,876 | 1,828,674 |
| Gain on disposal of property and equipment | - | (550) |
| Changes in | | |
| Patient accounts receivable, net | (3,806,716) | 529,992 |
| Grants and other receivables | (50,946) | 458,003 |
| Estimated amounts due to and from third-party payers | 7,787,061 | (3,705,470) |
| Prepaid expenses and others | (590,224) | (173,917) |
| Accounts payable and accrued expenses | (677,979) | 2,576,039 |
| Deferred compensation | 1,194,593 | 975,061 |
| Net cash provided by operating activities | 9,310,562 | 6,510,781 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Acquisition of assets limited as to use | (1,563,003) | (1,392,652) |
| Proceeds from disposition of assets limited as to use | 427,544 | 659,383 |
| Purchase of investments | (2,294,000) | (3,252,000) |
| Proceeds from disposition of investments | 2,597,000 | 2,504,000 |
| Purchase of property and equipment | (8,160,437) | (5,397,345) |
| Net cash used in investing activities | (8,992,896) | (6,878,614) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Principal payments on long-term debt | (2,274,452) | (1,351,366) |
| Proceeds from issuance of long-term debt | 1,992,430 | - |
| Proceeds on line of credit | 1,010,351 | 1,000,000 |
| Net cash provided by (used in) financing activities | 728,329 | (351,366) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 1,045,995 | (719,199) |
| CASH AND CASH EQUIVALENTS, beginning of year | 343,352 | 1,062,551 |
| CASH AND CASH EQUIVALENTS, end of year | $ 1,389,347 | $ 343,352 |
| SUPPLEMENTAL CASH FLOWS INFORMATION | | |
| Interest paid | $ 497,838 | $ 239,076 |
| Capital lease obligation incurred for property and equipment | $ 2,714,712 | $ 1,445,150 |

## NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Nature of operations** – Community Medical Centers, Inc. (the Organization), is a federally qualified health center (FQHC) which provides health care and education services to patients. The Organization primarily earns revenues by providing physician and related health care services and dental services through clinics located in San Joaquin County, Solano County, and Yolo County, California.

**Basis of presentation** – The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

*Without donor restrictions* – Net assets that are not subject to donor-imposed stipulations. This includes contributions without donor restrictions, income earned on net assets with or without donor restrictions, and amounts for which donor restrictions have expired. There were no board designated assets as of June 30, 2019 and 2018.

*With donor restrictions* – Net assets subject to donor-imposed stipulations. This includes resources from donors with a specific purpose based on a time restriction, and also represent cash and cash equivalents that are subject to gift instrument restrictions that require the principal to be invested in perpetuity. At June 30, 2019 and 2018, the Organization had no net assets with donor restrictions.

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

**Cash and cash equivalents** – The Organization considers all liquid investments with original maturities of three months or less to be cash equivalents. At times, cash and cash equivalents held by the Organization exceed Federal Deposit Insurance Corporation and Securities Investor Protection Corporation limits.

**Patient accounts receivable** – Patient accounts receivable are recorded at amounts that reflect the consideration to which the Organization expects to be entitled in exchange for providing patient care. In evaluating the collectability of accounts receivable, the Organization regularly analyzes its past history and identifies and reviews trends for each of its major payor sources of revenue to estimate appropriate and sufficient implicit and explicit price concessions reflected in accounts receivable.

For receivables associated with services provided to patients who have third-party coverage, the Organization analyzes contractually due amounts and provides additional implicit and explicit price concessions, if necessary, based upon historical collection history of deductibles and copayments on accounts for which the third-party payor had not been paid, or for remaining payor balances.

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 implicit price concession in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by sliding fee or other policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is reflected as a reduction in accounts receivable.

**Investments and investment return** – Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Investment return includes dividend, interest, and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

**Assets limited as to use** – Assets limited as to use include amounts held by trustee under bond indenture, funds held by trustees for unemployment claims, and deferred compensation plan assets. Amounts required to meet current liabilities of the Organization are included in current assets.

**Pharmacy inventory** – The Organization states supply inventories at the lower of cost, determined using the first-in, first-out method, or net realizable value.

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

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

| | |
|---|---|
| Buildings and leasehold improvements | 3 – 40 years |
| Equipment | 3 – 20 years |
| Software | 3 years |

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

Donations of property and equipment are reported at fair value as an increase in net assets without donor restrictions unless use of the assets is with donor restrictions. Monetary gifts that must be used to acquire property and equipment are reported as with donor restrictions. The expiration of such restrictions is reported as an increase in net assets without donor restrictions when the donated asset is placed in service.

**Intangibles** – On October 10, 2018, the Organization entered into an agreement to purchase a medical practice for $1,300,000, which resulted in intangibles of $1,000,000 (including goodwill of $150,000). The patient listing of $850,000 is recorded at fair value at the acquisition date and is amortized on a straight-line basis for 10 years based on management's expectation for continuing value of the intangible asset in the future. The fair value of assets acquired was less the fair value of liabilities assumed; therefore, the Organization recorded goodwill. Management has also elected to amortize the goodwill on a straight-line basis for 10 years. At June 30, 2019, the Organization had a patient listing of $850,000 and goodwill of $150,000, which are being amortized over 10 years with $27,777 in accumulated amortization.

**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 estimated 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 June 30, 2019 and 2018.

**Net patient service revenue** –Net patient service revenue is reported at the amount that reflects the consideration to which the Organization expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlements of audits, reviews, and investigations. The Organization bills the patients and third-party payors several days after the services are performed, and revenue is recognized as performance obligations are satisfied.

**Capitation revenue** – The Organization has agreements with various Medi-Cal Managed Care Organizations (MCOs) to provide medical services to subscribing participants. Under these agreements, the Organization receives monthly capitation payments based on the number of each MCO's participants, regardless of the services actually performed by the Organization. In addition, the MCOs make fee-for-service payments to the Organization for certain covered services based upon discounted fee schedules. The revenue for these services is recognized as performance obligations are satisfied.

**Sliding fee scales** – The Organization provides medical, dental, and optometry services to eligible patients at a discounted rate or for a nominal fee, based on eligibility determined by the patient's household size and income.

**Pharmacy revenue** – Pharmacy revenue is recognized as pharmaceuticals are dispensed. The Organization has a network of participating pharmacies that dispense the pharmaceuticals to its patients under contract arrangement with the Organization as well as one in-house pharmacy. The Organization participates in the 340B Drug Pricing Program (340B Program) which enables qualifying health care providers to purchase drugs from pharmaceutical suppliers at a substantial discount. The 340B Program is managed by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs. The Organization earns revenue under this program by purchasing pharmaceuticals at a reduced cost to fill prescriptions to qualified patients. The 340B Program revenue consists of the pharmacy reimbursements, net of the initial purchase price of the drugs, administrative and filling fees. Due to the unpredictability of pharmacy revenue amounts, the Organization recognizes pharmacy revenue on a cash basis.

Pharmacy revenue is as follows at June 30:

| | 2019 | 2018 |
|---|---|---|
| Gross receipts | $ 9,389,175 | $ 10,819,036 |
| Drug replenishment costs | (2,500,548) | (2,374,819) |
| Administrative and filling fees | (1,894,790) | (1,901,718) |
| | $ 4,993,837 | $ 6,542,499 |

The 340B Program gross receipts are included in net patient service revenue on the statement of operations. The drug replenishment costs and administrative and filling fees are included in pharmacy inventory, supplies and other on the statement of operations. The net 340B Program pharmacy revenue is used in furtherance of the Organization's mission.

**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 revenue** – 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 net assets without donor restrictions or net assets with donor restrictions. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, net assets with donor restriction are reclassified and reported as an increase in net assets without donor restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as net assets without donor restrictions contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

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

**Electronic health records incentive program** – The Electronic Health Records Incentive Program, enacted as part of the American Recovery and Reinvestment Act of 2009, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible organizations that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to six years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payments under both programs are contingent on the Organization continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the state, fiscal intermediary, or Medicare Administrative Contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

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

The Organization has recorded revenue of approximately $264,000 and $51,000 for the years ended June 30, 2019 and 2018, respectively, which is included in grant revenue in the statements of operations.

**Performance indicator** – The statements of operations include a performance indicator. Change in net assets is consistent with industry practice and includes contributions and grants of long-lived assets (including assets acquired using contributions or grants which by donor or granting agency restriction are to be used for the purpose of acquiring such assets). There were no such items in 2019 and 2018 and the changes in net assets is the performance indicator in those years.

**Debt issuance costs** – The amortized debt issuance costs for the years ended June 30, 2019 and 2018, are presented as a direct deduction from the carrying amount of the bonds payable.

**New accounting pronouncements –** In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01), which enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The update addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for the Organization beginning July 1, 2019. Management is currently evaluating the impact of the provisions of ASU 2016-01 on the financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02), which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position and disclosing key information about leasing arrangements in the financial statements of lessees. ASU 2016-02 is effective for the Organization beginning July 1, 2019. Management is currently evaluating the impact of the provisions of ASU 2016-02 on the financial statements.

**Recently adopted accounting pronouncements** – In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09), which provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services by identifying the contract(s) with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations in the contract, and recognizing revenue when (or as) the entity satisfied a performance obligation. In August 2015, the FASB issued ASU No. 2015-14, *Deferral of the Effective Date* (ASU 2015-14), which deferred the effective date of ASU 2014-09 for all entities by one year. In March 2016, the FASB issued ASU No. 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* (ASU 2016-08), which clarifies the implementation guidance on principal versus agent considerations in ASU 2014-09. In April 2016, the FASB issued ASU No. 2016-10, *Identifying Performance Obligations and Licensing* (ASU 2016-10), which clarifies the implementation guidance on identifying performance obligations and the licensing implementation guidance in ASU 2014-09, while retaining the related principles for those areas. In May 2016, the FASB issued ASU No. 2016-12, *Narrow-Scope Improvements and Practical Expedients* (ASU 2016-12), which provides narrow scope improvements and practical expedients to ASU 2014-09. The Organization adopted the provisions of ASU 2014-09, ASU 2015-14, ASU 2016-08, ASU 2016-10, and ASU 2016-12 using the modified retrospective method applied to all contracts existing as of July 1, 2018. Prior to the adoption of ASU 2014-09, a significant portion of the provision and allowance for uncollectible accounts was related to uninsured patients and expected uncollectible deductibles and copayments on accounts which the third-party payor had not yet paid. Under ASU 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that represent a direct reduction to net patient service revenue and a corresponding reduction to patient accounts receivable. The adoption of ASU 2014-09 also implemented additional disclosure requirements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958)*: *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14), which improves the current net asset classification requirements and the information presented in financial statements and notes about an entity's liquidity, financial performance, and cash flows. The update removes the requirement to present three classes of net assets with two classes, net assets with donor restrictions and net assets without donor restrictions. The Organization adopted ASU 2016-14 beginning July 1, 2018, and has adjusted the presentation of the financial statements accordingly, including changes to the presentation of net asset classification, inclusion of information about liquidity and availability of resources, and inclusion of information provided about expenses.

In June 2018, the FASB issued ASU No. 2018-08, *Not-For-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* (ASU 2018-08). ASU 2018-08 assists entities in (1) evaluation whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of *Topic 958, Not-for-Profit-Entities*, or as exchange (reciprocal) transactions subject to other guidance and (2) determining whether a contribution is conditional. The adoption of ASU 2018-08 is effective to the Organization beginning July 1, 2018. The adoption of ASU 2018-08 did not have a material impact on the Organization's financial statements.

**Reclassifications** – Certain amounts reported in the 2018 financial statements have been reclassified to conform to the 2019 presentation. These reclassifications did not affect previously reported net assets or changes thereto.

## NOTE 2 – PATIENT RECEIVABLES, NET

Credit risk related to patient accounts receivable arises from the granting of credit without collateral to patients, most of whom are residents of San Joaquin and Sacramento County in the State of California. The net patient receivables balance were comprised of the following as of June 30:

| | 2019 | 2018 |
|---|---|---|
| Medicare | $ 1,338,299 | $ 346,173 |
| Medicaid | 3,747,237 | 1,730,867 |
| Patients and other third-party payers | 1,271,384 | 663,499 |
| Self-pay | 334,575 | 144,239 |
| | $ 6,691,495 | $ 2,884,779 |

The mix of receivables from patients and third-party payers at June 30 was:

| | 2019 | 2018 |
|---|---|---|
| Medicare | 20% | 12% |
| Medicaid | 56% | 60% |
| Patients and other third-party payers | 19% | 23% |
| Self-pay | 5% | 5% |
| | 100% | 100% |

## NOTE 3 – GRANT REVENUE

The Organization is the recipient of a Consolidated Health Centers (CHC) grant from the U.S. Department of Health and Human Services. The general purpose of the grant is to provide expanded health care service delivery for residents of Stockton, California, and surrounding areas. 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 June 30, 2019 and 2018, the Organization recognized $8,081,087 and $7,733,182, respectively, in CHC grant revenue. Funding for the grant budget period ending December 31, 2019, is approved at $7,898,519.

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

## NOTE 4 – NET PATIENT SERVICE REVENUE

Performance obligations are determined based on the nature of the services provided by the Organization. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Organization believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Organization has elected to apply the optional exemption provided in FASB Accounting Standards Codification Topic 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

The Organization determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Organization's sliding fee policy, and implicit price concessions provided to uninsured patients. The Organization determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Organization determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Effective with the adoption of ASU 2014-09 on July 1, 2018, for changes in credit issues not assessed at the date of service, such as a payor files for bankruptcy or a patient defaults on a payment plan, the Organization recognizes these write-offs as bad debt expense, which is presented on the accompanying statements of activities and changes in net assets as a component of other expenses.

The Organization is approved as a FQHC for both Medicare and Medi-Cal reimbursement purposes. The Organization has agreements with third-party payors 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 based on a cost reimbursement methodology. The Organization is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Organization and audit thereof by the Medicare fiscal intermediary. Services not covered under the FQHC benefit are paid based on established fee schedules.

Effective July 1, 2015, covered FQHC services rendered to Medicare program beneficiaries will be paid on a prospective payment system (PPS). Medicare payment under the FQHC PPS will be 80% of the lesser of the Organization's actual charge or the applicable PPS rate (patient coinsurance will be 20% of the lesser of the Organization's actual charge or the applicable PPS rate). Accordingly, to the extent the Organization's charge is below the applicable PPS rate, Medicare FQHC reimbursement will be limited.

*Medi-Cal* – Covered FQHC services rendered to Medi-Cal program beneficiaries are paid based on a prospective reimbursement methodology. The Organization is reimbursed a prospectively determined encounter rate for covered services provided.

The Organization is required to submit an annual Medi-Cal Reconciliation Request Form to the California Department of Health Care Services (the Department) for purposes of determining whether it was paid appropriately for certain Medi-Cal visits. These annual reconciliations result in the determination of any underpayment or overpayment by the Medi-Cal program for the affected visits. The Organization has recorded estimated settlements for the Medi-Cal Reconciliation Request Forms for the years ended June 30, 2013 through 2019. Such amounts are recorded on the balance sheet as estimated amounts due from and to third-party payers. Following submission of the Medi-Cal Reconciliation Request Form, the Organization will generally receive a tentative settlement from the Medi-Cal program with a final settlement made within three years of the date of submission. Due to the timing of the interim and final settlement process, the Organization has allocated a portion of the estimated receivable as a noncurrent asset.

In November 2016, CMC, Inc. filed a Change in Scope of Service Request (CSOSR) with the California Department of Health Care Services (DHCS) to increase their consolidated clinics PPS rate for the period July 1, 2016, to June 30, 2019. The reason for the change in scope of service pertained to the addition of services (physical therapy, podiatrist, chiropractor, and optometry) which were not incorporated in the baseline consolidated PPS rate. The Organization recognized 80% of the anticipated rate increase as of June 30, 2018 (approximately $4.3 million in revenue). During the year ended June 30, 2019, a CSOSR rate increase was awarded by DHCS. As a result of the finalized rates, the Organization recognized a $1.9 million write down in revenue for the year ended June 30, 2019, due to fewer encounters occurring than originally estimated.

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

The 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 and discounts from established charges.

Net patient service revenue recognized for the years ended June 30 was:

| | 2019 | 2018 |
|---|---|---|
| Medicare | $ 5,538,896 | $ 3,401,127 |
| Medi-Cal | 15,731,116 | 17,461,257 |
| Other third-party payers | 5,264,573 | 6,697,965 |
| Self-pay | 1,502,640 | 1,334,654 |
| | $ 28,037,225 | $ 28,895,003 |

The mix of net patient revenue is as follows for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Medicare | 20% | 12% |
| Medi-Cal | 56% | 60% |
| Other third-party payers | 19% | 23% |
| Self-pay | 5% | 5% |
| | 100% | 100% |

**NOTE 5 – INVESTMENTS AND INVESTMENT RETURN**

Assets limited to use at June 30 include:

| | 2019 | 2018 |
|---|---|---|
| 457b deferred plan assets | | |
| Pooled investments | $ 5,616,932 | $ 4,127,015 |
| Guaranteed investment contract | - | 371,892 |
| Held by trustee | | |
| Money market funds | 461,363 | 453,456 |
| Self-insured unemployment reserve funds | | |
| Cash | 62,858 | 53,331 |
| | $ 6,141,153 | $ 5,005,694 |

Short-term investments at June 30 include:

| | 2019 | 2018 |
|---|---|---|
| Certificate of deposit | $ 1,630,000 | $ 1,933,000 |

Investment returns of $71,990 and $43,875 for the years ended June 30, 2019 and 2018, respectively, are comprised of interest and dividend income and is included in the statements of operations as other income.

## NOTE 6 – LONG-TERM DEBT

At June 30 the Organization's long-term debt consisted of:

| | 2019 | 2018 |
|---|---|---|
| Bond payable, bank - A | $ 980,000 | $ 1,195,000 |
| Note payable - B | 3,994,796 | - |
| Note payable | - | 1,044,746 |
| Capital lease obligations - C | 3,401,628 | 2,370,520 |
| Line of credit - D | 3,010,351 | 2,000,000 |
| Total debt | 11,386,775 | 6,610,266 |
| Less: Current maturities | (5,396,803) | (3,234,844) |
| Less: Deferred financing costs | (55,359) | (67,756) |
| Total long-term debt | $ 5,934,613 | $ 3,307,666 |

A The Revenue Bonds (Series 2005A) consist of Insured Revenue Bonds (the Bonds) in the original amount of $3,220,000 dated April 1, 2005, which bear interest at rates ranging from 3.00% to 5.00%. The Bonds are payable in annual installments from April 1, 2006, to April 1, 2025, and fluctuate between approximately $270,000 and $546,000. The Organization is required to make monthly deposits to the reserve fund of approximately $23,000. The Bonds are secured by the net revenues and accounts receivable of the Organization and the assets restricted under the bond indenture agreement. The fair market value of the Bonds as of June 30, 2019, was $757,393.

The proceeds of the Bonds were used to finance capital improvements and to redeem the 1994 Series B bonds. The Bond is subject to redemption at the option of the Organization, in whole or in part, at a price equal to 100% of the current outstanding principal amount of the bond.

The indenture agreement requires that certain funds be established with the trustee. Accordingly, these funds are included as assets limited as to use held by trustee in the financial statements. The indenture agreement also requires the Organization to comply with certain restrictive covenants including minimum insurance coverage, restrictions on incurrence of additional debt, submitting audited financial statements within 120 days after the end of each fiscal year, and maintaining a Net Income Available for Debt Service ratio of at least 1.20 times the Maximum Aggregate Annual Debt Service. For the years ended June 30, 2019 and 2018, the Organization met the Net Income Available for Debt Service ratio requirement but did not submit audited financial statements within 120 days after the years ended June 30, 2019 and 2018. Management has reported the noncompliance to the bank and the bank has decided to take no action against the Organization based solely on the default status of the covenant for the years ended June 30, 2019 and 2018.

B During the 2019 fiscal year, the Organization entered into multiple note payable agreements with Bank of Stockton in the amount of $1,684,400, which bear interest rates ranging from 5.60% to 5.75%. The notes mature in 2024, and the proceeds of the notes are used to finance capital improvements.

On October 10, 2018, the Organization entered into an agreement to purchase a medical practice for $1,300,000. The acquisition price is to be paid in installments with one-sixth paid on the closing date, one-sixth, paid six months from the closing, and the remaining one-thirds of the payable in October 2020 and 2021.

On August 10, 2016, the Organization entered into a loan agreement with New Resource Bank (now Amalgamated Bank) for a loan to finance the purchase of land and building located at 83 W. March Lane, Stockton, California. The total amount of the loan was $1,072,800. The loan had an interest rate of 5.50% with a maturity date of May 10, 2027. A prepayment premium of 3.00% of the outstanding principal balance will be assessed for prepayments made during the first loan year. The premium is reduced by 1.00% for prepayments made during each loan year thereafter through the third loan year.

The loan agreement requires the Organization to comply with certain restrictive covenants including minimum insurance coverage, restrictions on incurrence of additional debt, submitting audited financial statements within 150 days after the end of each fiscal year, maintaining a Net Income Available for Debt Service ratio of at least 1.25 times the Maximum Aggregate Annual Debt Service, and maintaining a Debt to Net Worth ratio not in excess of 2.25. For the years ended June 30, 2019 and 2018, the Organization met the Net Income Available for Debt Service ratio requirement. For the years ended June 30, 2019 and 2018 , the Organization did not submit audited financial statements within 150 days after the years ended June 30, 2019 and 2018. Management reported the noncompliance to the bank and the bank decided to take no action against the Organization based solely on the default status of the covenant for the year ended June 30,2019 and 2018.

C At varying rates of imputed interest ranging from 3.50% to 8.47% due through April 2024, collateralized by property and equipment.

Property and equipment include the following property under capital leases at June 30:

| | 2019 | 2018 |
|---|---|---|
| Equipment | $ 6,372,288 | $ 3,987,450 |
| Less accumulated depreciation | (2,758,415) | (1,485,251) |

D On March 28, 2016, the Organization obtained a line of credit from the Bank of Stockton whereby the Organization could obtain up to $2,000,000. Under this agreement, the line of credit accrues interest at a variable interest rate interest set as the Wall Street Journal Prime Rate (WSJPR). As of June 30, 2019 and 2018, the WSJPR was 5.50% and 5.00%, respectively. The line of credit is collateralized by a trust account held by the lender which had a balance of $2,008,951 and $1,961,428 as of June 30, 2019 and 2018, respectively. The Organization drew $0 and $2,000,000 against the line of credit as of June 30, 2019 and 2018, respectively.

The line of credit agreement requires the Organization to comply with certain restrictive covenants including providing tax returns within 15 days of filing and providing audited financial statements within 180 days after the end of fiscal year ended June 30, 2019, and within 120 days after the end of the fiscal year ended June 30, 2018. For the years ending June 30, 2018 and June 30, 2019, the Organization did not submit audited financial statements within 120 days and 180 days after the years ending June 30, 2018, and 2019. Management reported the noncompliance to the bank and the bank decided to take no action against the Organization based solely on the default status of the covenant for the years ending June 30, 2018, and 2019.

On January 24, 2019, the Organization obtained a line of credit from Bank of Stockton whereby the Organization could obtain up to $2,000,000. Under this agreement, the line of credit accrues interest at a variable interest rate interest set as the WSJPR. As of June 30, 2019, the WSJPR was 5.50% The line of credit is collateralized by the property located at 1031 Waterloo Road, Stockton, California. The Organization drew $1,010,351 against the line of credit as of June 30, 2019.

The line of credit agreement requires the Organization to comply with certain restrictive covenants including providing tax returns within 15 days of filing and providing audited financial statements within 180 days after the end of fiscal year ended June 30, 2019. For the year ended June 30, 2019, the Organization did not submit audited financial statements within 180 days after the year ended June 30, 2019, however the bank decided to take no action against the Organization based solely on the default status of the covenant for the year ended June 30, 2019.

Aggregate annual maturities of long-term debt and payments on capital leases at June 30, 2019, are as follows:

| | Long-Term Debt (Excluding Capital Lease Obligations) | Capital Lease Obligations |
|---|---|---|
| 2020 | $ 4,134,836 | $ 1,261,967 |
| 2021 | 909,547 | 1,475,673 |
| 2022 | 729,516 | 647,902 |
| 2023 | 217,119 | 167,979 |
| 2024 | 714,780 | 30,667 |
| Thereafter | 1,279,349 | - |
| | $ 7,985,147 | $ 3,584,188 |
| Less amount representing interest | | (182,560) |
| Present value of future minimum lease payments | | 3,401,628 |
| Less current maturities | | (1,261,967) |
| Noncurrent portion | | $ 2,139,661 |

**NOTE 7 – MEDICAL MALPRACTICE CLAIMS**

The U.S. Department of Health and Human Services has deemed the Organization and its practicing physicians 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. The Organization purchases excess umbrella liability coverage, which provides additional coverage above the FTCA coverage up to the amount specified in the umbrella policy.

Claim liabilities are to be determined without consideration of insurance recoveries. Expected recoveries are presented separately. Based upon the Organization's claims experience, no such accrual has been made for medical malpractice costs for the years ended June 30, 2019 and 2018. However, because of the risk of providing health care services, it is possible that an event has occurred which will be the basis of a future material claim.

## NOTE 8 – FUNCTIONAL EXPENSES

The Organization provides health care services to residents within its service area. Expenses related to providing these services, including depreciation expense, are as follows as of June 30:

| | 2019 | 2018 |
|---|---|---|
| Health care services | $ 56,183,388 | $ 46,724,847 |
| General and administrative | 17,720,984 | 15,296,185 |
| | $ 73,904,372 | $ 62,021,032 |

The expenses for providing program services and supporting services activities of the Organization that can be directly identified with a specific function are allocated directly to that function. Expenses that cannot be directly identified with a specific function are allocated among program services and supporting services activities benefited based upon employee time and effort recorded on functions related to the specific activity, or in the case of shared expenses, using an allocation based on personnel costs, space usage, or other relevant bases.

Expenses by function and nature consist of the following for the year ended June 30, 2019:

| | Health Care Services | General and Administrative | Total Expenses |
|---|---|---|---|
| Salaries and benefits | $ 40,670,476 | $ 9,779,838 | $ 50,450,314 |
| Purchased services | 547,022 | 2,359,937 | 2,906,959 |
| Rents and leases | 1,997,502 | 295,815 | 2,293,317 |
| Medical supplies and drugs | 4,935,221 | 781,238 | 5,716,459 |
| Professional fees | 2,522,150 | - | 2,522,150 |
| Office supplies | 211,130 | 74,543 | 285,673 |
| Depreciation | 1,615,441 | 1,385,435 | 3,000,876 |
| Insurance | 185,316 | 102,454 | 287,770 |
| Dues and subscriptions | 28,083 | 177,355 | 205,438 |
| Utilities and communication | 801,524 | 565,738 | 1,367,262 |
| Interest | 119,366 | 378,472 | 497,838 |
| Other expenses | 2,550,157 | 1,820,159 | 4,370,316 |
| Total expenditures | $ 56,183,388 | $ 17,720,984 | $ 73,904,372 |

## NOTE 9 – OPERATING LEASES

Noncancellable operating leases for primary care outpatient offices expire in various years through 2027. These leases generally contain renewal options for periods ranging from five to ten years and require the Organization to pay all executory costs (property taxes, maintenance and insurance).

Future minimum lease payments at June 30, 2019, were:

| | |
|---|---|
| 2020 | $ 2,071,643 |
| 2021 | 1,475,077 |
| 2022 | 1,324,279 |
| 2023 | 1,267,178 |
| 2024 | 1,257,645 |
| Thereafter | 3,656,678 |
| Future minimum lease payments | $ 11,052,500 |

## NOTE 10 – RETIREMENT PLAN

The Organization has a 403(b) defined contribution plan covering substantially all employees. For each eligible participant, the Organization contributes a matching contribution equal to 25% of employee contributions that do not exceed 6% of compensation; however, any employer contributions are discretionary in nature and are subject to reduction or termination. The Organization also has a 457(b) retirement plan that covers select highly compensated employees. Retirement plan expense for the years ended June 30, 2019 and 2018, was $20,191 and $5,330, respectively.

## NOTE 11 – DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs.

There is a hierarchy of three levels of inputs that may be used to measure fair value:

**Level 1** – Quoted prices in active markets for identical assets or liabilities

**Level 2** – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

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

**Recurring measurements** – The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2019 and 2018:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| June 30, 2019 | | | | |
| Money market funds | $ 461,363 | $ 461,363 | $ - | $ - |
| Pooled investments | 5,616,932 | - | 5,240,747 | - |
| Certificates of deposit | 1,630,000 | - | 1,630,000 | - |
| Fixed annuity contract | - | - | 376,185 | - |
| Total | $ 7,708,295 | $ 461,363 | $ 7,246,932 | $ - |
| June 30, 2018 | | | | |
| Money market funds | $ 453,456 | $ 453,456 | $ - | $ - |
| Pooled investments | 4,127,015 | - | 4,127,015 | - |
| Certificates of deposit | 1,933,000 | - | 1,933,000 | - |
| Fixed annuity contract | 371,892 | - | 371,892 | - |
| Total | $ 6,885,363 | $ 453,456 | $ 6,431,907 | $ - |

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended June 30, 2019.

**Cash equivalents and investments** – Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections, and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases, where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

## NOTE 12 – LIQUIDITY AND FUNDS AVAILABLE

As of June 30, 2019, the Organization has Financial assets available for general expenditure, within one year of June 30, 2019, comprise the following:

| | | |
|---|---|---|
| Cash and cash equivalents | $ | 1,389,347 |
| Patient accounts receivable, net | | 6,691,495 |
| Grants and other receivables | | 2,583,388 |
| Investments | | 1,630,000 |
| Financial assets available within one year | $ | 12,294,230 |

None of these financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the statement of financial position date. The Organization has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. The Organization also has available for general expenditures the $4,000,000 line of credit agreement with a bank (see Note 6). As of June 30, 2019, $3,010,351 of lines of credit remained outstanding.

## NOTE 13 – CONTINGENCIES

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

**Grant revenues** – Grant awarded to the Organization are subject to the funding agencies' criteria, contract terms, and regulations under which expenditures may be charged and are subject to audit under such terms, regulations, and criteria. Occasionally, such audits may determine that certain costs incurred in connection with the grants do not comply with the established criteria that govern them. In such cases, the Organization could be held responsible for repayments to the funding agency for the costs or be subject to a reduction of future funding in the amount of the costs.

Management does not anticipate any material questioned costs for the contracts and grants administered during the period. The Organization would be responsible for the absorption of any over-expenditure of its restricted grants which cannot be covered by additional grant funds or contribution from other sources.

**Litigation** – The Organization is aware of certain asserted and un asserted legal claims. While the outcome cannot be determined at this time, it is management's opinion that the liability, if any, from these actions will not have a material adverse effect on the Organization's financial position.

**340B Drug Pricing Program** – The Organization 340B Drug Pricing Program enabling the Organization to receive discounted prices from drug manufacturers on outpatient pharmaceutical purchases. The program is overseen by HRSA OPA. HRSA is currently conducting routine audits of these programs at health care organizations and increasing its compliance monitoring processes. Laws and regulations governing the 340B Drug Pricing Program are complex and subject to interpretation and change.

**Health Care Reform Legislation** – The Organization, including officers, governing board members, employees, and contractors who are physicians or other licensed or certified health care practitioners are covered under the Federal Tort Claims Act (FTCA), which is available to clinics funded under §330 of the Public Health Service Act. The Organization has been deemed to be a federal agency for the purposes of § 224 of the FTCA. FTCA coverage is comparable to an occurrence policy without a monetary cap.

The healthcare industry is subjected to numerous laws and regulations of federal, state, and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not limited to, accreditation, licensure, government health care program participation requirements, reimbursement for patient services, and Medicare and Medi-Cal fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statues and regulations by health care providers. Violations of these laws and regulations could result in exclusion from government health care program participation, together with the imposition of significant fines and penalties, as well as significant repayment for the past reimbursement for patient services received. While the Organization is subject to similar regulatory reviews, there are no reviews currently underway, and management believes that the outcome of any potential regulatory review will not have a material adverse effect on the Organization's financial position or changes in activities.

## NOTE 14 – SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the statement of financial position date, but before the financial statements are issued. The Organization recognizes in its financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. The Organization's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position, but arose after the statement of financial position as of June 30, 2019, and before financial statements are available to be issued. Subsequent events have been evaluated through January 15, 2020, the date the financial statements were issued.

Effective July 26, 2019, the Organization entered into an agreement to take over the operation of two clinic locations in Lodi, California from Adventist Health Lodi Memorial. The properties will be leased to the Organization and the personal property and other clinical assets will be donated to the Organization.

In September 2019, the Organization executed an agreement to purchase a modular building for $2,617,980 for one of its locations through a capital lease agreement.

# Supplementary Information

# Community Medical Centers, Inc.
## Schedule of Expenditures of Federal Awards
## Year Ended June 30, 2019

| Federal Grantor/Cluster-Program Title | Award Period | CFDA Number | Award Number | Federal Expenditures |
|---|---|---|---|---|
| *U.S. Department of Health and Human Services* | | | | |
| Direct Programs | | | | |
| Consolidated Health Centers | 7/1/2018 - 12/31/2018 | 93.224 | H80CS00138 | $ 575,810 |
| Consolidated Health Centers | 1/1/2019 - 12/31/2019 | 93.224 | H80CS00138 | 1,251,619 |
| | | | | 1,827,429 |
| Affordable Care Act (ACA) Grants for New and Expanded Services under the Health Center Program | 8/1/2017 - 7/31/2018 | 93.527 | H80CS00138 | 130,047 |
| Affordable Care Act (ACA) Grants for New and Expanded Services under the Health Center Program | 7/1/2018 - 12/31/2018 | 93.527 | H80CS00138 | 3,345,050 |
| Affordable Care Act (ACA) Grants for New and Expanded Services under the Health Center Program | 7/1/2018 - 06/30/2019 | 93.527 | H80CS00138 | 80,920 |
| Affordable Care Act (ACA) Grants for New and Expanded Services under the Health Center Program | 1/1/2019 - 12/31/2019 | 93.527 | H80CS00138 | 2,697,641 |
| | | | | 6,253,658 |
| Total Health Centers Program Cluster | | | | 8,081,087 |
| Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease | 7/1/2018 - 12/31/2018 | 93.918 | H76HA00191 | 160,184 |
| Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease | 7/1/2018 - 12/31/2018 | 93.918 | H76HA00191 | 101,772 |
| | | | | 261,956 |
| Passed through Solano County HIV Care Formula Grants | 7/1/2017 - 03/31/2019 | 93.917 | 00189-15 | 37,994 |
| | | | | 37,994 |
| *Total U.S. Department of Health and Human Services* | | | | 8,381,037 |
| *U.S. Department of Agriculture* | | | | |
| Direct Programs | | | | |
| Special Supplemental Nutrition Program for Women, Infants, and Children | 10/1/2017 - 09/30/2018 | 10.557 | 14-10233 | 411,496 |
| Special Supplemental Nutrition Program for Women, Infants, and Children | 10/1/2018 - 09/30/2019 | 10.557 | 14-10233 | 1,129,912 |
| | | | | 1,541,408 |
| *Total U.S. Department of Agriculture* | | | | 1,541,408 |
| *Total Expenditures of Federal Awards* | | | | $ 9,922,445 |

## NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of Community Medical Centers, Inc. (the Organization), under programs of the federal government for the year ended June 30, 2019. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Organization, it is not intended to, and does not present the balance sheets, statements of operations and changes in net assets, or cash flows of the Organization. Negative amounts shown on the Schedule represents adjustments or credits made in the normal course of business to amounts reports as expenditures in prior years.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

## NOTE 3 – INDIRECT COST RATE

The Organization has elected not to use the 10% de minimis indirect cost rate as allowed under Uniform Guidance.

## NOTE 4 – SUBRECIPIENTS

The Organization did not provide a federal award to a subrecipient during the year ended June 30, 2019.

MOSSADAMS

# 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*

To the Board of Directors
Community Medical Centers, Inc.

We have audited, in accordance with the 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, the financial statements of Community Medical Centers, Inc. (the Organization), which comprise the balance sheet as of June 30, 2019, and the related statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 15, 2020.

## Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from 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.*

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Sacramento, California
January 15, 2020

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# Independent Auditor's Report on Compliance for The Major Federal Program and on Internal Control over Compliance as Required by the Uniform Guidance

To the Board of Directors
Community Medical Centers, Inc.

## Report on Compliance for the Major Federal Program

We have audited Community Medical Center, Inc.'s (the Organization) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Organization's major federal program for the year ended June 30, 2019. The Organization's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

### *Management's Responsibility*

Management is responsible for compliance with the federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on compliance for each of the Organization's major federal program based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Organization's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Organization's compliance.

***Opinion on the Major Federal Program***

In our opinion, the Organization complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2019.

## Report on Internal Control over Compliance

Management of the Organization is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Organization's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a 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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Moss Adams LLP

Sacramento, California
January 15, 2020

## Section I - Summary of Auditor's Results

*Financial Statements*

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

*Federal Awards*

Internal control over major federal programs:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? ☐ Yes ☒ No

**Identification of Each Major Federal Program and Type of Auditor's Report Issued on Compliance for Each Major Federal Program:**

| *CFDA Number* | *Name of Federal Program or Cluster* | *Type of Auditor's Report Issued on Compliance for Each Major Federal Program* |
|---|---|---|
| *93.224 and 93.527* | *Health Center Program Cluster* | *Unmodified* |

Dollar threshold used to distinguish between type A and type B programs: $750,000

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

## Section II - Financial Statement Findings

None noted.

## Section III - Federal Award Findings and Questioned Costs

None noted.


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