

**West Side Community Health Services, Inc.**

Accountants' Report and Consolidated Financial Statements

September 30, 2012 and 2011

**West Side Community Health Services, Inc.**  
**September 30, 2012 and 2011**

**Contents**

**Independent Accountants' Report..... 1**

**Consolidated Financial Statements**

Balance Sheets..... 2  
Statements of Operations..... 3  
Statements of Changes in Net Assets ..... 4  
Statements of Cash Flows ..... 5  
Notes to Financial Statements ..... 6

**Supplementary Information**

Consolidating Schedule – Balance Sheet Information ..... 22  
Consolidating Schedule – Statement of Operations Information ..... 23  
Consolidating Schedule – Statement of Changes in Net Assets Information..... 24

## Independent Accountants' Report

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

We have audited the accompanying consolidated balance sheets of West Side Community Health Services, Inc. (the "Organization") as of September 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 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, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

*BKD, LLP*

January 28, 2013

**West Side Community Health Services, Inc.**  
**Consolidated Balance Sheets**  
**September 30, 2012 and 2011**

**Assets**

	<u>2012</u>	<u>2011</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 15,310,087	\$ 5,495,338
Short-term investments	-	3,427,203
Patient accounts receivable, net of allowance; 2012 - \$2,211,000, 2011 - \$4,227,000	910,790	889,026
Grants and other receivables	905,089	560,269
Contributions receivable - current	742,220	429,894
Estimated amounts due from third-party payers	255,000	333,000
Pharmacy inventory	91,759	100,652
Prepaid expenses and other	212,258	26,820
	<u>18,427,203</u>	<u>11,262,202</u>
<b>Notes Receivable</b>	<u>4,037,691</u>	<u>-</u>
<b>Property and Equipment, At Cost</b>		
Land and land improvements	622,641	615,140
Buildings and leasehold improvements	6,850,964	6,850,964
Furniture, fixtures and equipment	1,430,131	1,407,996
Construction in progress	784,192	-
	<u>9,687,928</u>	<u>8,874,100</u>
Less accumulated depreciation	<u>2,952,076</u>	<u>2,659,386</u>
	<u>6,735,852</u>	<u>6,214,714</u>
<b>Other Assets</b>		
Contributions receivable	140,909	233,060
Deferred financing costs	461,886	-
	<u>602,795</u>	<u>233,060</u>
<b>Total assets</b>	<u><u>\$ 29,803,541</u></u>	<u><u>\$ 17,709,976</u></u>

## Liabilities and Net Assets

	<u>2012</u>	<u>2011</u>
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 258,276	\$ 266,002
Accounts payable	783,041	489,346
Accrued expenses	1,228,008	1,249,383
Deferred grant revenue	<u>88,592</u>	<u>98,096</u>
Total current liabilities	2,357,917	2,102,827
<b>Long-Term Debt</b>	<u>14,227,530</u>	<u>3,938,707</u>
Total liabilities	<u>16,585,447</u>	<u>6,041,534</u>
<b>Net Assets</b>		
Unrestricted	11,899,983	10,833,149
Temporarily restricted	<u>1,318,111</u>	<u>835,293</u>
Total net assets	<u>13,218,094</u>	<u>11,668,442</u>
Total liabilities and net assets	<u><u>\$ 29,803,541</u></u>	<u><u>\$ 17,709,976</u></u>

**West Side Community Health Services, Inc.**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Unrestricted Revenues, Gains and Other Support</b>		
Patient service revenue (net of contractual discounts and allowances)	\$ 14,687,986	\$ 14,008,974
Provision for uncollectible accounts	(547,119)	(681,665)
Net patient service revenue less provision for uncollectible accounts	14,140,867	13,327,309
Grant revenue	7,829,836	8,309,883
Contribution revenue	765,253	638,938
Other revenue	6,006	924
Net assets released from restrictions used for operations	871,906	1,022,161
Total unrestricted revenues, gains and other support	23,613,868	23,299,215
<b>Expenses and Losses</b>		
Salaries and wages	12,105,132	11,788,117
Employee benefits	2,782,928	2,912,728
Purchased services and professional fees	1,278,696	1,116,070
Supplies and other	5,605,869	5,804,284
Rent	708,967	693,712
Depreciation and amortization	292,691	363,954
Interest	163,015	172,732
Total expenses and losses	22,937,298	22,851,597
<b>Operating Income</b>	676,570	447,618
<b>Other Income</b>		
Investment return	118,357	122,522
<b>Excess of Revenues Over Expenses</b>	794,927	570,140
Grants for acquisition of property and equipment	297,000	53,875
Investment return - change in unrealized gains and losses on other than trading securities	(30,130)	(46,809)
Net assets released from restriction used for purchase of property and equipment	5,037	3,000
<b>Increase in Unrestricted Net Assets</b>	\$ 1,066,834	\$ 580,206

**West Side Community Health Services, Inc.**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Unrestricted Net Assets</b>		
Excess of revenues over expenses	\$ 794,927	\$ 570,140
Grants for acquisition of property and equipment	297,000	53,875
Investment return - change in unrealized gains and losses on other than trading securities	(30,130)	(46,809)
Net assets released from restriction used for purchase of property and equipment	5,037	3,000
Increase in unrestricted net assets	1,066,834	580,206
<b>Temporarily Restricted Net Assets</b>		
Contributions	1,359,761	1,176,270
Net assets released from restriction	(876,943)	(1,025,161)
Increase in temporarily restricted net assets	482,818	151,109
<b>Change in Net Assets</b>	1,549,652	731,315
<b>Net Assets, Beginning of Year</b>	11,668,442	10,937,127
<b>Net Assets, End of Year</b>	\$ 13,218,094	\$ 11,668,442

**West Side Community Health Services, Inc.**  
**Consolidated Statements of Cash Flows**  
**Years Ended September 30, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Operating Activities</b>		
Change in net assets	\$ 1,549,652	\$ 731,315
Items not requiring (providing) cash		
Depreciation and amortization	292,691	363,954
Net gain on investments	(67,280)	(47,947)
Grants for acquisition of property and equipment	(297,000)	(53,875)
Changes in		
Patient accounts receivable, net	(21,764)	116,674
Grants receivable	(47,820)	134,980
Contributions receivable	(220,175)	(198,562)
Estimated amounts due from third-party payers	78,000	7,000
Prepaid assets	(185,438)	8,114
Inventory	8,893	(24,884)
Accounts payable and accrued expenses	689,769	(20,896)
Deferred revenue	(9,504)	(435,553)
	<u>1,770,024</u>	<u>580,320</u>
Net cash provided by operating activities		
<b>Investing Activities</b>		
Acquisition of short-term investments	(700,000)	(500,000)
Proceeds from disposition of short-term investments	4,194,483	509,606
Purchase of property and equipment	(1,231,278)	(78,828)
	<u>2,263,205</u>	<u>(69,222)</u>
Net cash provided by (used in) investing activities		
<b>Financing Activities</b>		
Proceeds from grants for acquisition of property and equipment	-	53,875
Payment of deferred financing costs	(461,886)	-
Proceeds from issuance of long-term debt	10,540,000	-
Principal payments on long-term debt	(258,903)	(248,390)
Issuance of notes receivable	(4,037,691)	-
	<u>5,781,520</u>	<u>(194,515)</u>
Net cash provided by (used in) financing activities		
<b>Increase in Cash and Cash Equivalents</b>	9,814,749	316,583
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>5,495,338</u>	<u>5,178,755</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 15,310,087</u>	<u>\$ 5,495,338</u>
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 163,015	\$ 172,732



**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**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 a new entity, 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 17*).

***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 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 Equivalents***

The Organization considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At September 30, 2012 and 2011, cash equivalents consisted primarily of repurchase agreements.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At September 30, 2012, the Organization's interest-bearing cash accounts and certificates of deposit did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010, through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing accounts are subject to the \$250,000 limit on FDIC insurance per covered institution. At September 30, 2012, the Organization had approximately \$10,682,000 in noninterest-bearing transaction accounts.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

The Organization also utilizes sweep products 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, 2012 and 2011, the Organization held \$4,701,227 and \$3,825,967 in sweep products, respectively.

***Investments and Investment Return***

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at 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. Investment return is included in unrestricted net assets.

***Patient Accounts Receivable***

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Organization analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for 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 88% and 94% of self-pay accounts receivable at September 30, 2012 and 2011, respectively. In addition, the Organization's write-offs increased approximately \$1,880,000 from approximately \$607,000 for the year ended September 30, 2011, to approximately \$2,487,000 for the year ended September 30, 2012. The increase in the write-offs was the result of significant clean-up efforts in fiscal year 2012.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Notes Receivable**

Notes receivable are stated at their outstanding principal amount, net of allowance for uncollectible notes. The Organization provides an allowance for uncollectible notes, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Outstanding notes accrue interest based on the terms of the respective note agreements. A note receivable is considered delinquent when the debtor has missed three or more payments. At that time, the note is placed on nonaccrual status and interest accrual ceases and does not resume until the note is no longer classified as delinquent. Delinquent notes are written off based on individual credit evaluation and specific circumstances of the borrower.

**Pharmacy Inventory**

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

**Property and Equipment**

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

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.

The Organization capitalized interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project. Total interest capitalized and incurred was:

	<b>2012</b>	<b>2011</b>
Interest capitalized	\$ 15,226	\$ -
Interest charged to expense	163,015	172,732
Total interest incurred	\$ 178,241	\$ 172,732

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

***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, 2012 and 2011.

***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.

***Temporarily Restricted Net Assets***

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

***Net Patient Service Revenue***

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

***Government Grants***

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.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

***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 financial statements and similarly increase temporarily restricted net assets or contribution revenue by a like amount. In-kind contributions of \$540,781 and \$460,847, respectively, were received for the years ended September 30, 2012 and 2011, and is included in the statements of operations as contribution revenue.

***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 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).

***Subsequent Events***

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

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**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. The Organization’s present CHC grant award covers the grant year ending January 31, 2013, and is approved at \$4,665,050. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. The Organization recognized \$4,669,532 and \$4,396,567 in revenues from this grant for the years ended September 30, 2012 and 2011, respectively.

In response to the current economic conditions, the federal government passed legislation appropriating grant dollars to community health centers under the American Recovery and Reinvestment Act (ARRA). The Organization has been awarded \$571,070 under the Increased Demand for Services (IDS) grant for the period March 27, 2009, through March 26, 2011, to assist in meeting the needs of the community served; and \$1,361,495 under the Capital Improvement Program (CIP) grant for the period of June 29, 2009, through June 28, 2011, for facility improvements and equipment. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. During the year ended September 30, 2011, the Organization recognized \$223,085 and \$454,889 in IDS and CIP grant funds, respectively. No revenue was recognized for these grants for the year ended September 30, 2012.

The Organization has been awarded \$4,000,000 under the Affordable Care Act (ACA) – Capital Development Grants for the May 1, 2012, to April 30, 2015, period to fund the planned construction of new facilities (see *Note 15*). During the years ended September 30, 2012 and 2011, the Organization recognized \$297,000 and \$0, respectively, in ACA grant funds.

In addition to the above 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 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 statement of operations as a component of net patient service revenue.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

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* - 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 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, 2012 and 2011, was approximately:

	<b>2012</b>			
	<b>Gross Charges</b>	<b>Contractual Adjustments</b>	<b>Sliding Fee Adjustments</b>	<b>Net Revenue</b>
Medicaid	\$ 14,110,246	\$ 6,155,434	\$ -	\$ 7,954,812
Medicare	1,417,512	740,144	-	677,368
Other third-party payers	5,916,286	2,317,294	-	3,598,992
Self-pay	12,289,678	-	9,832,864	2,456,814
Total	<u>\$ 33,733,722</u>	<u>\$ 9,212,872</u>	<u>\$ 9,832,864</u>	<u>\$ 14,687,986</u>
	<b>2011</b>			
	<b>Gross Charges</b>	<b>Contractual Adjustments</b>	<b>Sliding Fee Adjustments</b>	<b>Net Revenue</b>
Medicaid	\$ 11,902,141	\$ 4,441,910	\$ -	\$ 7,460,231
Medicare	1,167,132	534,920	-	632,212
Other third-party payers	5,660,985	2,253,487	-	3,407,498
Self-pay	11,624,554	-	9,115,521	2,509,033
Total	<u>\$ 30,354,812</u>	<u>\$ 7,230,317</u>	<u>\$ 9,115,521</u>	<u>\$ 14,008,974</u>

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**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, 2012 and 2011, was:

	<b>2012</b>	<b>2011</b>
Medicare	13%	13%
Medicaid	42%	39%
Other third-party payers	14%	30%
Patient responsibilities	31%	18%
	<u>100%</u>	<u>100%</u>

**Note 5: Investments and Investment Return**

Short-term investments include:

	<b>2012</b>	<b>2011</b>
Internally designated		
Money market mutual fund	\$ -	\$ 2,550
Bond mutual fund	-	779,238
Repurchase agreements	-	1,922,438
Corporate bonds	-	722,977
	<u>\$ -</u>	<u>\$ 3,427,203</u>

Total investment return is comprised of the following:

	<b>2012</b>	<b>2011</b>
Interest and dividend income	\$ 20,947	\$ 27,766
Realized and unrealized gains on other than trading securities	<u>67,280</u>	<u>47,947</u>
	<u>\$ 88,227</u>	<u>\$ 75,713</u>



**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

Total investment return is reflected in the statements of operations and changes in net assets as follows:

	<b>2012</b>	<b>2011</b>
Unrestricted net assets		
Other nonoperating income	\$ 118,357	\$ 122,522
Change in unrealized gains and losses on other than trading securities	(30,130)	(46,809)
	\$ 88,227	\$ 75,713

The Organization’s investment portfolio consists of the following: 1. A money market mutual fund which invests primarily in a portfolio of short-term, high quality, fixed income securities issued by banks, corporations and the U.S. government; 2. A bond mutual fund which invests in a minimum of 80% of assets in investment grade fixed income securities, but may also hold up to 10% of assets in lower rated fixed income securities and up to 10% of assets in preferred stocks; 3. Overnight repurchase agreements; and 4. Corporate bonds which were rated between “A” and “AA+” by Standard and Poor’s and mature in 2012.

**Note 6: Medical Malpractice Claims**

The U.S. Department of Health and Human Services has deemed the Health Center and its practicing providers covered under the Federal Tort 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.

In 2012, the Organization adopted the provisions of Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, which eliminates the practice of netting claim liabilities with expected insurance recoveries for balance sheet presentation. Claim liabilities are to be determined without consideration of insurance recoveries. Expected recoveries are presented separately. Prior to the adoption of ASU 2010-24, accounting principles generally accepted in the United States of America required a health care provider to accrue only an estimate of the malpractice claims costs for both reported claims and claims incurred but not reported where the risk of loss had not been transferred to a financially viable insurer. There was no impact of the ASU adoption to the Organization’s financial statements.

Based upon the Organization’s claims experience, no accrual has been made for medical malpractice costs for the years ended September 30, 2012 and 2011. 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.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Note 7: Note Receivable**

In conjunction with the New Market Tax Credit transaction (see *Note 17*), WSCHS issued an unsecured note receivable. The balance of the note receivable at September 30, 2012 and 2011, was \$4,037,691 and \$0, respectively. 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.

**Note 8: Line of Credit**

The Organization had a \$250,000 line of credit available at September 30, 2012 and 2011. The current line of credit has an interest rate of 5% and a maturity date of March 18, 2013, and is secured by certain assets of the Organization. The Organization had no borrowings against this line of credit at September 30, 2012 and 2011, respectively.

**Note 9: Long-Term Debt**

	<b>2012</b>	<b>2011</b>
Note payable (A)	\$ 3,670,890	\$ 3,878,600
Note payable (B)	24,145	65,182
Note payable (C)	250,771	260,927
Construction loan payable (D)	5,790,000	-
Construction loan payable (E)	4,750,000	-
	<u>14,485,806</u>	<u>4,204,709</u>
Less current maturities	<u>258,276</u>	<u>266,002</u>
	<u><u>\$ 14,227,530</u></u>	<u><u>\$ 3,938,707</u></u>

- (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 BankCherokee. The note payable to BankCherokee in the original amount of \$5,000,000, due July 1, 2025, payable in monthly installments of \$29,924, including variable interest. The current interest rate on the note is 4% and will continue as such until an adjustment date of July 1, 2014. 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%. The interest rate will also adjust on July 1, 2019. This note is secured by real estate.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

- (B) Note payable to the Nonprofits Assistance Fund in the original amount of \$191,499, due April 16, 2013, payable in monthly installments of \$3,614, including interest at 5.00%. This note is secured by equipment.
- (C) 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, with a final balloon payment of \$24,331 due May 1, 2028, including interest at 4.00%. This note is secured by real estate.
- (D) 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 17*). 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 begin September 20, 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. Monthly principal and interest payments begin September 20, 2012, in the amount of \$10,033.

“Tranche C” in the original amount of \$1,521,600 is due on September 7, 2042. Monthly principal and interest payments begin September 20, 2012, in the amount of \$6,997.

- (E) 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 17*). 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 begin September 20, 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. Monthly principal and interest payments begin September 20, 2012, in the amount of \$8,383.

“Capital City Loan C” in the original amount of \$1,193,000 is due on September 7, 2042. Monthly principal and interest payments begin September 20, 2012, in the amount of \$5,501.

Aggregate annual maturities of long-term debt at September 30, 2012, are:

2013	\$ 258,276
2014	243,669
2015	253,559
2016	264,008
2017	274,765
Thereafter	13,191,529
	<u>\$ 14,485,806</u>

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Note 10: Temporarily Restricted Net Assets**

Temporarily restricted net assets at September 30, 2012 and 2011, are available for the following purpose or periods:

	<u>2012</u>	<u>2011</u>
Health care services	\$ 692,826	\$ 718,412
Oral health services	141,183	47,058
Mental health services	-	-
Administrative and other services	59,102	69,823
Capital campaign - East Side	425,000	-
	<u>\$ 1,318,111</u>	<u>\$ 835,293</u>

During 2012, 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 \$871,906 and \$5,037 were released to purchase equipment. During 2011, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes of health care services in the amount of \$1,022,161 and administrative and other services in the amount of \$3,000.

**Note 11: Functional Expenses**

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

	<u>2012</u>	<u>2011</u>
Health care services	\$ 18,784,663	\$ 18,712,738
General and administrative	4,152,635	4,138,859
	<u>\$ 22,937,298</u>	<u>\$ 22,851,597</u>

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Note 12: Operating Leases**

The Organization has noncancelable operating leases for facilities which expire in various years through 2014. These leases generally require the Organization to pay all executory costs (property taxes, maintenance and insurance).

Future minimum lease payments at September 30, 2012, were:

2013	\$ 583,021
2014	<u>81,927</u>
Future minimum lease payments	<u><u>\$ 664,948</u></u>

**Note 13: 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 2012 and 2011, the Organization matched the maximum 50% of eligible employee contributions. Retirement plan expense for the years ended September 30, 2012 and 2011, was \$131,727 and \$144,741, respectively.

**Note 14: 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 that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

Following is a description of the valuation methodologies and inputs used for assets 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.

**Investments**

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include a money market mutual fund and bond mutual fund. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Pricing models are based on quoted prices for securities with similar coupons, ratings and maturities. Level 2 securities include corporate bonds. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Organization has no Level 3 securities.

**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 September 30, 2012 and 2011:

	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)
	<b>2012</b>			
Assets				
Money market mutual fund	\$ -	\$ -	\$ -	\$ -
Bond mutual fund	-	-	-	-
Corporate bonds	-	-	-	-
	<b>2011</b>			
Assets				
Money market mutual fund	\$ 2,550	\$ 2,550	\$ -	\$ -
Bond mutual fund	779,238	779,238	-	-
Corporate bonds	722,977	-	722,977	-

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Note 15: Construction in Progress**

The Organization is in the process of building a new East Side clinic, which will encompass approximately 34,000 square feet, hosting medical, dental and behavioral health services and is expected to be completed by May 2013. The clinic is funded by a \$4,000,000 capital development grant from the U.S. Department of Health and Human Services (*Note 2*) and new market tax credit financing (see *Note 17*). Total estimated costs of the project are approximately \$11,500,000.

**Note 16: 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 Awards***

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 6*.

***Current Economic Conditions***

The current protracted economic decline continues to present health centers with difficult circumstances and challenges, which in some cases have resulted in declines in the fair value of investments and other assets, declines in contributions and constraints on liquidity. The financial statements have been prepared using values and information currently available to the Organization.

Current economic conditions have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Organization's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the current economic conditions, the values of assets and liabilities recorded in the financial statements could change and negatively impact the Organization.

**West Side Community Health Services, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012 and 2011**

**Note 17: 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 7*) and a loan from a commercial bank in the amount of \$3,825,000.

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 is using the \$10,540,000 loan proceeds to construct a building 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.

WSCHS also contributed an additional \$926,861 directly to ESHC for use in construction of the building, which was eliminated in the consolidated financial statements. Upon completion of the East Side facility (see *Note 15* for progress and anticipated completion), WSCHS and ESHC plan to enter into a rental agreement in which WSCHS rents the new health center facility from ESHC for \$400,000 per year. The rental expense and rental income will be intercompany transactions that will be eliminated in future years for purposes of the consolidated financial statements.



## **Supplementary Information**

**West Side Community Health Services, Inc.**  
**Consolidating Schedule – Balance Sheet Information**  
**September 30, 2012**

**Assets**

	<b>West Side Community Health Services, Inc.</b>	<b>East Side Health Center, Inc.</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Total</b>
<b>Current Assets</b>				
Cash and cash equivalents	\$ 4,671,855	\$ 10,638,232	\$ -	\$ 15,310,087
Short-term investments	-	-	-	-
Patient accounts receivable, net of allowance; \$2,211,000	910,790	-	-	910,790
Grants and other receivables	929,314	-	(24,225)	905,089
Contributions receivable - current	742,220	-	-	742,220
Estimated amounts due from third-party payers	255,000	-	-	255,000
Pharmacy inventory	91,759	-	-	91,759
Prepaid expenses and other	212,258	-	-	212,258
Total current assets	<u>7,813,196</u>	<u>10,638,232</u>	<u>(24,225)</u>	<u>18,427,203</u>
<b>Property and Equipment, At Cost</b>				
Land and land improvements	622,641	-	-	622,641
Buildings and leasehold improvements	6,850,964	-	-	6,850,964
Furniture, fixtures and equipment	1,430,131	-	-	1,430,131
Construction in progress	-	784,192	-	784,192
	<u>8,903,736</u>	<u>784,192</u>	<u>-</u>	<u>9,687,928</u>
Less accumulated depreciation	<u>2,952,076</u>	<u>-</u>	<u>-</u>	<u>2,952,076</u>
	<u>5,951,660</u>	<u>784,192</u>	<u>-</u>	<u>6,735,852</u>
<b>Other Assets</b>				
Contributions receivable	140,909	-	-	140,909
Deferred financing costs	-	461,886	-	461,886
	<u>140,909</u>	<u>461,886</u>	<u>-</u>	<u>602,795</u>
<b>Notes Receivable</b>				
	<u>4,037,691</u>	<u>-</u>	<u>-</u>	<u>4,037,691</u>
Total assets	<u>\$ 17,943,456</u>	<u>\$ 11,884,310</u>	<u>\$ (24,225)</u>	<u>\$ 29,803,541</u>
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Current maturities of long-term debt	\$ 258,276	\$ -	\$ -	\$ 258,276
Accounts payable	389,817	417,449	(24,225)	783,041
Accrued expenses	1,228,008	-	-	1,228,008
Deferred grant revenue	88,592	-	-	88,592
Total current liabilities	<u>1,964,693</u>	<u>417,449</u>	<u>(24,225)</u>	<u>2,357,917</u>
<b>Long-Term Debt</b>				
	<u>3,687,530</u>	<u>10,540,000</u>	<u>-</u>	<u>14,227,530</u>
Total liabilities	<u>5,652,223</u>	<u>10,957,449</u>	<u>(24,225)</u>	<u>16,585,447</u>
<b>Net Assets</b>				
Unrestricted	10,973,122	926,861	-	11,899,983
Temporarily restricted	1,318,111	-	-	1,318,111
Total net assets	<u>12,291,233</u>	<u>926,861</u>	<u>-</u>	<u>13,218,094</u>
Total liabilities and net assets	<u>\$ 17,943,456</u>	<u>\$ 11,884,310</u>	<u>\$ (24,225)</u>	<u>\$ 29,803,541</u>

**West Side Community Health Services, Inc.**  
**Consolidating Schedule – Statement of Operations Information**  
**Year Ended September 30, 2012**

	West Side Community Health Services, Inc.	East Side Health Center, Inc.	Consolidating Adjustments and Eliminations	Total
<b>Unrestricted Revenues, Gains and Other Support</b>				
Patient service revenue (net of contractual discounts and allowances)	\$ 14,687,986	\$ -	\$ -	\$ 14,687,986
Provision for uncollectible accounts	(547,119)	-	-	(547,119)
Net patient service revenue less provision for uncollectible accounts	14,140,867	-	-	14,140,867
Grant revenue	7,829,836	-	-	7,829,836
Contribution revenue	765,253	-	-	765,253
Other revenue	6,006	-	-	6,006
Net assets released from restrictions used for operations	871,906	-	-	871,906
Total unrestricted revenues, gains and other support	23,613,868	-	-	23,613,868
<b>Expenses and Losses</b>				
Salaries and wages	12,105,132	-	-	12,105,132
Employee benefits	2,782,928	-	-	2,782,928
Purchased services and professional fees	1,278,696	-	-	1,278,696
Supplies and other	5,605,869	-	-	5,605,869
Rent	708,967	-	-	708,967
Depreciation and amortization	292,691	-	-	292,691
Interest	163,015	-	-	163,015
Total expenses and losses	22,937,298	-	-	22,937,298
<b>Operating Income</b>	676,570	-	-	676,570
<b>Other Income</b>				
Investment return	118,357	-	-	118,357
<b>Excess of Revenues Over Expenses</b>	794,927	-	-	794,927
Grants for acquisition of property and equipment	297,000	-	-	297,000
Investment return - change in unrealized gains and losses on other than trading securities	(30,130)	-	-	(30,130)
Contribution to East Side Health Center, Inc.	(926,861)	-	926,861	-
Contributions for acquisition of property and equipment	-	926,861	(926,861)	-
Net assets released from restriction used for purchase of property and equipment	5,037	-	-	5,037
<b>Increase in Unrestricted Net Assets</b>	\$ 139,973	\$ 926,861	\$ -	\$ 1,066,834

**West Side Community Health Services, Inc.**  
**Consolidating Schedule – Statement of Changes in Net Assets Information**  
**Year Ended September 30, 2012**

	<b>West Side Community Health Services, Inc.</b>	<b>East Side Health Center, Inc.</b>	<b>Consolidating Adjustments and Eliminations</b>	<b>Total</b>
<b>Unrestricted Net Assets</b>				
Excess (deficiency) of revenues over expenses	\$ 794,927	\$ -	\$ -	\$ 794,927
Grants for acquisition of property and equipment	297,000	-	-	297,000
Investment return - change in unrealized gains and losses on other than trading securities	(30,130)	-	-	(30,130)
Contribution to East Side Health Center, Inc.	(926,861)	-	926,861	-
Contributions for acquisition of property and equipment	-	926,861	(926,861)	-
Net assets released from restriction used for purchase of property and equipment	5,037	-	-	5,037
	<u>139,973</u>	<u>926,861</u>	<u>-</u>	<u>1,066,834</u>
<b>Increase in unrestricted net assets</b>				
<b>Temporarily Restricted Net Assets</b>				
Contributions	1,359,761	-	-	1,359,761
Net assets released from restriction	(876,943)	-	-	(876,943)
	<u>482,818</u>	<u>-</u>	<u>-</u>	<u>482,818</u>
<b>Increase in temporarily restricted net assets</b>				
<b>Change in Net Assets</b>	622,791	926,861	-	1,549,652
<b>Net Assets, Beginning of the Year</b>	<u>11,668,442</u>	<u>-</u>	<u>-</u>	<u>11,668,442</u>
<b>Net Assets, End of Year</b>	<u>\$ 12,291,233</u>	<u>\$ 926,861</u>	<u>\$ -</u>	<u>\$ 13,218,094</u>