

West Side Community Health Services, Inc.

Independent Auditor's Report and Consolidated Financial Statements

September 30, 2015 and 2014

West Side Community Health Services, Inc.
September 30, 2015 and 2014

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Independent Auditor's Report

Board of Directors
West Side Community Health Services, Inc.
St. Paul, Minnesota

We have audited the accompanying consolidated financial statements of West Side Community Health Services, Inc. (the "Organization"), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of West Side Community Health Services, Inc. as of September 30, 2015 and 2014, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating schedules, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

Springfield, Missouri
January 28, 2016

West Side Community Health Services, Inc.
Consolidated Balance Sheets
September 30, 2015 and 2014

Assets

	2015	2014
Current Assets		
Cash and cash equivalents	\$ 10,676,527	\$ 9,728,211
Patient accounts receivable, net of allowance; 2015 - \$1,704,399, 2014 - \$1,230,897	2,601,853	1,344,764
Grants and other receivables	923,137	958,075
Contributions receivable	23,194	82,671
Estimated amounts due from third-party payers	-	381,206
Pharmacy inventory	151,512	124,879
Prepaid expenses and other	371,397	355,790
Total current assets	14,747,620	12,975,596
Long-Term Investments	485,000	485,000
Notes Receivable	4,037,691	4,037,691
Property and Equipment, At Cost		
Land and land improvements	632,640	632,640
Buildings and leasehold improvements	16,088,073	16,051,301
Furniture, fixtures and equipment	4,076,235	3,962,192
	20,796,948	20,646,133
Less accumulated depreciation	5,481,712	4,461,211
	15,315,236	16,184,922
Deferred Financing Costs	442,917	459,360
Total assets	\$ 35,028,464	\$ 34,142,569

Liabilities and Net Assets

	<u>2015</u>	<u>2014</u>
Current Liabilities		
Current maturities of long-term debt	\$ 383,391	\$ 368,616
Accounts payable	819,650	693,652
Accrued expenses	1,442,604	1,377,655
Estimated amounts due to third-party payers	526,871	-
Deferred grant revenue	96,530	487,859
	<u>3,269,046</u>	<u>2,927,782</u>
Long-Term Debt	<u>13,752,430</u>	<u>14,136,529</u>
Total liabilities	<u>17,021,476</u>	<u>17,064,311</u>
Net Assets		
Unrestricted	17,684,455	16,858,398
Temporarily restricted	322,533	219,860
	<u>18,006,988</u>	<u>17,078,258</u>
Total liabilities and net assets	<u>\$ 35,028,464</u>	<u>\$ 34,142,569</u>

West Side Community Health Services, Inc.
Consolidated Statements of Operations
Years Ended September 30, 2015 and 2014

	2015	2014
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	\$ 19,826,178	\$ 17,983,366
Provision for uncollectible accounts	(2,330,834)	(1,148,428)
Net patient service revenue less provision for uncollectible accounts	17,495,344	16,834,938
Grant revenue	9,114,308	8,031,059
Contribution revenue	332,572	400,234
Other revenue	454,522	509,895
Net assets released from restrictions used for operations	335,264	380,781
Total unrestricted revenues, gains and other support	27,732,010	26,156,907
Expenses and Losses		
Salaries and wages	13,671,696	12,646,241
Employee benefits	3,331,699	3,116,628
Purchased services and professional fees	1,775,084	1,623,445
Supplies and other	6,540,777	6,165,974
Rent	255,097	306,948
Depreciation and amortization	1,036,944	1,008,293
Interest	377,250	388,574
Total expenses and losses	26,988,547	25,256,103
Operating Income	743,463	900,804
Other Income		
Investment return	69,011	59,801
Excess of Revenues Over Expenses	812,474	960,605
Net assets released from restriction used for purchase of property and equipment	13,583	73,792
Increase in Unrestricted Net Assets	\$ 826,057	\$ 1,034,397

West Side Community Health Services, Inc.
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2015 and 2014

	2015	2014
Unrestricted Net Assets		
Excess of revenues over expenses	\$ 812,474	\$ 960,605
Net assets released from restriction used for purchase of property and equipment	13,583	73,792
Increase in unrestricted net assets	826,057	1,034,397
Temporarily Restricted Net Assets		
Contributions	451,520	273,977
Net assets released from restriction	(348,847)	(454,573)
Increase (decrease) in temporarily restricted net assets	102,673	(180,596)
Change in Net Assets	928,730	853,801
Net Assets, Beginning of Year	17,078,258	16,224,457
Net Assets, End of Year	\$ 18,006,988	\$ 17,078,258

West Side Community Health Services, Inc.
Consolidated Statements of Cash Flows
Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating Activities		
Change in net assets	\$ 928,730	\$ 853,801
Items not requiring operating cash flow		
Depreciation and amortization	1,036,944	1,008,293
Changes in		
Patient accounts receivable, net	(1,257,089)	(354,605)
Grants receivable	34,938	(491,234)
Contributions receivable	59,477	19,440
Estimated amounts due from and due to third-party payers	908,077	(203,472)
Prepaid assets	(15,607)	(243,579)
Inventory	(26,633)	(46,977)
Accounts payable and accrued expenses	190,947	121,274
Deferred grant revenue	(391,329)	367,443
	<u>1,468,455</u>	<u>1,030,384</u>
Net cash provided by operating activities		
Investing Activities		
Proceeds from disposition of assets limited as to use	-	395,000
Purchase of investments	-	(485,000)
Purchase of property and equipment	(150,815)	(328,445)
	<u>(150,815)</u>	<u>(418,445)</u>
Net cash used in investing activities		
Financing Activities		
Principal payments on long-term debt	(369,324)	(328,595)
	<u>(369,324)</u>	<u>(328,595)</u>
Net cash used in financing activities		
Increase in Cash and Cash Equivalents	948,316	283,344
Cash and Cash Equivalents, Beginning of Year	<u>9,728,211</u>	<u>9,444,867</u>
Cash and Cash Equivalents, End of Year	<u>\$ 10,676,527</u>	<u>\$ 9,728,211</u>
Supplemental Cash Flows Information		
Interest paid (net of amount capitalized)	\$ 377,250	\$ 388,574
Capital lease obligation incurred for property and equipment	\$ -	\$ 598,700

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

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

Nature of Operations

West Side Community Health Services, Inc. (WSCHS) is a federally qualified health center which provides health care and education services to patients. WSCHS primarily earns revenues by providing physician and related health care services through clinics located in St. Paul, Minnesota.

During September 2012, the Organization formed East Side Health Center, Inc. (ESHC), a 501(c)3 nonprofit organization which will operate exclusively for the benefit of WSCHS. The entity was formed in conjunction with the New Market Tax Credit transaction (see *Note 12*).

Principles of Consolidation

The consolidated financial statements include the accounts and transactions of WSCHS and ESHC (collectively, the "Organization"). All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated 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 consolidated 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 September 30, 2015 and 2014, cash equivalents consisted primarily of repurchase agreements.

At September 30, 2015, the Organization's cash accounts exceeded federally insured limits by approximately \$4,180,000.

The Organization utilizes repurchase agreements as part of their cash management policy, which are not FDIC insured. However, the Organization has a secured interest in securities backing these deposits. At September 30, 2015 and 2014, the Organization held approximately \$6,000,000 and \$5,500,000, respectively, in repurchase agreements.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Investments and Investment Return

Long-term investments are valued at cost. Investment return includes interest income. Investment return is reflected in the consolidated statements of operations as a component of unrestricted net assets.

Patient Accounts Receivable

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

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

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

The Organization's allowance for doubtful accounts for self-pay patients was 95% and 89% of self-pay accounts receivable at September 30, 2015 and 2014, respectively. The Organization's write-offs increased approximately \$768,000 from approximately \$1,089,000 for the year ended September 30, 2014, to approximately \$1,857,000 for the year ended September 30, 2015.

Pharmacy Inventory

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

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

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. Assets under capital lease obligations and 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 leasehold improvements	3-40 years
Furniture, fixtures and equipment	3-20 years

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 objective.

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.

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 September 30, 2015 and 2014.

Deferred Financing Costs

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

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

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 in-house pharmacies. The Organization participates in the 340B “Drug Discount Program” which enables qualifying health care providers to purchase drugs from pharmaceutical suppliers at a substantial discount. The 340B Drug Pricing 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. Reported 340B revenue consists of the pharmacy reimbursements, net of the initial purchase price of the drugs.

	2015	2014
Internal pharmacy net receipts	\$ 3,656,872	\$ 3,367,382
Internal pharmacy cost of goods sold	(2,575,944)	(2,079,667)
Internal pharmacy other operating expenses	(1,147,398)	(1,097,961)
Internal pharmacy net revenue	(66,470)	189,754
Contract pharmacy gross receipts	591,389	554,197
Contract pharmacy drug replenishment costs	(142,278)	(147,385)
Contract pharmacy administrative and filling fees	(143,462)	(137,350)
Contract pharmacy net revenue	305,649	269,462
Net revenue	\$ 239,179	\$ 459,216

The 340B gross receipts are included in net patient service revenue on the consolidated statements of operations. The drug replenishment costs, administrative and filling fees and other operating expenses are included in supplies and other expenses on the consolidated statements of operations. The net 340B revenue from this program is used in furtherance of the Organization’s mission.

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.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

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.

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.

Deferred Grant Revenue

Revenue from grants to provide health care services is deferred and recognized over the periods to which the eligibility requirements are met.

Contributions

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

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

In-Kind Contributions

In addition to receiving cash contributions, the Organization receives in-kind contributions of pharmacy inventory, rent and other services. It is the policy of the Organization to record the estimated fair value of certain in-kind donations as inventory or expense in its consolidated financial statements and similarly increase temporarily restricted net assets or contribution revenue by a like amount. In-kind contributions of \$271,398 and \$345,222, respectively, were received for the years ended September 30, 2015 and 2014, and is included in the consolidated statements of operations as contribution revenue.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Income Taxes

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

Excess of Revenues Over Expenses

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

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible federally qualified health centers that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the federally qualified health center 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 fiscal intermediary. 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 recognized revenue of approximately \$327,250 and \$454,750 for the years ended September 30, 2015 and 2014, respectively, which is included in other revenue within operating revenues in the consolidated statements of operations.

Subsequent Events

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

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Note 2: Grant Revenue

The Organization is the recipient of a Consolidated Health Centers (CHC) grant from the U.S. Department of Health and Human Services (the “granting agency”). The general purpose of the grant is to provide expanded health care service delivery in St. Paul, Minnesota, 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. The Organization recognized \$5,778,842 and \$5,073,851 in revenues from this grant for the years ended September 30, 2015 and 2014, respectively. Funding for the budget year ending January 31, 2016, is approved in the amount of \$6,024,584.

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

Note 3: Net Patient Service Revenue

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

The Organization is approved as a Federally Qualified Health Center (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 – For the fiscal year ended September 30, 2015, covered FQHC services rendered to Medicare program beneficiaries were paid on a prospective payment system (PPS). Medicare payment under the FQHC PPS is 80% of the lesser of the Organization’s actual charge or the applicable PPS rate (patient coinsurance is 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 is limited.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

For the fiscal year ended September 30, 2014, covered FQHC services rendered to Medicare program beneficiaries were 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 administrative contractor. 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 on a prospective reimbursement methodology. The Organization is reimbursed a set encounter rate for all services under the plan. Services not covered under the FQHC benefit are paid based on established fee schedules.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, 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 discharge, discounts from established charges and prospectively determined daily rates.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended September 30, 2015 and 2014, was:

	2015			
	Gross Charges	Contractual Adjustments	Sliding Fee Adjustments	Net Revenue
Medicaid	\$ 27,059,833	\$ 16,960,377	\$ -	\$ 10,099,456
Medicare	2,886,832	1,954,848	-	931,984
Other third-party payers	8,869,537	4,384,032	-	4,485,505
Self-pay	19,769,864	-	15,460,631	4,309,233
Total	<u>\$ 58,586,066</u>	<u>\$ 23,299,257</u>	<u>\$ 15,460,631</u>	<u>\$ 19,826,178</u>
	2014			
	Gross Charges	Contractual Adjustments	Sliding Fee Adjustments	Net Revenue
Medicaid	\$ 15,310,154	\$ 4,998,627	\$ -	\$ 10,311,527
Medicare	1,427,316	577,707	-	849,609
Other third-party payers	5,640,228	1,670,968	-	3,969,260
Self-pay	11,986,081	-	9,133,111	2,852,970
Total	<u>\$ 34,363,779</u>	<u>\$ 7,247,302</u>	<u>\$ 9,133,111</u>	<u>\$ 17,983,366</u>

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

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 receivables from patients and third-party payers at September 30, 2015 and 2014, was:

	2015	2014
Medicare	3%	5%
Medicaid	81%	61%
Other third-party payers	13%	30%
Patient responsibilities	3%	4%
	<u>100%</u>	<u>100%</u>

Note 5: Investments and Investment Return

Long-term investments, at September 30, include:

	2015	2014
Participation shares	<u>\$ 485,000</u>	<u>\$ 485,000</u>

Total investment return is comprised of the following:

	2015	2014
Interest and dividend income	<u>\$ 69,011</u>	<u>\$ 59,801</u>

Total investment return is reflected in the consolidated statements of operations as a component of unrestricted net assets.

At September 30, 2015 and 2014, the Organization's investments included participation shares in a certain loan by Central Bank to East Side Clinic Investment Fund, LLC. The Organization is required to purchase additional participation shares in this debt each calendar year under a Participation Agreement entered into between the Organization and Central Bank as part of the New Market Tax Credit transaction (see *Note 12*). The Organization earns interest monthly at a rate of 4.0% on the participation shares. Interest income earned in 2015 and 2014 is included in investment return on the consolidated statement of operations.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Note 6: Note Receivable

In conjunction with the New Market Tax Credit transaction (see *Note 12*), WSCHS issued an unsecured note receivable to East Side Clinic Investment Fund, LLC. The balance of the note receivable at September 30, 2015 and 2014, was \$4,037,691. The note matures on September 7, 2042, and interest accrues monthly at a rate of 1.0%. Interest-only payments are due monthly for seven years. Beginning on September 7, 2019, principal and interest payments of \$16,382 are payable monthly. Interest income earned is included in investment return on the consolidated statement of operations.

Note 7: Medical Malpractice

The U.S. Department of Health and Human Services has deemed the Organization and its participating providers covered under the Federal Torts Claims Act (FTCA) for damage for 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 upon the Organization's claim experience, no accrual has been made for the Organization's medical malpractice cost for the years ended September 30, 2015 and 2014. However, because of the risk in providing health care services, it is possible that an event has occurred which will be the basis of a future medical claim.

Note 8: Long-Term Debt

	2015	2014
Note payable (A)	\$ 2,985,448	\$ 3,228,428
Note payable (B)	217,751	229,200
Note payable (C)	5,790,000	5,790,000
Note payable (D)	4,750,000	4,750,000
Capital lease obligations (E)	392,622	507,517
	<u>14,135,821</u>	<u>14,505,145</u>
Less current maturities	<u>383,391</u>	<u>368,616</u>
	<u>\$ 13,752,430</u>	<u>\$ 14,136,529</u>

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

- (A) Medical Facilities Revenue Note, Series 2004 (West Side Community Health Services, Inc. Project) issued by the Ramsey County Housing and Redevelopment Authority. This note is held by Bank Cherokee. The note payable to Bank Cherokee in the original amount of \$5,000,000, due June 1, 2025, payable in monthly installments of \$30,642, including variable interest. The current interest rate on the note is 4.00% and will continue as such until an adjustment date of July 1, 2019. On this date, the interest rate shall adjust to 85% of the New York Prime Rate as published in the Wall Street Journal as of the most recent date prior to the adjustment date, but no lower than 4.00%. This note is secured by real estate.

In connection with the note, the Organization is required to comply with certain restrictive covenants including maintaining a debt-service coverage ratio in excess of 1 to 1 and determining the amount of excess arbitrage required to be paid to the United States every five years. As of September 30, 2015, West Side Community Health Services was in compliance with all financial covenants.

- (B) Note payable to the City of St. Paul, Minnesota, in the original amount of \$300,000, due May 1, 2028, payable in monthly installments of \$1,622, including interest at 4.00%, with a final principal-only balloon payment of \$24,331 due May 1, 2028. This note is secured by real estate.
- (C) Construction loan payable to New Markets Investment 69, LLC consisting of three tranches, each with an interest rate of 2.1555%, was issued in conjunction with the New Market Tax Credit transaction (see *Note 12*). The construction loan payable is secured by all assets of the Organization.

“Tranche A” in the original amount of \$2,086,582 is due on September 7, 2019. Interest-only payments began September 7, 2012, and are due monthly for seven years. Principal balance is due at maturity.

“Tranche B” in the original amount of \$2,181,818 is due on September 7, 2042. Interest-only payments began September 7, 2012, and are due monthly for seven years. Monthly principal and interest payments begin September 7, 2019, in the amount of \$10,033.

“Tranche C” in the original amount of \$1,521,600 is due on September 7, 2042. Interest-only payments began September 7, 2012, and are due monthly for seven years. Monthly principal and interest payments begin September 7, 2019, in the amount of \$6,997.

In connection with the note, the Organization is required to comply with certain restrictive covenants including maintaining a debt-service coverage ratio in excess of 1.25 to 1. The covenants also require submission of annual audited financial statements within 120 days of fiscal year end. As of September 30, 2015, East Side Community Health Services was in compliance with all financial covenants.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

- (D) Construction loan payable to Capital City New Markets Fund III, LLC, consisting of three notes, each with an interest rate of 2.1808%, was issued in conjunction with the New Market Tax Credit transaction (see *Note 12*). The construction loan payable is secured by all assets of the Organization.

“Capital City Loan A” in the original amount of \$1,738,818 is due on September 7, 2019. Interest-only payments began September 7, 2012, and are due monthly for seven years. Principal balance is due at maturity.

“Capital City Loan B” in the original amount of \$1,818,182 is due on September 7, 2042. Interest-only payments began September 7, 2012, and are due monthly for seven years. Monthly principal and interest payments begin September 7, 2019, in the amount of \$8,383.

“Capital City Loan C” in the original amount of \$1,193,000 is due on September 7, 2042. Interest-only payments began September 7, 2012, and are due monthly for seven years. Monthly principal and interest payments begin September 7, 2019, in the amount of \$5,501.

In connection with the note, the Organization is required to comply with certain restrictive covenants including maintaining a debt-service coverage ratio in excess of 1.25 to 1. The covenants also require submission of annual audited financial statements within 120 days of fiscal year end. As of September 30, 2015, East Side Community Health Services was in compliance with all financial covenants.

- (E) At varying rates of imputed interest from 3.775% to 6.403%, due through April 2019; collateralized by the following equipment under capital leases:

	2015	2014
Equipment	\$ 598,700	\$ 598,700
Less accumulated depreciation	229,122	109,382
	\$ 369,578	\$ 489,318

West Side Community Health Services, Inc.
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Aggregate annual maturities of long-term debt at September 30, 2015, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2016	\$ 264,847	\$ 131,786
2017	275,637	131,786
2018	286,867	131,786
2019	298,554	24,055
2020	4,136,117	-
Thereafter	8,481,177	-
	<u>\$ 13,743,199</u>	<u>419,413</u>
Less amount representing interest		26,791
Present value of future minimum lease payments		392,622
Less current maturities		118,544
Noncurrent portion		<u>\$ 274,078</u>

Note 9: Temporarily Restricted Net Assets

Temporarily restricted net assets at September 30, 2015 and 2014, are available for the following purpose or periods:

	2015	2014
Health care services	\$ 322,533	\$ 190,110
Oral health services	-	29,750
	<u>\$ 322,533</u>	<u>\$ 219,860</u>

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

During 2015, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes of health care and administrative and other services in the amount of \$335,264 and \$13,583 were released to purchase equipment. During 2014, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes of health care and administrative services in the amount of \$380,781 and \$73,792 were released to purchase 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:

	2015	2014
Health care services	\$ 22,406,862	\$ 20,502,812
General and administrative	4,581,685	4,753,291
	\$ 26,988,547	\$ 25,256,103

Note 11: Retirement Plan

The Organization has a 403(b) defined contribution plan covering its employees who have at least one year of service and are age 21 or older. For each eligible participant, the Organization may contribute a matching contribution equal to 50% of eligible employee contributions that do not exceed 5% of compensation; however, any employer contributions are discretionary in nature and are subject to reduction or termination. During fiscal years 2015 and 2014, the Organization matched the maximum 50% of eligible employee contributions. Retirement plan expense for the years ended September 30, 2015 and 2014, was \$172,558 and \$157,358, respectively.

Note 12: New Market Tax Credit

On September 7, 2012, WSCHS and ESHC entered into a transaction which generated “New Market Tax Credits” (NMTCs) under Section 45D of Internal Revenue Code of 1986, as amended (Section 45D). The transaction was initiated by U.S. Bank who contributed \$3,174,400 to an investment fund established for the transaction. The investment fund also secured a loan from WSCHS of \$4,037,691 (see *Note 6*) and a loan from a commercial bank in the amount of \$3,825,000.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

The investment fund used the contribution and the loan proceeds to pay certain transaction fees and the remaining funds were contributed to two third parties (Sub-CDEs) as the Qualified Equity Investment (QEI) under Section 45D. The Sub-CDEs then funded loans totaling \$10,540,000 to ESHC, the Qualified Low-Income Business (QALICB) under Section 45D. The transaction was structured as 30-year debt financing with a 7-year NMTC compliance period, at the end of which time WSCHS will have the option to acquire all membership rights of the investment fund and forgive the related debt.

ESHC used the \$10,540,000 loan proceeds to structure financing related to the construction of the new facility on the east side of St. Paul, Minnesota. The debt is guaranteed and secured by the building. The site of the new building qualifies as low-income property under Section 45D. As such, the financing arrangements between ESHC and the lenders qualify as a “qualified low-income community investment” (QLICI) and generate NMTCs.

ESHC contributed \$369,804 directly to WSCHS to purchase the participation shares described in *Note 5* during 2014. ESHC did not contribute any amount to WSCHS during 2015. The intercompany contribution expense and revenue were eliminated in the consolidated financial statements. Upon completion of the East Side facility, WSCHS and ESHC entered into a rental agreement in which WSCHS rents the new health center facility from ESHC for \$400,000 per year through December 31, 2042. The rental expense and rental income of approximately \$400,000 in 2015 and 2014, was eliminated in the consolidated financial statements.

Note 13: Significant Estimates and Concentrations

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 Revenue

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

Allowance for Net Patient Service Revenue Adjustments

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

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Note 7*.

West Side Community Health Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2015 and 2014

Current Economic Conditions

The current economic environment presents community health centers with difficult circumstances and challenges. As employers make adjustments to health insurance plans or more patients become unemployed, certain patients may find it difficult to pay for services rendered. The continuing implementation of the *Affordable Care Act*, including the health insurance exchanges, will directly impact community health centers' net revenues. Further, the effect of economic conditions on federal and state budgets could adversely impact the grant revenues available to community health centers and the programs they administer. Each of these factors could have an adverse impact on the Organization's future operating results.

Supplementary Information

West Side Community Health Services, Inc.
Consolidating Schedule – Balance Sheet Information
September 30, 2015

Assets

	West Side Community Health Services, Inc.	East Side Health Center, Inc.	Consolidating Adjustments and Eliminations	Total
Current Assets				
Cash and cash equivalents	\$ 10,452,148	\$ 224,379	\$ -	\$ 10,676,527
Patient accounts receivable, net of allowance; \$1,704,399	2,601,853	-	-	2,601,853
Grants and other receivables	923,137	-	-	923,137
Contributions receivable	23,194	-	-	23,194
Due from WSCHS	-	4,000,000	(4,000,000)	-
Pharmacy inventory	151,512	-	-	151,512
Prepaid expenses and other	371,397	-	-	371,397
	<u>14,523,241</u>	<u>4,224,379</u>	<u>(4,000,000)</u>	<u>14,747,620</u>
Total current assets				
Long-Term Investments	<u>485,000</u>	<u>-</u>	<u>-</u>	<u>485,000</u>
Notes Receivable	<u>4,037,691</u>	<u>-</u>	<u>-</u>	<u>4,037,691</u>
Property and Equipment, At Cost				
Land and land improvements	632,640	-	-	632,640
Buildings and leasehold improvements	6,886,793	9,201,280	-	16,088,073
Furniture, fixtures and equipment	2,271,343	1,804,892	-	4,076,235
	<u>9,790,776</u>	<u>11,006,172</u>	<u>-</u>	<u>20,796,948</u>
Less accumulated depreciation	3,997,784	1,483,928	-	5,481,712
	<u>5,792,992</u>	<u>9,522,244</u>	<u>-</u>	<u>15,315,236</u>
Deferred Financing Costs	<u>-</u>	<u>442,917</u>	<u>-</u>	<u>442,917</u>
Total assets	<u>\$ 24,838,924</u>	<u>\$ 14,189,540</u>	<u>\$ (4,000,000)</u>	<u>\$ 35,028,464</u>

Liabilities and Net Assets

	West Side Community Health Services, Inc.	East Side Health Center, Inc.	Consolidating Adjustments and Eliminations	Total
Current Liabilities				
Current maturities of long-term debt	\$ 383,391	\$ -	\$ -	\$ 383,391
Accounts payable	819,650	-	-	819,650
Accrued expenses	1,442,604	-	-	1,442,604
Estimated amounts due to third-party payers	526,871	-	-	526,871
Due to ESHC	4,000,000	-	(4,000,000)	-
Deferred grant revenue	96,530	-	-	96,530
	<u>7,269,046</u>	<u>-</u>	<u>(4,000,000)</u>	<u>3,269,046</u>
Total current liabilities	7,269,046	-	(4,000,000)	3,269,046
Long-Term Debt	<u>3,212,430</u>	<u>10,540,000</u>	<u>-</u>	<u>13,752,430</u>
Total liabilities	<u>10,481,476</u>	<u>10,540,000</u>	<u>(4,000,000)</u>	<u>17,021,476</u>
Net Assets				
Unrestricted	14,034,915	3,649,540	-	17,684,455
Temporarily restricted	322,533	-	-	322,533
	<u>14,357,448</u>	<u>3,649,540</u>	<u>-</u>	<u>18,006,988</u>
Total net assets	14,357,448	3,649,540	-	18,006,988
Total liabilities and net assets	<u>\$ 24,838,924</u>	<u>\$ 14,189,540</u>	<u>\$ (4,000,000)</u>	<u>\$ 35,028,464</u>

West Side Community Health Services, Inc.
Consolidating Schedule – Statement of Operations Information
Year Ended September 30, 2015

	West Side Community Health Services, Inc.	East Side Health Center, Inc.	Consolidating Adjustments and Eliminations	Total
Unrestricted Revenues, Gains and Other Support				
Patient service revenue (net of contractual discounts and allowances)	\$ 19,826,178	\$ -	\$ -	\$ 19,826,178
Provision for uncollectible accounts	(2,330,834)	-	-	(2,330,834)
Net patient service revenue less provision for uncollectible accounts	17,495,344	-	-	17,495,344
Grant revenue	9,114,308	-	-	9,114,308
Contribution revenue	332,572	-	-	332,572
Other revenue	442,222	412,308	(400,008)	454,522
Net assets released from restrictions used for operations	335,264	-	-	335,264
Total unrestricted revenues, gains and other support	27,719,710	412,308	(400,008)	27,732,010
Expenses and Losses				
Salaries and wages	13,671,696	-	-	13,671,696
Employee benefits	3,331,699	-	-	3,331,699
Purchased services and professional fees	1,775,084	-	-	1,775,084
Supplies and other	6,464,001	76,776	-	6,540,777
Rent	655,105	-	(400,008)	255,097
Depreciation and amortization	396,239	640,705	-	1,036,944
Interest	148,858	228,392	-	377,250
Total expenses and losses	26,442,682	945,873	(400,008)	26,988,547
Operating Income (Loss)	1,277,028	(533,565)	-	743,463
Other Income				
Investment return	69,011	-	-	69,011
Excess (Deficiency) of Revenues Over Expenses	1,346,039	(533,565)	-	812,474
Net assets released from restriction used for purchase of property and equipment	13,583	-	-	13,583
Contributions to ESHC	(30,329)	-	30,329	-
Contributions from WSCHS	-	30,329	(30,329)	-
Increase (Decrease) in Unrestricted Net Assets	\$ 1,329,293	\$ (503,236)	\$ -	\$ 826,057