

SAN JOSE CLINIC

Financial Statements

December 31, 2007 and 2006
(With Independent Auditors' Report Thereon)

INDEPENDENT AUDITORS' REPORT

Board of Directors
San Jose Clinic:

We have audited the statements of financial position of San Jose Clinic (the Clinic) as of December 31, 2007 and 2006, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the Clinic'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Clinic's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 the Clinic as of December 31, 2007 and 2006, and 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.

Mir Fox, Rodriguez

July 7, 2008

SAN JOSE CLINIC

Statements of Financial Position December 31, 2007 and 2006

| <u>Assets</u> | <u>2007</u> | <u>2006</u> |
|---------------------------------------|---------------------|------------------|
| Cash and cash equivalents | \$ 509,096 | 577,106 |
| Investments | 195,347 | 180,445 |
| United Way pledge receivable | 737,761 | 720,827 |
| Pledges receivable, net | 1,230,246 | 1,162,171 |
| Other receivables | 2,458 | 458 |
| Prepaid expenses | 1,300 | 1,375 |
| Property and equipment, net | 225,005 | 229,302 |
| Cash held for long-term investment | 69,867 | 69,867 |
| Total assets | <u>\$ 2,971,080</u> | <u>2,941,551</u> |
| <u>Liabilities and Net Assets</u> | | |
| Liabilities: | | |
| Accounts payable | 117,228 | 94,026 |
| Accrued expenses | 114,355 | 60,494 |
| Deferred revenue | 100 | 4,000 |
| Total liabilities | <u>231,683</u> | <u>158,520</u> |
| Net assets: | | |
| Unrestricted: | | |
| Undesignated | 280,828 | 254,089 |
| Board designated | - | - |
| Temporarily restricted | 2,388,702 | 2,459,075 |
| Permanently restricted | 69,867 | 69,867 |
| Total net assets | <u>2,739,397</u> | <u>2,783,031</u> |
| Total liabilities and net assets | <u>\$ 2,971,080</u> | <u>2,941,551</u> |

See accompanying notes to financial statements.

SAN JOSE CLINIC

Statements of Activities and Changes in Net Assets
Years Ended December 31, 2007 and 2006

| | 2007 | | 2006 | | |
|---|--------------|------------------------|------------------------|------------------------|-----------|
| | Unrestricted | Temporarily Restricted | Temporarily Restricted | Permanently Restricted | Total |
| Public support and revenue: | | | | | |
| Contributions from United Way | \$ 1,090,570 | 737,766 | 734,804 | | 734,804 |
| Other public support | 1,380,925 | 772,689 | 1,635,824 | | 2,497,165 |
| Contributions in-kind | 37,687 | | 9,866 | | 1,499,283 |
| Investment income | 552,971 | | | | 29,221 |
| Program service fees | 2,529 | | | | 457,190 |
| Other income | 1,580,828 | (1,580,828) | (1,443,139) | | - |
| Net assets released from restrictions | 4,645,510 | (70,373) | 4,280,308 | | - |
| Total public support and revenue | | | | | 5,217,663 |
| Expenses: | | | | | |
| Program services - medical services to indigent persons | 3,952,714 | | 3,652,096 | | 3,652,096 |
| Support services: | | | | | |
| Management and general | 419,654 | | 445,707 | | 445,707 |
| Fund-raising | 246,403 | | 292,292 | | 292,292 |
| Total expenses | 4,618,771 | - | 4,390,095 | | 4,390,095 |
| Change in net assets | 26,739 | (70,373) | (109,787) | | 827,568 |
| Net assets, beginning of year | 254,089 | 2,459,075 | 363,876 | 69,867 | 1,955,463 |
| Net assets, end of year | \$ 280,828 | 2,388,702 | 254,089 | 69,867 | 2,783,031 |

See accompanying notes to financial statements.

SAN JOSE CLINIC

Statements of Functional Expenses
Years Ended December 31, 2007 and 2006

| | 2007 | | | 2006 | | | |
|---|---|------------------------------|----------------|---|------------------------------|----------------|------------------|
| | Medical Services to Indigent Persons | Management and General | Fund-raising | Medical Services to Indigent Persons | Management and General | Fund-raising | Total |
| Personnel costs: | | | | | | | |
| Salaries | \$ 1,161,696 | 277,306 | 128,249 | 1,079,756 | 250,646 | 117,208 | 1,447,610 |
| Employee benefits | 266,085 | 44,518 | 22,602 | 258,746 | 38,907 | 23,824 | 321,477 |
| Payroll taxes | 84,393 | 19,122 | 9,506 | 79,715 | 17,923 | 8,859 | 106,497 |
| Total personnel costs | <u>1,512,174</u> | <u>340,946</u> | <u>160,357</u> | <u>1,418,217</u> | <u>307,476</u> | <u>149,891</u> | <u>1,875,584</u> |
| Donated services | 328,304 | | 7,888 | 315,759 | 975 | 12,147 | 328,881 |
| Occupancy | 288,145 | 32,973 | 16,487 | 227,817 | 75,056 | 32,545 | 335,418 |
| Supplies | 1,075,229 | 1,633 | 4,075 | 1,137,019 | 4,728 | 11,986 | 1,153,733 |
| Professional medical fees | 527,196 | | 527,196 | 326,837 | | | 326,837 |
| Consulting and audit fees | 55,656 | 20,241 | 8,681 | 88,458 | 21,323 | 5,012 | 114,793 |
| Telephone | 21,126 | 2,485 | 1,242 | 14,999 | 4,285 | 2,233 | 21,517 |
| Liability insurance | 21,600 | | | 21,600 | | | 21,600 |
| Local transportation | 3,049 | 1,331 | 285 | 2,072 | 735 | 232 | 3,039 |
| Miscellaneous | 2,202 | 12,677 | 5,829 | 8,298 | 8,298 | 12,178 | 20,476 |
| Postage and shipping | 3,197 | 29 | 6,997 | 3,689 | | 3,922 | 7,611 |
| Conference and meetings | 18,430 | 7,274 | 8,997 | 3,955 | 16,393 | 29,552 | 49,900 |
| Equipment rental and maintenance | 7,653 | | 721 | 15,336 | 473 | 4,758 | 20,567 |
| Printing and publications | 618 | 65 | 20,993 | 186 | 5,870 | 25,970 | 32,026 |
| Assistance to individuals | <u>25,980</u> | | | <u>12,942</u> | | | <u>12,942</u> |
| Total expenses before depreciation and amortization | 3,890,559 | 419,654 | 242,552 | 3,588,886 | 445,612 | 290,426 | 4,324,924 |
| Depreciation and amortization | 62,155 | | 3,851 | 63,210 | 95 | 1,866 | 65,171 |
| Total expenses | <u>\$ 3,952,714</u> | <u>419,654</u> | <u>246,403</u> | <u>3,652,096</u> | <u>445,707</u> | <u>292,292</u> | <u>4,390,095</u> |

See accompanying notes to financial statements.

SAN JOSE CLINIC

Statements of Cash Flows Years Ended December 31, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|---|-------------------|------------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ (43,634) | 827,568 |
| Adjustments to reconcile change in net assets to net cash (used) provided by operating activities: | | |
| Depreciation and amortization | 66,006 | 65,171 |
| Unrealized gain on investments | (14,902) | (8,356) |
| Loss on sale of investment | | 35,850 |
| Changes in operating assets and liabilities: | | |
| United Way pledge receivable | (16,934) | (85,531) |
| Pledges receivable, net | (68,075) | (744,824) |
| Other receivables | (2,000) | |
| Prepaid expenses | 75 | (1,375) |
| Accounts payable | 23,202 | 16,278 |
| Accrued expenses | 53,861 | 22,408 |
| Deferred revenue | (3,900) | 4,000 |
| Net cash (used) provided by operating activities | <u>(6,301)</u> | <u>131,189</u> |
| Cash flows from investing activities - purchase of property and equipment | <u>(61,709)</u> | <u>(11,247)</u> |
| Cash flows from financing activities: | | |
| Proceeds from revolving promissory note | 100,000 | 100,000 |
| Payments on revolving promissory note | <u>(100,000)</u> | <u>(100,000)</u> |
| Net cash used by investing activities | <u>-</u> | <u>-</u> |
| Net (decrease) increase in cash and cash equivalents | (68,010) | 119,942 |
| Cash and cash equivalents, beginning of year | <u>577,106</u> | <u>457,164</u> |
| Cash and cash equivalents, end of year | <u>\$ 509,096</u> | <u>577,106</u> |
| Supplemental disclosures of cash flow information - cash paid during the year for interest | <u>\$ 5,537</u> | <u>8,527</u> |

See accompanying notes to financial statements.

SAN JOSE CLINIC

Notes to Financial Statements December 31, 2007 and 2006

1. Description of Organization

San Jose Clinic (the Clinic) is a nonprofit organization rendering medical aid and services to indigent persons, regardless of their ability to pay. The Clinic is an agency of the Archdiocese of Galveston-Houston (the Archdiocese). The Clinic is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code.

2. Summary of Significant Accounting Policies

Basis of accounting

The Clinic's financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Clinic's resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor imposed restrictions. Accordingly, net assets of the Clinic and changes therein are classified and reported as follows:

- Unrestricted - net assets that are not subjected to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors.
- Temporarily restricted - net assets whose use by the Clinic is subject to donor imposed stipulations that can be fulfilled by action of the Clinic pursuant to those stipulations or that expire by the passage of time. Temporarily restricted net assets are available for specific clinic operations and future clinic capital improvements.
- Permanently restricted - net assets subject to donor imposed stipulations that assets be maintained permanently by the Clinic. Generally the donor of these assets permits the Clinic to use all or part of the investment income on these assets. The investment income from permanently restricted net assets is available for operations.

Support that is restricted by the donor and is to be used in future periods or for a specific purpose is reported as an increase in temporarily restricted or permanently restricted net assets in the reporting period in which the support is recognized. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Temporarily restricted contributions, the restrictions of which are met in the year the contribution is received, are reported as unrestricted support. United Way contributions are recorded as temporarily restricted contributions until the year they are to be utilized for operations. Expenses are generally reported as decreases in unrestricted net assets.

Cash and cash equivalents

The Clinic considers all demand deposits, certificates of deposit, and highly liquid investments with maturity dates of less than three months at date of purchase, other than those held for long-term investment, to be cash equivalents.

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SAN JOSE CLINIC

Notes to Financial Statements, Continued

Investments

Investments in equity securities are considered available for sale and are recorded at fair value based upon quoted market prices. Income earned on investments is recorded as unrestricted income unless the donor specifies otherwise. At December 31, 2007 and 2006, investments consisted of \$170,347 and \$155,445 of variable annuities, respectively, and \$25,000 of equities.

At December 31, 2007 and 2006, cash held for long-term investment consisted of \$69,867 of government bonds.

Contribution and pledges receivable

Contributions are recorded as revenue in the year they are received unless they contain a conditional promise to give. Conditional promises to give are recorded as revenue when the conditions on which they depend are substantially met. Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Amounts that are expected to be collected in future years are discounted to estimate the present value of future cash flows if material. Amortization of the discount is included in contribution revenue.

Property and equipment

Property and equipment are recorded at cost if purchased or, if donated, at the approximate fair value at the date of donation. Fair values are determined by Clinic personnel familiar with the items donated. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years. The land and building used by the Clinic are owned by the Archdiocese.

Program service fees

Program service fees represent amounts charged to patients based on services provided and the patients' ability to pay.

Contributions in-kind

Contributed services are recognized as revenue if the services received create or enhance nonfinancial assets, require specialized skills provided by individuals possessing those skills, and typically need to be purchased if not provided by donation. Contributed services are recorded at the fair market value of the services provided. Contributed services that do not meet the above criteria are not recognized as revenues and are not reported in the accompanying financial statements.

Pharmaceutical inventory

The Clinic maintains supplies of drugs, which are distributed to patients free of charge. The drug inventory is of nominal value to the Clinic and is, therefore, charged to expense when purchased.

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SAN JOSE CLINIC

Notes to Financial Statements, Continued

Liability insurance

The Clinic is a participant of the CHRISTUS Health Group Property and Liability Insurance Trust (the Trust) for professional and comprehensive general liability insurance for any employee or volunteer of the Clinic. The Clinic would have contributed approximately \$21,600 per year for both 2007 and 2006 as a participant of the Trust; however, during 2007 and 2006, CHRISTUS Health waived the fee.

The Clinic also has insurance coverage for general liability, property and workman's compensation, through the Archdiocese at a cost of approximately \$24,000 for the years ended December 31, 2007 and 2006, respectively.

Functional allocation of expenses

The majority of expenses can generally be directly identified with the program or supporting services to which they relate and are charged accordingly. Other expenses have been allocated among the program and supporting services benefited based on square footage of office space occupied, salaries and other bases determined by the management of the Clinic.

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 in the Clinic's financial statements and accompanying notes. Actual results could differ from those estimates.

3. **Pledges Receivable**

Pledges receivable consist of the following at December 31:

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|------------------|
| Amounts to be collected in one year: | | |
| United Way receivable | \$ 737,761 | 720,827 |
| Other pledges receivable | 560,226 | 472,169 |
| Amounts to be collected in one to five years | 695,504 | 750,675 |
| Less: discount on pledges receivable | <u>(25,484)</u> | <u>(60,673)</u> |
| | <u>\$ 1,968,007</u> | <u>1,882,998</u> |

4. **Property and Equipment**

Property and equipment consisted of the following at December 31:

| | <u>2007</u> | <u>2006</u> |
|--|-------------------|------------------|
| Furniture, fixtures and equipment | \$ 381,652 | 350,515 |
| Leasehold improvements | 576,459 | 545,887 |
| Less accumulated depreciation and amortization | <u>(733,106)</u> | <u>(667,100)</u> |
| Property and equipment, net | <u>\$ 225,005</u> | <u>229,302</u> |

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SAN JOSE CLINIC

Notes to Financial Statements, Continued

5. **Compensated Absences**

Employees earn annual vacation leave monthly. Accrued vacation hours are payable upon termination. The Clinic had accrued approximately \$114,000 and \$60,000 at December 31, 2007 and 2006, related to accumulated earned vacation.

6. **Contributions In-Kind**

The Hamilton Street land and building occupied by the Clinic is owned by the Archdiocese. The estimated fair rental value of \$210,000 has been recorded as contributions in-kind and as occupancy expense for the years ended December 31, 2007 and 2006.

The Clinic receives donations of vaccines, medication and other clinical supplies. These items are valued at the estimated fair value as determined by Clinic personnel familiar with the items donated. For the years ended December 31, 2007 and 2006, the Clinic received donations of these supplies amounting to \$813,132 and \$939,021, respectively.

The Clinic also receives contributed services, which are donations of physician's services and other volunteer services requiring specialized skills. Contributed services of, \$336,192 and \$328,881 were recorded in 2007 and 2006, respectively.

7. **Related Party Transactions**

Support recognized from the Archdiocese in the form of cash contributions were \$184,664 and \$170,202 to the Clinic in 2007 and 2006, respectively, and are included in other public support.

8. **Trusts**

In September 1991 an unaffiliated entity entered into a trust agreement, which named San Jose Clinic as the sole beneficiary. The purpose of the trust is to support the Clinic in the form of annual disbursements to the Clinic's Pediatric Program. The Trustee may distribute net income of the trust to the Clinic at such times and in such amounts as the Trustee in its sole discretion may determine; provided, however, that such distributions be consistent with the Grantor's and Trustee's intent that the trust accumulate sufficient principal to allow annual payments of net income to the trust to be made to the Clinic in amounts of no less than \$50,000 per year. The Clinic may use payments from the trust solely for the support of its Pediatric Program. On April 26, 2006, the Clinic and the Trustee agreed to terminate the trust. The Clinic and Trustee entered into an agreement on that date whereby the Clinic will receive \$625,844, the entire corpus of the trust, over a five year period.

9. **Note Payable**

The Clinic has a revolving promissory note with a bank bearing interest at prime rate payable monthly. The note provides for a maximum borrowing of \$100,000. The note expires April 29, 2010 and is guaranteed by the Archdiocese. There was no outstanding balance due on the note at December 31, 2007 or 2006.

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SAN JOSE CLINIC

Notes to Financial Statements, Continued

10. Restrictions on Net Assets

Temporarily restricted net assets are available for the following purposes:

| | <u>2007</u> | <u>2006</u> |
|---|---------------------|------------------|
| Purpose restrictions: | | |
| Maternity fund | \$ 16,890 | 16,890 |
| Capital Campaign | 120,617 | 211,824 |
| Dental program | 429,535 | 574,335 |
| Back to school | 1,369 | 6,789 |
| Time restrictions: | | |
| United Way | 737,766 | 720,827 |
| Other | <u>1,082,525</u> | <u>928,410</u> |
| Total temporarily restricted net assets | <u>\$ 2,388,702</u> | <u>2,459,075</u> |

11. Net Assets Released From Restrictions

During the years ended December 31, 2006 and 2005, temporarily restricted net assets of \$1,580,828 and \$1,443,139, respectively, were released from donor restrictions by satisfying donor restrictions.

12. Pension and Thrift Plans

The Clinic participates in a multi-employer noncontributory defined benefit pension plan (the Plan) sponsored by United Way, which is administered by a pension plan committee. For the years ended December 31, 2007 and 2006, the Clinic contributed \$38,400.

The Plan was amended effective July 1, 2004 to allow each employer to elect a percentage between 0% and 10% of total compensation credited to all participants of such employer, and all participating employers, including United Way, have elected 0% as the pay-based credit rate on behalf of their participants beginning July 1, 2004. All participants will continue to receive interest credits on their existing accounts. The amendment further specifies that participants in the Plan as of June 30, 2004 shall be deemed to be 100% vested in their account balances regardless of whether or not they have completed at least five years of vesting service. As of July 1, 2004, the Plan was closed to new entrants, and no employee will be eligible to become a participant in the Plan. If United Way decides to terminate participation in the Plan, the Clinic would be required to fully fund their allocable share of any unfunded liability. The Clinic's estimated expense under the amended Plan is \$3,200 per month through 2009.

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SAN JOSE CLINIC

Notes to Financial Statements, Continued

On June 4, 2002, the Clinic, by board resolution, changed service providers and adopted a 401(k) Plan effective July 11, 2002. The 401(k) Plan shortens the eligibility period to three months of service with monthly entry dates. Employees may defer up to 50% of total compensation on a pre-tax basis not to exceed the maximum amount permitted by law. The 401(k) Plan provides for a matching and fixed contribution component. The Clinic matches 100% of the first 6% of compensation contributed by participating employees and contributes 2% of compensation for eligible participants. Employer contributions are subject to a four-year graduating vesting schedule, whereas employees are 100% vested in their deferred compensation. The 401(k) Plan contributions expensed by the Clinic for the years ended December 31, 2007 and 2006 were \$89,140 and \$74,483, respectively.

13. Commitments

The Clinic leases certain office space for the Spring Branch satellite clinic and office equipment under operating leases expiring in various years through 2011. During the years ended December 31, 2007 and 2006, lease expense amounted to approximately \$60,000 and \$70,000, per annum respectively. Future minimum lease commitments are as follows:

| <u>Year Ending</u> <u>December 31,</u> | |
|---|-------------------|
| 2008 | \$ 61,534 |
| 2009 | 61,534 |
| 2010 | 61,024 |
| 2011 | <u>56,920</u> |
| | \$ <u>241,012</u> |