CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES
DBA CHILDREN'S CLINICS

YEARS ENDED JUNE 30, 2019 AND 2018

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

YEARS ENDED JUNE 30, 2019 AND 2018

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BeachFleischman

Independent Auditors' Report

Board of Directors and Management
Children's Clinics for Rehabilitative Services dba Children's Clinics
Tucson, Arizona

We have audited the accompanying financial statements of Children's Clinics for Rehabilitative Services dba Children's Clinics, which comprise the statements of financial position as of June 30, 2019 and 2018, and the related statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Children's Clinics for Rehabilitative Services dba Children's Clinics as of June 30, 2019 and 2018, and 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.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, in 2019, the Organization adopted Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

Beach Fleischman PC

Tucson, Arizona
December 10, 2019

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2019 AND 2018

ASSETS

	2019	2018
Current assets:		
Cash and cash equivalents	$ 1,694,586	$ 1,664,307
Investments	3,997,515	4,424,680
Accounts receivable, net	2,345,459	1,369,057
Other current assets	189,747	176,300
Total current assets	8,227,307	7,634,344
Equipment and leasehold improvements, net	898,082	720,041
Total assets	$ 9,125,389	$ 8,354,385

LIABILITIES AND NET ASSETS

Current liabilities:		
Accounts payable	$ 389,857	$ 370,045
Advances from providers	605,000	-
Accrued employee compensation	470,567	405,564
Other accrued expenses	84,769	78,483
Deferred revenue	7,877	11,541
Total current liabilities	1,558,070	865,633
Commitments and contingencies		
Net assets:		
Net assets without donor restrictions:		
Invested in equipment and leasehold improvements	898,082	720,041
Undesignated	6,669,237	6,768,711
Total net assets	7,567,319	7,488,752
Total liabilities and net assets	$ 9,125,389	$ 8,354,385

See notes to financial statements.

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2019 AND 2018

	2019	2018
Revenues and other support, without donor restrictions:		
Net patient service revenue	$ 10,729,034	$ 10,150,895
Other revenues	385,157	552,666
Donated facility	734,602	724,976
Donated services	8,738	10,950
Contributions	118,457	188,946
	11,975,988	11,628,433
Expenses:		
Program	10,714,462	9,730,230
Administrative and operating	1,212,759	1,270,250
Fundraising	52,882	51,846
	11,980,103	11,052,326
Gain (loss) from operations	(4,115)	576,107
Net unrealized gain (loss) on investments	82,682	(91,738)
Increase in net assets without donor restrictions	78,567	484,369
Net assets without donor restrictions, beginning	7,488,752	7,004,383
Net assets without donor restrictions, ending	$ 7,567,319	$ 7,488,752

See notes to financial statements.

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2019

	Program	Administrative and operating	Fundraising	Total expenses
Salaries and benefits	$ 6,516,847	$ 785,335	$ 27,936	$ 7,330,118
Bad debt	197,354	-	-	197,354
Depreciation and amortization	149,744	77,141	-	226,885
Facility and facility insurance	113,120	25,821	-	138,941
Facility rent	684,240	75,141	-	759,381
Fees	126,930	48,826	-	175,756
Physician and other professional	50,224	15,860	-	66,084
Professional care of patients	1,287,367	-	-	1,287,367
Other	51,224	13,450	7,822	72,496
Outside services	224,488	25,532	4,235	254,255
Outreach	136,116	11,630	-	147,746
Repairs and maintenance	286,308	80,065	2,400	368,773
Supplies	685,998	16,555	10,370	712,923
Travel	39,832	16,278	119	56,229
Utilities	164,670	21,125	-	185,795
	$ 10,714,462	$ 1,212,759	$ 52,882	$ 11,980,103

See notes to financial statements.

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2018

	Program	Administrative and operating	Fundraising	Total expenses
Salaries and benefits	$ 5,827,509	$ 840,394	$ 26,349	$ 6,694,252
Bad debt	90,835	-	-	90,835
Depreciation and amortization	122,856	72,154	-	195,010
Facility and facility insurance	106,322	26,200	-	132,522
Facility rent	674,798	80,918	-	755,716
Fees	107,005	46,853	-	153,858
Physician and other professional	50,224	15,860	-	66,084
Professional care of patients	1,324,183	-	-	1,324,183
Other	51,880	17,793	1,615	71,288
Outside services	222,494	40,173	6,000	268,667
Outreach	161,388	6,491	-	167,879
Repairs and maintenance	235,365	67,329	2,700	305,394
Supplies	571,001	20,467	12,357	603,825
Travel	38,740	15,119	2,825	56,684
Utilities	145,630	20,499	-	166,129
	$ 9,730,230	$ 1,270,250	$ 51,846	$ 11,052,326

See notes to financial statements.

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2019 AND 2018

	2019	2018
Cash flows from operating activities:		
Increase in net assets without donor restrictions	$ 78,567	$ 484,369
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Provision for bad debts	197,354	90,835
Depreciation and amortization	226,885	195,010
Loss on disposal of assets	4,750	-
Net realized gains on investments	(107,075)	(294,755)
Net unrealized (gains) losses on investments	(82,682)	91,738
Changes in operating assets and liabilities:		
Accounts receivable	(1,173,756)	352,099
Other current assets	(13,447)	(6,925)
Accounts payable	19,812	7,305
Advances from providers	605,000	-
Accrued employee compensation	65,003	(11,512)
Other accrued expenses	6,286	28,100
Deferred revenue	(3,664)	28
Total adjustments	(255,534)	451,923
Net cash provided by (used in) operating activities	(176,967)	936,292
Cash flows from investing activities:		
Purchases of investments	(1,490,567)	(2,580,292)
Proceeds from sales of investments	2,107,489	1,865,213
Purchases of equipment and leasehold improvements	(409,676)	(71,397)
Net cash provided by (used in) investing activities	207,246	(786,476)
Net increase in cash and equivalents	30,279	149,816
Cash and cash equivalents, beginning	1,664,307	1,514,491
Cash and cash equivalents, ending	$ 1,694,586	$ 1,664,307

See notes to financial statements.

CHILDREN'S CLINICS FOR REHABILITATIVE SERVICES DBA CHILDREN'S CLINICS

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2019 AND 2018

1. Description of organization and summary of significant accounting policies:

Description of organization:

Children's Clinics for Rehabilitative Services dba Children's Clinics (Children's Clinics or Organization) is an Arizona not-for-profit corporation located in Tucson, Arizona. Children's Clinics was incorporated in June 1990 and initially formed by three corporations. Two of these corporations are corporate members (Members) and all have representation on the Board of Directors (the Board) of Children's Clinics.

Children's Clinics provides health care services to members of Children's Rehabilitative Services (CRS), a state program in southern Arizona, under subprovider agreements with UnitedHealthcare Insurance Company (UHC), Banner University Health Plans (Banner), and Health Net of Arizona, Inc. dba Arizona Complete Health (ACH). These services are provided to CRS enrollees through a contracted network of providers that includes the Organization, Banner University Medical Center (BUMC), Community Providers and TMC HealthCare (TMC). The Organization also provides health care services to non CRS members.

Basis of presentation:

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and the AICPA Audit and Accounting Guide, *Health Care Entities*.

Estimates:

The preparation of financial statements in conformity with GAAP 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 amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net patient service revenue:

Under the subprovider agreements with UHC, Banner and ACH, which provide the bulk of the Organization's net patient service revenue, payments to Children's Clinics for most clinical services is on a fee-for-service basis. Children's Clinics is paid as a percentage of AHCCCS allowable rates for services performed onsite through their clinic. Children's Clinics also receives a guaranteed fee per member visit. Net patient service revenue, which is recorded net of contractual allowances, also includes net realizable amounts from patients, third-party payors and others for services rendered.

Contributions:

Unconditional promises to give cash and other assets to Children's Clinics are reported at fair value at the date the promise is received. The gifts are reported as support with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. Donor restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying statements of activities.

1. Description of organization and summary of significant accounting policies (continued):

Cash and cash equivalents:

Children's Clinics considers all highly liquid debt instruments with an original purchased maturity of three months or less to be cash equivalents.

Children's Clinics places its cash and cash equivalents with various credit institutions. At times, such investments may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Accounts receivable:

The Organization grants unsecured credit to its patients and other third party payors without interest. Accounts receivable are considered past due after 90 days. Children's Clinics provides an allowance for doubtful accounts equal to the estimated collection losses that will be incurred. The estimated losses are based on historical collection experience coupled with review of the current status of existing receivables. Doubtful accounts are periodically reviewed for collectibility and are written off to the allowance when all reasonable collection efforts have been exhausted.

Investments and investment income:

Investments are measured at fair value in the statements of financial position. Investment income or loss (including realized gains and losses on investments) is included in other revenues in revenues and other support in the accompanying statements of activities. Net unrealized gains or losses on investments are recognized as a separate component of the change in unrestricted net assets.

Fair value measurements:

Fair value is defined as the price to sell an asset or transfer a liability between market participants in an orderly exchange in the principal or most advantageous market for that asset or liability. The fair value for qualifying alternative investments is determined based on the investment’s net asset value as a practical expedient. Considerable judgment is required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented in the financial statements are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on the estimated fair value.

Equipment, leasehold improvements, depreciation and amortization:

Expenditures for major improvements or items which benefit future periods are capitalized at cost, if purchased, or at fair market value at date of gift, if donated. Expenditures for repairs and maintenance are expensed as incurred. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years.

1. Description of organization and summary of significant accounting policies (continued):

Net assets:

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

- Net assets without donor restrictions - Net assets available for use in general operations and not subject to donor restrictions.

- Net assets with donor restrictions - Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

Functional expenses:

Expenses other than hospital and physician expenses are allocated as program or administrative expense based on the portion of administrative salaries and benefits. The allocation for 2019 and 2018 was 63% to hospital and physician and 34% to administrative and operating. Expenses that are specific to the program are not allocated.

Income taxes:

The Organization is exempt from federal income taxes under Internal Revenue Code Section 501(c)(3) and is classified as other than a private foundation. The Organization is also exempt for state purposes. Accordingly, no income tax provision is made in the financial statements. Income from certain activities not directly related to Children's Clinic's tax-exempt purpose, however, may be subject to taxation as unrelated business taxable income (UBTI).

From time to time, the Organization may be subject to penalties and interest assessed by various taxing authorities, which are classified as administrative and operating expenses, if they occur.

1. Description of organization and summary of significant accounting policies (continued):

Change in accounting principle:

In August 2016, FASB issued Accounting Standards Update (ASU) 2016-14, "Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities." The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Organization has implemented ASU 2016-14 and has adjusted the presentation in these consolidated financial statements accordingly. The ASU has been applied retrospectively to all periods presented.

Subsequent events:

The Organization's management has evaluated the events that have occurred subsequent to June 30, 2019 through December 10, 2019, the date that the financial statements were available to be issued. Management has no responsibility to update these financial statements for events and circumstances occurring after this date.

2. Liquidity and availability of financial assets:

The following reflects the Organization's financial assets as of the statement of financial position date, reduced by amounts not available for general use within one year of the statement of financial position date because of contractual or donor-imposed restrictions, or internal designations.

	2019	2018
Cash and cash equivalents	$ 1,694,586	$ 1,664,307
Investments	3,997,515	4,424,680
Accounts receivable, net	2,345,459	1,369,057
Financial assets available to meet cash needs for general expenditures within one year	$ 8,037,560	$ 7,458,044

As part of the Organization’s liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. To help manage unanticipated liquidity needs, the Organization has a line of credit in the amount of $500,000, which it could draw upon as needed.

3. Accounts receivable:

	2019	2018
Patients	$ 2,441,829	$ 1,434,391
Other	64,846	28,586
	2,506,675	1,462,977
Less allowance for uncollectible accounts	161,216	93,920
	$ 2,345,459	$ 1,369,057

4. Investments:

The market value of investments is as follows:

	2019	2018
Mutual funds - equities	$ 3,092,835	$ 3,511,367
Mutual funds - fixed income	904,680	913,313
	$ 3,997,515	$ 4,424,680

Net investment income is classified with other revenues and consists of the following:

	2019	2018
Interest and dividends	$ 103,266	$ 91,286
Net realized gains	107,075	294,755
	$ 210,341	$ 386,041

5. Fair value measurements:

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used maximize the use of observable inputs and minimize the use of unobservable inputs:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

5. Fair value measurements (continued):

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets or active markets that the Organization does not have access to;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

At June 30, 2019, the fair value of assets measured on a recurring basis is as follows:

	Fair value	Level 1	Level 2	Level 3
Mutual funds:				
Equity, U.S.	$ 1,830,595	$ 1,830,595	$ -	$ -
Equity, International	1,262,240	1,262,240	-	-
Fixed income	904,680	904,680	-	-
	$ 3,997,515	$ 3,997,515	$ -	$ -

At June 30, 2018, the fair value of assets measured on a recurring basis is as follows:

	Fair value	Level 1	Level 2	Level 3
Mutual funds:				
Equity, U.S.	$ 1,887,739	$ 1,887,739	$ -	$ -
Equity, International	1,623,628	1,623,628	-	-
Fixed income	913,313	913,313	-	-
	$ 4,424,680	$ 4,424,680	$ -	$ -

The assets in the preceding tables were measured primarily using the market approach. The following is a description of the valuation methodologies used for assets measured at fair value.

Mutual funds are valued at the closing price reported in the active market in which the individual securities are traded.

6. Equipment and leasehold improvements:

	2019	2018
Equipment and software	$ 4,013,595	$ 3,663,109
Leasehold improvements	271,601	267,277
Work in progress	49,277	-
	4,334,473	3,930,386
Less accumulated depreciation and amortization	3,436,391	3,210,345
	$ 898,082	$ 720,041

7. Note payable, bank:

The Organization has a $500,000 revolving line of credit with JPMorgan Chase Bank with no specified maturity date. Monthly interest payments are due at the prime rate (5.5% and 5% at June 30, 2019 and 2018) plus 1.07%. The line is collateralized by substantially all assets of the Organization and subject to certain nonfinancial covenants. The Organization did not have an outstanding balance related to this line of credit at June 30, 2019 and 2018.

8. Advances from providers:

Children's Clinics has recorded advances received from ACH and Banner in the amounts of $400,000 and $205,000. The amounts, which are unsecured and noninterest bearing, were advanced from ACH and Banner due to delays in processing the Organization's claims. The Organization has agreed to repay amounts owed to Banner in monthly payments starting in October 2019 in the amount of $68,330 with a final payment of $68,340. The amounts due to ACH will be repaid at a date to be mutually agreed upon, and have been classified as current in the accompanying statements of financial position.

9. Commitments and contingencies:

Operating leases:

Children's Clinics leases a building from Square and Compass, a related party with representation on the Board. The terms of the lease provide for annual payments of $1 through 2040 for all areas of the building used by the Organization, an amount below fair market value. Monthly rent for other areas of the building is determined on an annual basis, at fair market value rates. Children's Clinics is also required to pay all taxes and assessments, utilities, insurance, and property and facility maintenance. Donated facility revenue and rent expense of $734,602 and $724,976 for 2019 and 2018 have been recognized at fair market value for the portion of the building used in connection with patient and supporting services.

9. Commitments and contingencies (continued):

Compliance with laws and regulations:

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse regulations. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that Children's Clinics is in compliance with fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

10. Related parties:

Total expenses and amounts payable with related parties were as follows:

	Expenses	Accounts payable
2019		
BUMC	$ 754,297	$ 66,488
TMC	327,757	26,785
Square and Compass, other than rent	24,779	1,437
2018		
BUMC	$ 765,745	$ 76,565
TMC	289,567	43,631
Square and Compass, other than rent	30,740	2,096

Children's Clinics received $64,890 and $67,420 in contributions for 2019 and 2018 from Square and Compass, a related party, primarily to offset fees for patients who cannot afford treatment.

11. Retirement plan:

Children's Clinics has a 401(k) defined contribution retirement plan (the Plan) covering all eligible employees. Eligible employees may make contributions to the Plan not to exceed statutory limits. Children's Clinics matches employee contributions to the Plan up to 4% of the employee's base salary. Also, Children's Clinics is required to make a contribution of 1% of compensation for employees who were employed as of December 31, 1996. Participants vest 100% immediately in employee contributions and ratably over a period of four years in employer contributions. In 2019 and 2018, Children's Clinics made contributions to the Plan of approximately $190,500 and $187,000.

12. Concentration of credit risk:

In 2019, three providers accounted for approximately 69% of total revenues while one provider accounted for approximately 74% of total revenues in 2018. Additionally, at June 30, 2019, approximately 48% of the Organization's accounts receivable was due from UHC, Banner and ACH.

Two providers accounted for approximately 71% of total hospital and physician expenses for professional care of patients for 2019 and 2018.

13. Pending pronouncements:

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contracts with Customers.” ASU 2014-09 applies to contracts with customers, excluding, most notably, insurance and leasing contracts. ASU 2014-09 prescribes a framework in accounting for revenues from contracts within its scope, including (a) identifying the contract, (b) identifying the performance obligations under the contract, (c) determining the transaction price, (d) allocating the transaction price to the identified performance obligations and (e) recognizing revenues as the identified performance obligations are satisfied. ASU 2014-09 also prescribes additional financial statement presentations and disclosures. ASU 2014-09 is effective for reporting periods beginning after December 15, 2018, with early adoption permitted.

In February 2016, the FASB issued ASU 2016-02 "Leases". ASU 2016-02 requires a lessee to recognize in the statements of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term, along with additional qualitative and quantitative disclosures. ASU 2016-02 is effective for reporting periods beginning after December 15, 2020, with early adoption permitted.

Management is currently evaluating the effect that these standards will have on the financial statements.