

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NASHVILLE, TENNESSEE

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORTS

JUNE 30, 2006

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

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CONTENTS

	<u>PAGE</u>
<u>INDEPENDENT AUDITORS' REPORT</u> .....	1
 <u>FINANCIAL STATEMENTS</u>	
Statements of Financial Position .....	2
Statement of Activities .....	3
Statements of Cash Flows .....	4
Statement of Functional Expenses.....	5
Notes to Financial Statements .....	6 - 12
 <u>OTHER REPORT</u>	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	13 - 14



## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
University Community Health Services, Inc.  
Nashville, Tennessee

We have audited the accompanying statements of financial position of University Community Health Services, Inc. (the "Organization"), a Tennessee not-for-profit corporation, as of June 30, 2006 and 2005, the related statements of activities and functional expenses for the year ended June 30, 2006, and the statements of cash flows for the years ended June 30, 2006 and 2005. 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. The prior year summarized comparative information has been derived from University Community Health Services, Inc.'s 2005 financial statements and, in our report dated April 5, 2006, we expressed an unqualified opinion on those statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 financial statements referred to above present fairly, in all material respects, the financial position of University Community Health Services, Inc. as of June 30, 2006 and 2005, the changes in its net assets for the year ended June 30, 2006, and its cash flows for the years ended June 30, 2006 and 2005, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2007 on our consideration of University Community Health Services, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

*KraftCPAs PLLC*

Nashville, Tennessee  
June 6, 2007

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
Cash and cash equivalents	\$ 759,117	\$ 740,009
Accounts receivable:		
Patients, net - Note 2	101,134	7,842
Other contracts	116,054	42,303
Contributions receivable - Note 3	250,000	-
Property and equipment, net - Note 4	<u>192,420</u>	<u>174,448</u>
TOTAL ASSETS	<u>\$ 1,418,725</u>	<u>\$ 964,602</u>
<u>LIABILITIES AND NET ASSETS</u>		
LIABILITIES		
Accounts payable	\$ 7,293	\$ 8,213
Accrued expenses	42,110	60,523
Due to Vanderbilt University - Note 5	<u>4,341</u>	<u>122,133</u>
TOTAL LIABILITIES	<u>53,744</u>	<u>190,869</u>
COMMITMENTS - Note 8		
NET ASSETS		
Unrestricted:		
Designated for property and equipment	192,420	174,448
Undesignated	<u>774,789</u>	<u>589,620</u>
Total unrestricted	967,209	764,068
Temporarily restricted - Note 7	<u>397,772</u>	<u>9,665</u>
TOTAL NET ASSETS	<u>1,364,981</u>	<u>773,733</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,418,725</u>	<u>\$ 964,602</u>

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

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2006, WITH COMPARATIVE TOTALS FOR 2005

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTALS</u>	<u>TOTALS</u>
			<u>2006</u>	<u>2005</u>
REVENUE AND PUBLIC SUPPORT				
Revenues:				
Net patient service revenue - Note 2	\$ 523,802	\$ -	\$ 523,802	\$ 148,695
Contract services and other	601,799	-	601,799	130,729
Premium program revenue	963,644	-	963,644	1,869,764
Contributions and grants	100	550,900	551,000	250
Net assets released resulting from satisfaction of donor restrictions	<u>162,793</u>	<u>(162,793)</u>	<u>-</u>	<u>-</u>
TOTAL REVENUE AND PUBLIC SUPPORT	<u>2,252,138</u>	<u>388,107</u>	<u>2,640,245</u>	<u>2,149,438</u>
EXPENSES				
Program services	2,372,988	-	2,372,988	1,849,571
Management and general	<u>264,901</u>	<u>-</u>	<u>264,901</u>	<u>166,994</u>
TOTAL EXPENSES	<u>2,637,889</u>	<u>-</u>	<u>2,637,889</u>	<u>2,016,565</u>
CHANGE IN NET ASSETS	(385,751)	388,107	2,356	132,873
Equity transfer from Vanderbilt University	588,892	-	588,892	-
NET ASSETS - BEGINNING OF YEAR	<u>764,068</u>	<u>9,665</u>	<u>773,733</u>	<u>640,860</u>
NET ASSETS - END OF YEAR	<u>\$ 967,209</u>	<u>\$ 397,772</u>	<u>\$ 1,364,981</u>	<u>\$ 773,733</u>

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

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Change in net assets	<u>\$ 2,356</u>	<u>\$ 132,873</u>
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	18,890	20,914
Decrease (increase) in:		
Accounts receivable	(167,043)	(28,170)
Contributions receivable	(250,000)	-
Increase (decrease) in:		
Accounts payable	(920)	(1,487)
Accrued expenses	(18,413)	31,034
Due to Vanderbilt University	<u>(117,792)</u>	<u>(94,946)</u>
TOTAL ADJUSTMENTS	<u>(535,278)</u>	<u>(72,655)</u>
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(532,922)	60,218
NET CASH USED IN INVESTING ACTIVITIES		
Additions to property and equipment	(36,862)	-
NET CASH PROVIDED BY FINANCING ACTIVITIES		
Equity transfer from Vanderbilt University	<u>588,892</u>	<u>-</u>
INCREASE IN CASH	19,108	60,218
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>740,009</u>	<u>679,791</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 759,117</u>	<u>\$ 740,009</u>

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

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2006, WITH COMPARATIVE TOTALS FOR 2005

	PROGRAM	MANAGEMENT	TOTALS	
	SERVICES	AND GENERAL	2006	2005
Salaries and wages	\$ 564,862	\$ 70,875	\$ 635,737	\$ 491,285
Employee benefits	125,347	21,279	146,626	107,471
Contracted services - Note 5	1,379,558	129,625	1,509,183	961,720
Advertising	-	3,327	3,327	227
Depreciation	17,001	1,889	18,890	20,914
Equipment rental and maintenance	26,538	2,949	29,487	28,740
Fees and licenses	11,003	913	11,916	19,918
Insurance	12,632	2,721	15,353	9,355
Medical supplies and services	98,398	-	98,398	52,132
Meetings and conferences	1,684	187	1,871	1,106
Occupancy - Note 8	62,019	6,891	68,910	60,659
Postage and shipping	2,553	284	2,837	6,676
Printing and publications	2,002	222	2,224	-
Professional services	-	16,381	16,381	20,150
Payments to subgrantees	-	-	-	121,106
Supplies	20,965	2,329	23,294	63,442
Telephone	40,313	4,479	44,792	48,491
Travel and continuing education	8,029	540	8,569	1,080
Miscellaneous	84	10	94	2,093
TOTAL EXPENSES	<u>\$ 2,372,988</u>	<u>\$ 264,901</u>	<u>\$ 2,637,889</u>	<u>\$ 2,016,565</u>

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

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

University Community Health Services, Inc. (the "Organization" or "UCHS") was formed in July 1990, as a Tennessee not-for-profit corporation. The Organization's sole member has been Vanderbilt Health Services, Inc., a Tennessee not-for-profit corporation, which is controlled by Vanderbilt University ("Vanderbilt"). The Organization provides nurse-managed primary care and mental health medical services at three (four in 2005) public housing clinics, one senior continuing care community, four employer health sites beginning in 2006, and a Housecalls program beginning in 2006. With a focus on vulnerable populations, these clinics provide comprehensive, cost effective, medical procedures, treatments and services.

On December 6, 2006, the Organization's charter was amended and restated to provide that the Organization shall have no members, which effectively removed Vanderbilt Health Services, Inc. as the sole member of the Organization. Under the original charter, the Organization was to operate exclusively for the benefit of Vanderbilt Health Services, Inc. Under the amended and restated charter, the Organization's purpose is to own, operate and maintain health centers for the study, diagnosis, and treatment of human ailments and injuries in populations served; to use those health centers as clinical laboratories for health professions training, particularly the education of basic and advanced practice nurses, as well as physicians, osteopaths, physicians assistants and allied health personnel; and to conduct clinical and health services research to improve the health of vulnerable populations, particularly focusing on the elimination of health disparities and the promotion of healthier lifestyles.

The Organization was considered financially interrelated with Vanderbilt University through the date the amended and restated charter was approved by the Board. Equity transfers from Vanderbilt subsequent to June 30, 2006, include its commitment in August 2006 to assist with the costs of renovation and expansion of UCHS's Vine Hill Community Clinic in the amount of \$447,000. This funding occurred in December 2006, January and April 2007. Another equity transfer of approximately \$300,000 is anticipated to be made to fund UCHS's operating deficits for the period July 1, 2006 through November 30, 2006. The Organization has established itself separate and independent from Vanderbilt under its amended and restated charter. It has restructured its Board membership to include community representation and has applied for federally qualified health center ("FQHC") Look-Alike status. Vanderbilt has verbally committed to provide funding for UCHS's operating deficits from December 1, 2006 through June 30, 2007, in the form of a bridge loan or note payable. UCHS plans to seek alternative financing arrangements if the FQHC Look-Alike status is approved.



UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of presentation

The financial statements of the Organization have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America.

Based on the existence or absence of donor-imposed restrictions, the Organization classifies resources into three categories: unrestricted, temporarily restricted and permanently restricted net assets.

- *Unrestricted net assets* are free of donor-imposed restrictions. All revenues, gains and losses that are not temporarily or permanently restricted by donors are included in this classification. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donors' stipulations results in the release of the restriction.
- *Temporarily restricted net assets* are limited as to use by donor-imposed restrictions that expire with the passage of time or that can be satisfied by use for the specific purpose.
- *Permanently restricted net assets* are amounts required by donors to be held in perpetuity, including gifts requiring in perpetuity that the principal be invested and the income or specific portions thereof be used for operations. The Organization had no permanently restricted net assets as of June 30, 2006 or 2005.

Cash and cash equivalents

Cash and cash equivalents consist principally of checking account balances.

Property and equipment

Property and equipment are reported at cost at the date of purchase, or fair value at the date of gift if the value is readily determinable, or other reasonable basis, if cost is unknown. Depreciable assets are depreciated by the straight-line method over their estimated useful lives, which range from three to fifteen years.

Net patient service, contract and other revenue

Patient service revenue, contract and other revenues are recorded at the Organization's established rates, with contractual, sliding scale fee and indigent care adjustments deducted to arrive at net reported revenues.

Contractual adjustments represent the difference between the Organization's established rates and third-party payor payments. Contractual adjustments are estimated during the period in which the services are provided and adjusted to actual when payments are received.

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Premium program revenue

Prior to December 1, 2005, the Organization participated in a capitation program with Victory Health Plans ("VHP"), a TennCare contractor for the State of Tennessee. This program paid \$14.50 per member per month regardless of the level of service, if any, that was provided. Effective December 1, 2005, this program became a fee-for-service program. A second capitation program, with the Veterans Administration ("VA"), pays \$17.00 per member per month. These programs represent 37% in 2006 (87% in 2005) of the Organization's net revenues (VHP - 30% and VA - 7%, in 2006; VHP - 80% and VA - 7%, in 2005). Services provided to VHP and VA plan participants are recorded as gross patient service revenue and written off 100%, less any applicable co-pays, through contractual adjustments at the time of service. Such accounting has no effect on net patient service revenue reported. (See Note 2.)

Contributions and support

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a restriction is fulfilled (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted and reported in the Statement of Activities as net assets released from restrictions.

Grant revenue from federal and state governmental agencies is recognized in the period a liability is incurred for eligible expenditures under the terms of the grant. Governmental grant funds received prior to expenditure are recorded initially as deferred revenue.

The Organization reports any gifts of equipment or materials as unrestricted support absent any explicit donor restrictions as to how the assets must be used. Gifts of long-lived assets, and/or support that is restricted to the acquisition of long-lived assets, are reported as restricted support. Expirations of donor restrictions are recognized when the donated or acquired long-lived assets are placed in service.

Promises to give

Unconditional promises to give that are expected to be collected within one year are recorded as contributions receivable at their estimated net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discount on those amounts is computed using a risk-free interest rate applicable to the year in which the promise is received. Amortization of the discount is recognized on the interest method over the term of the gift and included in contribution revenue.

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Promises to give (continued)

No such discounts were recorded in 2006 or 2005. Conditional promises to give are not included as support until such time as the conditions are substantially met.

No provision for uncollectible contributions was considered necessary in 2006, based on management's review of these pledges and historical trends.

Equity transfers

Transfers of assets from Vanderbilt University are reported as equity transactions due to the financial interrelationship between the organizations and Vanderbilt's control of the Organization's board and operational activities.

Income taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been provided in the accompanying financial statements.

Program and supporting services

The following functional expense classifications are included in the accompanying financial statements:

Program services - includes medical services provided at primary care and mental health nurse-managed clinics at public housing, senior continuing care community and employer health sites.

Management and general - relates to the overall direction of the Organization. These expenses are not identifiable with a particular program or event or with fundraising, but are indispensable to the conduct of those activities and are essential to the organization. Specific activities include organization oversight, business management, recordkeeping, budgeting, financing, and other administrative activities.

Allocation of functional expenses

Expenses that can be directly attributed to a particular function are charged to that function. Certain costs have been allocated among more than one program or activity based on objectively evaluated financial and nonfinancial data or reasonable subjective methods determined by management.

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of estimates in the preparation of financial statements

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.

Reclassifications

Certain reclassifications have been made in the prior year's financial statements in order to be comparative with the current year's presentation.

NOTE 2 - ACCOUNTS RECEIVABLE

Accounts receivable are comprised of payments due from third-party payors and patients and are reported net of allowance for estimated contractual, sliding scale fee and indigent care adjustments. Third-party payors consist primarily of Medicare, TennCare, Blue Cross Blue Shield and certain commercial insurance carriers. As of June 30, 2006, approximately 96% of patient accounts receivable were due from third-party payors, and 4% were due from patients (91% and 9%, respectively, at June 30, 2005).

Gross billings, including services provided to participants in capitation programs, and contractual, sliding scale fee and indigent care adjustments for the years ended June 30, 2006 and 2005, are as follows:

	<u>2006</u>	<u>2005</u>
Gross billings	\$ 2,237,431	\$ 2,024,543
Contractual adjustments	(1,561,083)	(1,849,126)
Sliding scale fee and indigent care adjustments	<u>(152,546)</u>	<u>(26,722)</u>
Net patient service revenue	<u>\$ 523,802</u>	<u>\$ 148,695</u>

Patient receivables consist of the following as of June 30:

	<u>2006</u>	<u>2005</u>
Gross patient receivables	\$ 326,199	\$ 52,384
Allowance for contractual adjustments	(210,017)	(43,586)
Allowance for sliding scale fee and indigent care adjustments	<u>(15,048)</u>	<u>(956)</u>
Patient receivables, net	<u>\$ 101,134</u>	<u>\$ 7,842</u>

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 3 - CONTRIBUTIONS RECEIVABLE

The contribution receivable at June 30, 2006, is from The Memorial Foundation for the expansion and renovation of the Vine Hill Community Clinic (see Note 4). The grant has been collected in full.

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Medical equipment, computer equipment, furniture and fixtures	\$ 120,868	\$ 120,868
Leasehold improvements	249,133	249,133
Construction in progress	<u>36,862</u>	<u>-</u>
	406,863	370,001
Less: accumulated depreciation	<u>(214,443)</u>	<u>(195,553)</u>
	<u>\$ 192,420</u>	<u>\$ 174,448</u>

Fully depreciated assets at June 30, 2006 amounted to approximately \$101,000.

Subsequent to June 30, 2006, UCHS obtained the final approval from Vanderbilt University Medical Center to expand and renovate the Vine Hill Community Clinic. The total cost of the project was approximately \$875,000. As of June 30, 2006, construction in progress consisted of architectural fees paid to date. The project was funded by a \$400,000 grant from The Memorial Foundation, \$447,000 from Vanderbilt and \$28,000 from private donations. The project was completed in May 2007.

NOTE 5 - CONTRACTED SERVICES

The Organization contracts for licensed advanced practice nurses, physicians and other administrative support under an agreement with Vanderbilt University, by and through the Vanderbilt University School of Nursing ("VUSN"). The contract requires the Organization to pay all salaries plus a fringe benefit rate that includes an administrative overhead charge related to the healthcare providers from VUSN. Total contracted services expense recognized under the contract amounted to \$1,509,183 in 2006 (\$961,720 in 2005).

UNIVERSITY COMMUNITY HEALTH SERVICES, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 6 - EMPLOYEE BENEFIT PLAN

The Organization participates in Vanderbilt University's retirement plan. Under the retirement plan, full time staff members participate in defined contribution retirement plans administered by third-party investment and insurance firms. For eligible employees with one year of continuous service, these plans require employee and matching employer contributions. Participant accounts under these plans are immediately 100% vested.

Vanderbilt University's retirement plan contribution obligations are fully funded by periodic transfers to the respective plan administrators, with the corresponding expenses recognized in the period incurred. Total such contributions by the Organization were \$18,081 for the year ended June 30, 2006 (\$16,053 for 2005).

NOTE 7 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following at June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Patient donations	\$ 1,193	\$ 1,193
Midwifery practice consulting	29,776	2,767
Interpretations of retinal screenings	2,765	5,705
Vine Hill Community Clinic renovation	<u>364,038</u>	<u>-</u>
	<u>\$ 397,772</u>	<u>\$ 9,665</u>

NOTE 8 - COMMITMENTS

The Organization operates its clinics under various operating leases that are renewed annually, with one site contracted for 10 years plus two five-year renewal options. Metropolitan Development and Housing Authority, which operates the City's public housing projects, provides varying amounts of space to the Organization for its use as clinics at nominal rates of \$1 to \$1,225 per month. Rental cost at the senior continuing care community site is \$1,050 per month. Future minimum lease payments required under these leases through June 30, 2007 total \$6,881. Certain equipment is also leased under various short-term rental agreements. Future minimum lease payments due under these agreements are not significant.

NOTE 9 - CONCENTRATIONS OF CREDIT RISK

The Organization maintains cash and investment balances in bank deposit accounts with financial institutions which, at times, may exceed FDIC insurance limits. Management considers this to be a normal business risk, which is mitigated by the use of high quality financial institutions.

At June 30, 2006, contributions receivable are from one grantor. During 2006, the Organization received contributions and grants from two sources representing approximately 94% of such revenues.