GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL

DISTRICT OF COLUMBIA

NOT-FOR-PROFIT
HOSPITAL CORPORATION
UNITED MEDICAL CENTER

Financial Statements
(With Independent Auditors' Report Thereon)
Fiscal Years Ended September 30, 2012, and 2011

CHARLES J. WILLOUGHBY
INSPECTOR GENERAL

OIG No. 13-1-08HW **February 22, 2013**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General

February 22, 2013

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Gray and Chairman Mendelson:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2012, KPMG LLP (KPMG) submitted the enclosed final report on the Not-for-Profit Hospital Corporation's United Medical Center (Medical Center) financial performance for the years ended September 30, 2012, and 2011 (OIG 13-1-08HW).

KPMG opined that the financial statements present fairly, in all material respects, the financial position of the Medical Center as of September 30, 2012, and 2011, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

If you have questions or need additional information, please contact Ronald W. King, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

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NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Financial Statements

September 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

The Board of Directors
Not-for-Profit Hospital Corporation:

We have audited the accompanying balance sheets of the Not-For-Profit Hospital Corporation, commonly known as United Medical Center (the Medical Center), a component unit of the District of Columbia, as of September 30, 2012 and 2011 and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years ended September 30, 2012 and 2011. These financial statements are the responsibility of the Medical Center'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 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 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 Medical Center'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 audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of September 30, 2012 and 2011, and the results of its operations and its cash flows for the years ended September 30, 2012 and 2011, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2013, on our consideration of the Medical Center's internal control and on 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 audit.

U.S. generally accepted accounting principles require that Management's Discussion and Analysis on pages 3 – 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

February 1, 2013

The following is a discussion and analysis of Not-for-Profit Hospital Corporation's, commonly known as United Medical Center (the Medical Center), financial performance for the years ended September 30, 2012 and September 30, 2011. We encourage readers to consider the information presented here in conjunction with additional information furnished in our financial statements, including the notes that follow the basic financial statements, which begin on page 10. All amounts are reported in whole dollars unless otherwise stated.

Overview of the Financial Statements

Management's discussion and analysis (MD&A) is intended to serve as an introduction to the Medical Center's basic financial statements. The Medical Center's financial statements consist of three statements: a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets, and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for specific purposes by contributors, grantors, or enabling legislation.

1. ***Balance Sheet*** – The Balance Sheet is designed to present information on all of the Medical Center's assets and liabilities, with the difference between the two reported as net assets. The Balance Sheet also provides the basis for evaluating the capital structure of the Medical Center and assessing its liquidity and financial flexibility. Over time, an increase or decrease in the Medical Center's net assets is one indicator of whether its financial health is improving or deteriorating. It is recommended one considers additional nonfinancial factors, such as changes in the Medical Center's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Medical Center.

2. ***Statement of Revenues, Expenses, and Changes in Net Assets*** – The Statement of Revenues, Expenses and Changes in Net Assets presents changes to the Medical Center's net assets during the most recent period. This statement measures the success of the Medical Centers operations over the years ending September 30, 2012 and 2011, and can be used to determine whether the Medical Center successfully recovered all of its costs through patient fees and other charges to assess profitability and credit worthiness. Activities are reported as either operating or non-operating. Operating revenues are generally earned by providing goods or services to various customers, patients and related parties. Operating expenses were incurred to acquire or procure the goods and services to carry out the Medical Center's mission. Non-operating revenues and expenses result from activities other than providing goods and services related to patient care. All changes in net assets were reported as soon as the underlying event giving rise to the change occurred, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows only in future fiscal periods (e.g., uncollected patient receivables and earned but unused vacation leave). The utilization of capital assets is reflected in the Statement of Revenues, Expenses and Changes in Net Assets as depreciation and amortization expense which amortizes the cost of a long-lived asset over its expected useful life.

3. ***Statement of Cash Flows*** – The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing and capital and related financing activities. The Statement describes the sources of cash, for what the cash was

used, and the change in cash balance during the reporting period. This statement aids in the assessment of the Medical Center's ability to generate future net cash flows and to meet obligations and commitments as they come due. The primary source of operating cash flows was clinical service revenues received from patients and their public and private insurance providers. Uses of these cash sources include payments as wages and fringe benefits to employees and payments to suppliers and contractors for goods and services procured by the Medical Center.

4. ***Notes to the Financial Statements*** – The Notes to the Financial Statements provide additional information that is essential for a complete understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 15-27 of this report.

Financial Highlights

- On July 9, 2010, the District acquired United Medical Center after foreclosing on the Capital Medical Center's assets for non-payment of loans owed to the District. The District established the Not-for-Profit Hospital Corporation as a separate legal entity of the District government to receive the assets of the Medical Center (including land, buildings, equipment, furnishings and accounts) and operate the Medical Center until such time that a buyer is identified. Upon the purchase of the Medical Center, the District also assumed certain limited liabilities previously incurred by the hospital. The District simultaneously contributed the foreclosed assets and assumed liabilities to the Not-for-Profit Hospital Corporation. The fair market value of identifiable net assets acquired and transferred by the District to the Not-for-Profit Hospital Corporation was $48,128,251. For further discussion see Note 1(a) in the notes to the basic financial statements.
- The Medical Center's total assets exceed its liabilities at September 30, 2012 and 2011, by $51,690,090 and $52,012,508, respectively.
- The Medical Center's excess of revenues (under) over expenses was ($322,418) and $2,491,992 for the years ending September 30, 2012 and 2011, respectively.
- The Medical Center's total liabilities decreased from $26,071,345 to $25,101,473 during fiscal year 2012.
- The Medical Center's net working capital (current assets minus current liabilities) excluding the amount due to the District of Columbia increased from a negative $2,983,581 to a positive $1,453,476 during fiscal year 2012.
- In fiscal year 2012, the District of Columbia Department of Healthcare Finance changed its methodology for calculating the Disproportionate Share Hospital (DSH) funds paid to hospitals. As a result, the Medical Center received $7.9 million in fiscal year 2012 as compared to $14.9 million in fiscal year 2011, a reduction of $7 million. Of the $7.9 million received, the Medical Center had a current obligation due back to the District of Columbia Department of Healthcare Finance of $699K as of September 30, 2012.
- The Medical Center recorded a $3 million third party settlement reserve due to DC Medicaid in fiscal year 2012. This reserve is based on an estimated overpayment of DSH funds that were received in fiscal year 2011 that is estimated to exceed its OBRA limit of $11.9 million that may be due to DC Medicaid in fiscal year 2014.

- The Medical Center recorded a total $13.7 million subsidy from the District in fiscal year 2012 and recognized it as nonoperating revenue in fiscal year 2012. Of this amount, $7.7 million of the subsidy was received as cash and $6 million was received as an intra-agency allocation.

Financial Analysis of the Medical Center as a Whole

The balance sheet provides the perspective of the Medical Center as a whole. The table below provides a summary of the Medical Center's total assets, liabilities, and net assets as of September 30, 2012 and 2011:

Condensed Balance Sheets

		2012	2011
Assets:			
Current assets	$	19,000,488	15,771,147
Noncurrent assets:			
Capital assets		57,185,324	61,624,058
Other assets		605,751	688,648
Total noncurrent assets		57,791,075	62,312,706
Total assets		76,791,563	78,083,853
Liabilities:			
Current liabilities		17,547,012	24,754,728
Noncurrent liabilities		7,554,461	1,316,617
Total liabilities		25,101,473	26,071,345
Net assets:			
Invested in capital assets, net of related debt		56,229,031	60,825,437
Unrestricted		(4,538,941)	(8,812,929)
Total Net Assets	$	51,690,090	52,012,508

Over time, net assets can serve as a useful indicator of an organizations financial position. At September 30, 2012 and 2011, the Medical Center's assets exceeded liabilities by $51.7 million and $52 million, respectively.

Capital assets reported on the financial statements represent the largest portion of the Medical Center's assets. At September 30, 2012 and 2011, capital assets represent 74.5% and 78.9% of total assets, respectively. Capital assets include land, land improvements, buildings, equipment, software, equipment under capital lease obligations and construction in progress. The Medical Center uses these capital assets to provide medical care to citizens of the District of Columbia Wards 7 and 8 and the adjoining Prince Georges County, Maryland. Consequently, these assets are not available for future spending.

The next largest portion of the Medical Center's assets is current assets. At September 30, 2012 and 2011, current assets represented 24.7% and 20.2%, respectively, of total assets and include cash resources that are subject to restriction on their use.

The Medical Center's net assets decreased by $322 thousand and increased by $2.5 million during the years ending September 30, 2012 and 2011. The following table reflects the change in nets assets for the years ended September 30, 2012 and 2011:

Change in Net Assets

Balance at September 30, 2010	$	49,520,516
Excess of revenues over expenses		2,491,992
Increase in net assets		2,491,992
Balance at September 30, 2011		52,012,508
Excess of revenues under expenses		(322,418)
Decrease in net assets		(322,418)
Balance at September 30, 2012	$	51,690,090

The change in net assets, since September 30, 2010, resulted from excess revenues generated from operating and non-operating activities in fiscal year 2011 and reduction of DSH payments, increases in operating expenses, a $7.7 million subsidy from the District of Columbia and a $6.0 million intra-agency allocation in fiscal year 2012.

(Continued)

The following schedule presents condensed financial information from the Statement of Revenues, Expenses and Changes in Net Assets for the years ended September 30, 2012 and 2011:

Condensed Schedule of Revenues, Expenses and Changes in Net assets

		2012	2011
Revenues:			
Operating revenues:			
Net patient service revenue	$	86,274,338	77,801,723
Disproportionate share revenues, net		4,197,391	14,894,510
Grant revenues		350,542	—
Other operating revenues		2,915,906	3,020,350
Total operating revenues		93,738,177	95,716,583
Nonoperating revenues (expenses):			
Investment income (expense), net		(295,229)	(273,603)
Subsidy from District of Columbia		7,700,000	—
Intra-agency Allocation		6,000,000	—
Other, net		135,157	1,920,847
Total nonoperating revenues		13,539,928	1,647,244
Total revenues		107,278,105	97,363,827
Expenses:			
Operating expenses:			
Salaries and benefits		65,352,935	60,991,399
Supplies		11,034,470	8,410,183
Depreciation and amortization		5,756,099	5,686,419
Other expense		25,457,019	19,783,834
Total operating expenses		107,600,523	94,871,835
Excess of revenues over (under) expenses		(322,418)	2,491,992
Net assets, beginning of period		52,012,508	49,520,516
Net assets, end of period	$	51,690,090	52,012,508

The Medical Center's total revenues were $107,278,105 and $97,363,827 for the years ended September 30, 2012 and 2011. Revenues from patient care services represent 80.4% and 80.0% of total revenues, respectively. The Medical Center receives approximately 83% of its clinical service revenue from public payers (primarily Medicare and Medicaid) and the remainder from private payers, including self-pay patients.

The total cost of all programs and services was $107,600,523 and $94,871,835 for the years ended September 30, 2012 and 2011. The Medical Center's net assets decreased $322 thousand or 0.6% during fiscal year 2012 and increased $2.5 million or 5% during fiscal year 2011.

(Continued)

Capital and Debt Administration

Capital Assets – The Medical Center's capital assets as of September 30, 2012 and 2011 amount to $57,185,324 and $61,624,058 (net of accumulated depreciation and amortization), respectively. This investment in capital assets includes land, land improvements, buildings, equipment, software, equipment under capital lease obligations and construction in progress. The following table summarizes the Medical Center's capital assets net of accumulated depreciation and amortization at September 30, 2012 and 2011, respectively:

		2012	2011
Asset category:			
Land	$	8,100,000	8,100,000
Land improvements		525,245	690,357
Buildings		37,432,436	39,932,199
Equipment		10,306,015	11,568,199
Equipment under capital lease obligations		695,905	671,131
Software		125,723	230,262
Construction in progress		—	431,910
Capital assets, net	$	57,185,324	61,624,058

See notes 1 and 3 to the basic financial statements for additional disclosure on capital assets.

Long-Term Debt – At September 30, 2012 and 2011, the Medical Center had total long-term debt outstanding of $7.6 million and $1.3 million, respectively. The following table summarizes the Medical Center's long-term debt which is presented in more detail in Note 4 of the basic financial statements:

		2012	2011
Outstanding debt:			
Capital lease obligations		274,216	289,053
Estimated third party settlements		3,643,162	—
Other liabilities		3,637,083	1,027,564
Total noncurrent liabilities	$	7,554,461	1,316,617

Economic Factors

The Patient Protection and Affordable Care Act of 2010 will continue to have a profound economic impact on the nation's healthcare system and on the Medical Center in particular. Among the numerous provisions of the Act, those with the greatest effect on the Medical Center and that will be fully implemented in 2014 include the Medicaid population expansion and the so-called individual mandate, both of which should enlarge the Medical Center's insured population and concomitantly shrink its uninsured population; and the decrease of Medicare and Medicaid DSH payments. Other legislation that may impact the Medical Center include requirements related to the "meaningful use" of electronic health records; Medicare prospective payment system rate changes; and the increasingly aggressive Medicare and Medicaid programs use of Recovery Audit Collectors (RAC) to recover allege improper payments.

Requests for Information

This financial report is designed to provide a general overview of the Medical Centers financial activities and to demonstrate the Medical Center's accountability for the funds it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

The Office of the Chief Financial Officer
Not-for-Profit Hospital Corporation
United Medical Center
1310 Southern Avenue, S.E.
Washington, D.C., 20032
(202) 574-6611

NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Balance Sheets

September 30, 2012 and 2011

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents (includes restricted cash of $1,704,057 and $901,864 as of September 30, 2012 and 2011, respectively)	$	3,338,922	1,527,544
Accounts receivable, net of allowances for estimated uncollectibles of $7,827,579 and $6,528,887 as of September 30, 2012 and 2011, respectively (note 2)		13,424,809	11,877,160
Inventories		1,519,770	1,308,121
Prepaid expenses and other assets		716,987	1,058,322
Total current assets		19,000,488	15,771,147
Capital assets, net (note 3)		57,185,324	61,624,058
Estimated third-party payor settlements (note 5)		448,164	475,861
Other noncurrent assets, net		157,587	212,787
Total assets	$	76,791,563	78,083,853
Liabilities and Net Assets			
Current liabilities:			
Accounts payable (note 2)	$	9,487,912	12,364,425
Accrued salaries and benefits		5,668,013	5,059,995
Due to District of Columbia (note 9)		—	6,000,000
Current portion of note payable		—	54,598
Current portion of obligations under capital leases		682,077	509,568
Estimated third-party payor settlements (note 5)		698,552	51,158
Other liabilities		1,010,458	714,984
Total current liabilities		17,547,012	24,754,728
Obligations under capital leases, net of current portion (note 4)		274,216	289,053
Estimated third-party payor settlements, net of current portion (note 5)		3,643,162	—
Other long-term liabilities (note 4)		3,637,083	1,027,564
Total liabilities		25,101,473	26,071,345
Net assets:			
Invested in capital assets, net of related debt		56,229,031	60,825,437
Unrestricted		(4,538,941)	(8,812,929)
Total net assets		51,690,090	52,012,508
Total liabilities and net assets	$	76,791,563	78,083,853

See accompanying notes to financial statements.

NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Statement of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2012 and 2011

		2012	2011
Operating revenues:			
Net patient service revenue (net of provision for bad debts of $10,443,791 and $17,483,448 in 2012 and 2011, respectively)	$	86,274,338	77,801,723
Disproportionate share revenues, net (note 10)		4,197,391	14,894,510
Grant revenues		350,542	—
Other operating revenues		2,915,906	3,020,350
Total operating revenues		93,738,177	95,716,583
Operating expenses:			
Salaries and wages		52,986,292	50,048,786
Employee benefits		12,366,643	10,942,613
Contract labor		3,729,450	2,129,983
Supplies		11,034,470	8,410,183
Professional fees		4,655,210	4,518,724
Purchased services		7,123,798	5,561,593
Depreciation and amortization		5,756,099	5,686,419
Utilities		2,304,755	2,468,517
Insurance		4,766,875	3,013,073
Rent and leases		650,749	729,950
Repairs and maintenance		720,446	595,049
Other expense		1,505,736	766,945
Total operating expenses		107,600,523	94,871,835
Operating income (loss)		(13,862,346)	844,748
Nonoperating revenues (expenses):			
Investment income (expense), net		(295,229)	(273,603)
Subsidy from District of Columbia (note 10)		7,700,000	—
Intra-agency Allocation (note 10)		6,000,000	—
Other, net		135,157	1,920,847
Total nonoperating revenues		13,539,928	1,647,244
Excess of revenues over (under) expenses		(322,418)	2,491,992
Net assets, beginning of period		52,012,508	49,520,516
Net assets, end of period	$	51,690,090	52,012,508

See accompanying notes to financial statements.

NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Statement of Changes in Net Assets

Years ended September 30, 2012 and 2011

Balance at September 30, 2010	$ 49,520,516
Excess of revenues over expenses	2,491,992
Increase in net assets	2,491,992
Balance at September 30, 2011	52,012,508
Deficit of revenues under expenses	(322,418)
Decrease in net assets	(322,418)
Balance at September 30, 2012	$ 51,690,090

See accompanying notes to financial statements.

NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Statement of Cash Flows

Years ended September 30, 2012 and 2011

		2012	2011
Cash flows from operating activities:			
Receipts from and on behalf of patients	$	89,044,932	76,357,866
Payments to employees and fringe benefits		(64,744,914)	(64,666,933)
Payments to suppliers and contractors		(36,217,199)	(30,898,300)
Other receipts and payments, net		7,463,839	18,666,867
Net cash used in operating activities		(4,453,342)	(540,500)
Cash flows from investing activities:			
Payments of interest and dividends		(160,072)	(273,603)
Net cash used in investing activities		(160,072)	(273,603)
Cash flows from noncapital financing activities:			
Repayment of notes payable		(54,598)	(495,845)
Proceeds from (payments to) District of Columbia		7,700,000	(20,000,000)
Net cash provided by (used in) noncapital financing activities		7,645,402	(20,495,845)
Cash flows from capital and related financing activities:			
Repayment of capital lease obligations		(186,269)	(565,700)
Capital grants and contributions		—	1,920,846
Purchase of property, plant, and equipment		(1,034,341)	(5,833,421)
Net cash used in capital and related financing activities		(1,220,610)	(4,478,275)
Net increase (decrease) in cash and cash equivalents		1,811,378	(25,788,223)
Cash and cash equivalents, beginning of period		1,527,544	27,315,767
Cash and cash equivalents, end of period	$	3,338,922	1,527,544

(Continued)

NOT-FOR-PROFIT HOSPITAL CORPORATION
UNITED MEDICAL CENTER
(A Component Unit of the District of Columbia)

Statement of Cash Flows

Years ended September 30, 2012 and 2011

		2012	2011
Reconciliation of operating income to net cash (used in) operating activities:			
Operating income (loss)	$	(13,862,346)	844,748
Adjustments to reconcile operating income to net cash (used in) operating activities:			
Depreciation and amortization		5,756,099	5,686,419
Provision for bad debts		10,443,791	17,483,448
Changes in assets and liabilities:			
Increase in patient receivables		(11,991,441)	(18,927,305)
Decrease in grant receivable		—	187,370
Increase in inventories		(211,649)	(329,289)
Decrease (increase) in prepaid expenses and other assets		341,335	(669,959)
Decrease in due from Specialty Hospital of Washington		—	752,008
Decrease (increase) in third-party payor settlements		4,318,253	(412,338)
Decrease in accounts payable		(2,760,396)	(822,710)
Increase (decrease) in accrued salaries and benefits		608,018	(3,675,534)
Increase (decrease) in other liabilities		2,904,994	(657,358)
Net cash used in operating activities	$	(4,453,342)	(540,500)

Noncash Investing, Capital, and Financing Activities

The Medical Center entered into capital lease obligations of $343,941 for new equipment in fiscal year 2012

The outstanding operating advances of $6 million from the District was reclassed as an intra-agency allocation in fiscal year 2012.

See accompanying notes to financial statements.

(1) Description of Reporting Entity and Summary of Significant Accounting Policies

(a) Reporting Entity

The Not-For-Profit Hospital Corporation, commonly known as United Medical Center (the Medical Center) is a 354-bed facility that serves as the primary community health care provider to the Southeast area of the District of Columbia (the District). The Medical Center provides inpatient, outpatient, psychiatric, skilled nursing and emergency care services for residents of the District.

On July 9, 2010, the District acquired the land, buildings, equipment, furnishings and accounts of the Medical Center pursuant to a foreclosure auction. The consideration given by the District was in the form of forgiveness of a portion of the outstanding working capital and acquisition loans owed to the District.

Upon the acquisition of the Medical Center, the Not-For-Profit Hospital Corporation (the Hospital Corporation) was created as an independent instrumentality of the District government. The primary purposes of the Hospital Corporation are to receive the land, improvements on the land, equipment, and other assets of the Medical Center, to operate and take all actions necessary to ensure the continued operations of the hospital; and to sell or otherwise transfer all or part of the hospital and site, when a buyer is identified.

The fair value of the assets acquired and liabilities assumed by the District upon foreclosure, were as follows:

Assets:		
Cash	$	534,773
Accounts receivable		11,444,245
Inventories		883,836
Due from Specialty		2,197,523
Capital assets		61,783,424
Other assets		1,134,929
Liabilities		(29,850,479)
Identifiable net assets acquired	$	48,128,251

Simultaneous to the foreclosure, the District made a capital contribution of these assets to the newly established Hospital Corporation. The Medical Center depends on financial resources flowing from, or associated with, the District of Columbia, a related entity. Funds flowing from the District of Columbia to the Medical Center are subject to changes to the District's laws and appropriations.

On October 1, 2010, the Medical Center assumed ownership and control over United Medical Nursing Center (UMNC), a 120-bed skilled nursing facility, from its previous owner Specialty Hospitals of Washington. As a distinct part of the hospital, the skilled nursing facility provides short or long-term residential care, 24 hours a day. Residents receive a full range of services from a team

(Continued)

of skilled healthcare professionals. Net revenues from resident services and operating expense of the skilled nursing facility are included in the financial statements of the Medical Center.

Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments (Statement 34), established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of activities and changes in net assets and a statement of cash flows. It requires the classification of net assets into three components: invested in capital assets, net of related debt; restricted; and unrestricted net assets. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
- *Restricted net assets* – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. Restricted net assets are either expendable or nonexpendable. Nonexpendable net assets are those that are required to be retained in perpetuity.
- *Unrestricted net assets* – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The accounting policies and practices of the Medical Center conform to U.S. generally accepted accounting principles applicable to an enterprise fund of a government medical center. The financial statement presentation and significant accounting policies adopted by the Medical Center conform to general practice within the healthcare industry, as published by the American Institute of Certified Public Accountants in its audit and accounting guide, *Health Care Entities.*

(b) Enterprise Fund Accounting

The Medical Center uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. As permitted by GASB Statement No. 20, as amended, the Medical Center has elected to follow only those Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) issued prior to December 1, 1989.

(c) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles (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 reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

(d) Cash and Cash Equivalents

The Medical Center considers all highly-liquid, temporary investments with original maturities of three months or less to be cash equivalents for purpose of the statement of Cash Flows. Cash and cash equivalents include amounts invested in accounts with depository institutions which are readily converted to cash. Total deposits maintained at these institutions at times exceed the amount insured by federal agencies and therefore, bear a risk of loss. The Medical Center has not experienced such losses on these funds.

(e) Restricted Cash

Restricted cash consists of funds made available by the District through its approved budget for funding the near-term operations of the Medical Center.

(f) Inventories

Inventories, which primarily consist of medical supplies and pharmaceuticals, are valued at the lower of cost or market with cost determined mainly on the first-in, first-out basis.

(g) Revenue Recognition

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Under the terms of various agreements, regulations, and statues, certain elements of third-party reimbursement are subject to negotiation, audit, and/or final determination by the third-party payors. As a result, there is at least a possibility that recorded estimates could change in the near term. Variances between preliminary estimates of net patient service revenue and final third party settlements are included in net patient service revenue in the year in which the settlement or change in estimate occurs.

Patient accounts receivable are recorded net of estimated contractual allowances and amounts estimated to be uncollectible. The total estimated allowance for contractual and doubtful accounts at September 30, 2012 and 2011 was $36,330,933 and $31,419,850, respectively.

In addition to patient accounts receivable, the Medical Center received a $13.7 million subsidy from the District and recognized it as nonoperating revenue in fiscal year 2012. Of this amount, $7.7 million was received in cash and $6 million was received as an intra-agency allocation.

(h) Disproportionate Share Revenues

Disproportionate Share Revenue (DSH) is funding received by the Medical Center for the treatment of indigent patients. DSH revenue is recognized as operating revenue in the year to which it applied. The Medical Center is dependent on DSH revenues to fund a portion of its operating expenses. In June 2012, the Department of Healthcare Finance changed its methodology for calculating the DSH funds paid to Hospitals. As a result, approximately $7.9 million was received in fiscal year 2012 as compared to approximately $14.9 million in fiscal year 2011, a reduction of $7 million. The Medical Center recognized $4.2 million and $14.9 million, net, in Medicaid DSH revenues for the years ended September 30, 2012 and 2011, respectively. The current year gross amount of $7.9 million received was reduced by a $3.7 million third party settlement reserve recorded by the Medical Center as of September 30, 2012 related to potential payback exposure to DC Medicaid. The Medical Center expects that DSH revenue will continue; however there is no assurance that the revenue will not be reduced, restricted or eliminated in the future.

(i) Fair Market Value of Financial Instruments

The carrying amounts of the Medical Center’s financial instruments, as reported in the accompanying balance sheets, approximate their fair market value.

(j) Capital Assets

Land, land improvements, buildings and improvements, equipment, equipment under capital lease obligations, software, and construction in progress are stated at cost at the date of acquisition, estimated historical cost (if actual cost records are not available) or fair market value at the date of inception. When assets are sold or otherwise disposed of, the asset and related accumulated depreciation are removed from the accounts, and any remaining gain or loss is included in operations. Repairs and maintenance are charged to expense when incurred. Capital assets are depreciated or amortized using the straight line method over the estimated useful lives of the assets.

The half-year depreciation convention is applied during the year in which the assets are acquired or disposed. All capital assets other than land are depreciated or amortized (in the case of capital leases) utilizing the straight-line method of depreciation over the following estimated useful lives of the assets:

Land improvements	5–25 years
Buildings and improvements	10–40 years
Building fixtures	5–20 years
Equipment	3–15 years
Computers	5 years
Software	3–10 years

(k) Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

(l) Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge and does not pursue collection of amounts determined to qualify as charity care. These amounts are not reported as revenue. The Medical Center maintains records to identify and monitor the level of charity care provided. The criteria for charity service consider family income, net worth and other eligibility criteria at time of application. The amount of charges forgone for services and supplies furnished under the Medical Center's charity care policy were approximately $8.2 million and $3.9 million, respectively, for the years ending September 30, 2012 and 2011.

(m) Net Assets

Unrestricted net assets are those whose use by the Medical Center is not subject to donor-imposed stipulations. Temporarily restricted net assets are those whose use by the Medical Center is subject to donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Medical Center pursuant to those stipulations. Permanently restricted net assets are those whose use by the Medical Center is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Medical Center. Income from these assets can be unrestricted or restricted based on donor stipulations. Currently, the Medical Center does not have any temporarily restricted or permanently restricted net assets.

(n) Operating Revenues and Expenses

The Medical Center's statement of revenues, expenses and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Medical Center's principal activity. Non-exchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues. Operating expenses are all incurred to provide health care services, other than financing costs.

(o) Risk Management

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage.

(p) Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment agreements with major third-party payors is as follows:

Medicare

Payments to the Medical Center from Medicare for inpatient acute services are made on a prospective basis. Under this program, payments are made at a predetermined specified rate for each discharge, based on a patient's diagnosis, weighted by an acuity factor. The Medical Center is paid a disproportionate share adjustment for servicing certain low income patients. Outpatient services are paid at prospectively determined rates per procedure under a methodology which utilizes ambulatory payment classifications (APCs). Similar to the inpatient rates, outpatient rates vary according to the procedures performed. Other outpatient services are based on fee schedules. Sub-acute services are reimbursed on a prospective rate, based on a patient's level of acuity. Additional payments are made to the Medical Center for the cost of cases that have an unusually high cost in comparison to national averages. The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. In addition, the Medical Center receives payments for residents in the Skilled Nursing Facility who are covered by Medicare. The Medicare program pays the Skilled Nursing Facility per diem rates, which cover all routine services, ancillary services, and capital-related costs for a resident's Part A stay. The program pays different rates for residents according to case-mix adjustments, which are based on residents' Resource Utilization Groups, or RUGs, score.

Medicaid

The Medical Center is paid by Medicaid based on diagnosis related groupings at a predetermined specified rate for each discharge, subject to a weight or acuity factor, based on a patient's diagnosis. Outpatient services are reimbursed based on a fixed-rate per visit basis determined by Medicaid. The Medical Center is also paid a disproportionate share adjustment for servicing certain low income patients. The District-run Medicaid program reimburses for Skilled Nursing Facility care on a per diem rate, calculated using a formula that appears in the District's Medicaid State Plan.

Other Insurance Carriers

The Medical Center also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily or procedure rates. The CareFirst agreement contains a "most-favored nations" clause which means CareFirst would reimburse the Medical Center at a rate that is lower than the other third party payors.

(q) Income Taxes

The principal operations of the Medical Center, as a instrumentality of the District, are recognized as exempt from income tax under the applicable income tax regulations of the Internal Revenue Code and the District.

(r) Reclassifications

Certain prior year amounts have been reclassified to conform to the current year financial statement presentation, the effect of which is not material.

(2) Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Medical Center at September 30, 2012 and 2011, consisted of these amounts:

	2012	2011
Patient accounts receivable:		
Receivable from patients and their insurance carriers	$ 9,131,916	6,599,915
Receivable from Medicare	5,432,161	4,799,033
Receivable from Medicaid	6,688,311	7,007,099
Total patient accounts receivable	21,252,388	18,406,047
Less allowance for uncollectible amounts	7,827,579	6,528,887
Patient accounts receivable, net	$ 13,424,809	11,877,160

	2012	2011
Accounts payable and accrued expenses:		
Payable to employees	$ 5,026,807	4,292,721
Payable to suppliers	9,487,912	12,364,425
Payable to payroll taxing authorities and others	641,206	767,274
Total accounts payable and accrued expenses	$ 15,155,925	17,424,420

(3) Capital Assets and Depreciation

Property, plant, and equipment additions, retirements, and balances for period ended September 30, 2012 and 2011 were as follows:

	Balance September 30, 2011	Additions	Transfers	Retirements	Balance September 30, 2012
Land	$ 8,100,000	—	—	—	8,100,000
Land improvements	889,472	—	—	—	889,472
Buildings	42,924,619	—	—	(5,762)	42,918,857
Equipment	14,644,766	849,637	425,347	—	15,919,750
Equipment under capital lease obligations	1,211,408	343,941	—	—	1,555,349
Software	573,803	74,347	6,563	—	654,713
Construction in progress	431,910	—	(431,910)	—	—
Total costs	68,775,978	1,267,925	—	(5,762)	70,038,141
Less accumulated depreciation and amortization	(7,151,920)	(5,700,897)	—	—	(12,852,817)
Capital assets, net	$ 61,624,058	(4,432,972)	—	(5,762)	57,185,324

(4) Long-Term Debt and Other Noncurrent Liabilities

A schedule of the Medical Center's noncurrent liabilities for September 30, 2012 and 2011 follow:

		Balance September 30, 2011	Additions	Reductions	Balance September 30, 2012
Capital lease obligations		289,053	251,408	(266,245)	274,216
Estimated third party settlements		—	3,643,162	—	3,643,162
Other liabilities		1,027,564	2,984,708	(375,189)	3,637,083
Total noncurrent liabilities	$	1,316,617	6,879,278	(641,434)	7,554,461

Long-Term Debt

The terms and due dates of the Medical Center's long-term debt, including capital lease obligations, at September 30, 2012 and 2011 follows:

- Capital lease obligations, at varying rates of imputed interest from 1.4% to 5.25%, were collateralized by leased equipment valued at approximately $1.6 million and $1.3 million on September 30, 2012 and 2011, respectively.

Scheduled principal and interest repayments on capital lease obligations are as follows:

		Capital lease obligations	
Year ending September 30:		**Principal**	**Interest**
2013	$	682,077	45,289
2014		90,053	7,287
2015		69,463	4,957
2016		71,755	2,665
2017		42,945	467
Total	$	956,293	60,665

The current portion of obligations under capital leases consists of $346,231 of additional principal lease payments that are due and payable as of September 30, 2012. See footnote (5) below for discussion of the third party settlement obligation.

(5) Third Party Settlements

Certain services rendered by the Medical Center are reimbursed by third-party payors at cost based upon costs reports filed after year-end. Contractual allowances are recorded based upon preliminary estimates of reimbursable costs. The Medical Center's net patient revenue recorded under cost reimbursement agreements for the current and prior years is subject to audit and retroactive adjustment by Medicare for the years 2006 – 2012. This does not address the long term liability recorded in the current year.

Final settlements and changes in estimates related to Medicare third-party cost reports for prior years resulted in an increase of net patient service revenues of approximately $1,067,953 for the year ended September 30, 2012. There were no settlement revenues for the year ended September 30, 2011.

The Medical Center recorded a $3 million third party settlement reserve due to DC Medicaid in fiscal year 2012. The Medical Center received disproportionate share funding beyond its estimated OBRA limit of $11.9 million in fiscal year 2011 which created a potential exposure due to DC Medicaid in fiscal year 2014.

(6) Medical Malpractice Claims

The Medical Center is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Medical Center and are currently in various stages of litigation. Additional claims may be asserted against the Medical Center arising from services provided to patients through September 30, 2012. The Medical Center purchases professional and general liability insurance to cover medical malpractice claims.

(7) Compensated Absences

The Medical Center's accumulated leave policy allows employees to accumulate unused leave at various limits depending on employee's classification and years of service. Generally, all employees are allowed to accrue at a minimum of 208 hours of accumulated leave up to a maximum of 480 hours, and the department heads or other designated personnel can accrue a minimum of 248 hours of leave up to a maximum of 480 hours. The accrued accumulated leave balance is payable to employees in those cases where (1) the Medical Center is short-staffed, (2) at employee's request, and approved by the Vice President and CEO, or (3) upon separation of employment.

The Medical Center's accumulated leave policy allows regular full-time and part-time employees with paid leave benefits. The Medical Center records accumulated leave as an expense and related liability as the benefit accrues to employees based on salary rates and accumulated leave hours. The policy of the Medical Center is to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the amounts do not vest and are not payable upon termination of the employee. All vacation pay is accrued when earned. The liability recorded as of September 30, 2012 and 2011, within the line item Accrued Salaries and Benefits, includes all salary related benefit payments in accordance with GASB Statement No. 16.

(8) Retirement Plans

During the current fiscal year, the Medical Center made two types of retirement plans available to its employees.

(Continued)

(a) Defined Contribution Plan

The Medical Center maintains a defined contribution plan in accordance with Internal Revenue Code (IRC) Section 401(a) covering all employees providing for matching contributions by the organization for the fiscal years ending September 30, 2012 and 2011 of 3% of employees' compensation. Participants vest in their accounts at a rate of 20% for each year of service, with 100% vesting after 5 years of service. For the fiscal years ending September 30, 2012 and 2011, the Medical Center's contributions to the 401(a) plan were $652,125 and $414,315, respectively. The Medical Center contracts with ING as its third-party administrator for this plan.

(b) Deferred Compensation Plan

The Medical Center offers its employees a deferred compensation plan in accordance with IRC Section 457(b), which allowed employees in FY2012 to defer up to $17,000 of compensation under the IRS annual limitations. The participants are fully vested in their contributions to the 457(b) plan at all times. This plan is also administered by ING.

(9) Commitments under Noncancelable Operating Leases

The Medical Center is committed under various noncancelable operating leases, all of which are related to equipment and software licenses. The following is a schedule by year of future minimum lease payments under operating leases as of September 30, 2012, that have initial remaining lease terms in excess of one year:

2013	$	205,729
2014		84,698
2015		47,322
2016		47,322
2017		3,943
Total	$	389,014

(10) Transactions with Related-Parties

The Medical Center receives payments from the District for services provided to Medicaid-eligible residents of the District. The Medical Center also receives grant funding for certain expenditure needs and to cover additional costs of providing services to certain at-risk populations of the District. During fiscal year 2012, the Medicaid DSH revenues, net, recognized by the Medical Center was $4.2 million as compared to $14.9 million for fiscal year 2011 resulting in a decrease of approximately $10.7 million. As a result of the DSH reduction and other funding deficiencies, the Medical Center received a $7.7 million subsidy from the District of Columbia in fiscal year 2012 and recognized it as nonoperating revenue. In addition, $6 million was received as an intra-agency allocation.

The following is a summary of related-party transaction balances as of September 30, 2012 and 2011:

		2012	2011
Accounts receivable due from DC Medicaid	$	6,609,501	6,715,780
Due to District of Columbia		—	6,000,000
Net patient revenue – DC Medicaid		26,595,328	19,863,788
Disproportionate Share revenues, net - DC Medicaid		4,197,391	14,894,510
Nonoperating revenue – DC Department of Health grant		178,335	1,920,847

(11) Concentrations of Credit Risk

The Medical Center maintains cash and cash equivalent balances and securities at several financial institutions. The cash balance at each financial institution is insured under the Federal Deposit Insurance Corporation (FDIC) up to $250,000 and securities are insured up to $500,000 under Securities Investor Protection Corporation (SIPC). At times, the balances on deposit and securities will exceed the balance insured by the FDIC and SIPC, however, the Medical Center has not experienced any losses related to this concentration to date and believes it is not exposed to any significant credit risks.

The Medical Center grants credit without collateral to its patients, most of who are local residents and insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2012 and 2011 are as follows:

	2012	2011
Medicare	23%	21%
Medicaid	22	21
HMO Medicare/Medicaid	25	34
HMO/PPO	8	5
Commercial/Other	8	8
Patients	14	11
	100%	100%

The Medical Center's policy is to write-off all patient accounts that have been identified as uncollectible. An allowance for uncollectible accounts is recorded for accounts not yet written-off which are expected to become uncollectible in future period.

(Continued)

(12) Commitments and Contingencies

(a) Litigation Matters

The Medical Center and the District Government are in litigation with Capital Behavioral Health (CBH). CBH is seeking an order requiring the transfer of the Medical Center, including its real property assets among other assets, to CBH based on claims the District improperly foreclosed upon, seized assets from, and engaged in fraudulent transfers with Capitol Medical Center, LLC and CMC Realty, LLC, to the detriment of CBH. The CBH litigation is pending and the Medical Center and District both were seeking dismissal on several substantive and procedural grounds.

(b) Collective Bargaining Agreements

The Medical Center has several collective bargaining agreements in effect with unions representing certain employees. The agreement with 1199 SEIU United Healthcare Workers East (SEIU) expired on April 30, 2012. The agreement was extended until May 31, 2012. The Medical Center completed the renegotiations of the Collective Bargaining Agreements on May 4, 2012. The current terms and conditions remain open for the Union's ratification, and the Medical Center Board's, District Council's and District Chief Financial Officer's approval and/or certification. The agreement with the District of Columbia Nurses Association (DCNA) which expires on January 7, 2013 has been extended until March 7, 2013. The agreement with International Union of Engineers (IUOE) expires on September 30, 2014. The agreement with United Federation of Special Police and Security Officers Local 672 (UFSO) expired on September 30, 2012 and has been extended until March 31, 2013. 1199 SEIU members represent 39.8%, DCNA members represent 23.2%, IUOE members represent 2.8% and UFSO members represent 2.9% of the Medical Center's salaries and wages in FY2012.

(13) Subsequent Events

On December 21, 2012, the Medical Center's board of directors extended the Chief Executive Officer's (CEO) contract through March 31, 2013. The CEO's employment contract had been due to end on December 28, 2012.

On January 14, 2013, the Mayor of the District of Columbia announced that Huron Healthcare had been awarded a two-year $12.7 million contract to address certain operational and financial matters of the Medical Center. The contract will take effect only upon its approval by the District Council.

Subsequent events have been evaluated by management through February 1, 2013, which is the date the financial statements were available to be issued.