

# THE ARC OF THE THREE RIVERS, INC.

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## *Financial and Compliance Report*

*December 31, 2011*

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DHHR - Finance

JAN 31 2013

Date Received



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## INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

To the Board of Directors  
The Arc of the Three Rivers, Inc  
Charleston, West Virginia

We have audited the accompanying balance sheets of The Arc of the Three Rivers, Inc. (the Arc) as of December 31, 2011 and 2010, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Arc'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Arc of the Three Rivers, Inc. as of December 31, 2011 and 2010, and the results of its operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Schedule of Expenditures of State Awards is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of State Awards, is fairly stated, in all material respects, in relation to the financial statements as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 11, 2012, on our consideration of The Arc of the Three Rivers, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. We issued a similar report for the year ended December 31, 2010, dated January 5, 2012, which has not been included with the 2011 financial statements. The purpose of these reports 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. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits of each year.

ARNETT & FOSTER, P. L. L. C.

*Arnett + Foster, P.L.L.C.*

Charleston, West Virginia  
June 11, 2012

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AF Center 101 Washington Street, East · P.O. Box 2629 Charleston, West Virginia 25329  
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## THE ARC OF THE THREE RIVERS, INC.

## BALANCE SHEETS

December 31, 2011 and 2010

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 377,710	\$ 502,676
Cash held for others	352,248	636,945
Patient accounts receivable, net of allowance for doubtful accounts of approximately \$376,000 (2011); \$162,000 (2010)	851,516	791,335
Grant receivables	64,213	44,160
Prepaid expenses and other	60,322	87,136
<b>Total current assets</b>	<b>1,706,009</b>	<b>2,062,252</b>
<b>Assets Limited as to Use</b>	<b>66,109</b>	<b>65,013</b>
<b>Property and Equipment, net</b>	<b>55,928</b>	<b>44,278</b>
<b>Total assets</b>	<b>\$ 1,828,046</b>	<b>\$ 2,171,543</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>Current Liabilities</b>		
Current maturities of long-term obligations	\$ 3,804	\$ -
Accounts payable and accrued expenses	1,259,104	1,230,137
Fiduciary liability for assets held for others	352,248	636,945
<b>Total current liabilities</b>	<b>1,615,156</b>	<b>1,867,082</b>
<b>Long-term obligations, net of current portion</b>	<b>14,059</b>	<b>-</b>
<b>Total liabilities</b>	<b>1,629,215</b>	<b>1,867,082</b>
<b>Net Assets</b>		
Unrestricted	198,831	304,461
<b>Total net assets</b>	<b>198,831</b>	<b>304,461</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,828,046</b>	<b>\$ 2,171,543</b>

See Notes to Financial Statements

## THE ARC OF THE THREE RIVERS, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS  
Years Ended December 31, 2011 and 2010

	2011	2010
<b>Unrestricted revenues, gains and other support:</b>		
Net patient service revenue	\$ 8,812,374	\$ 8,939,314
Grant funding	268,919	283,111
Other revenue	128,797	151,653
Interest income	418	807
Donations	250	12,879
<b>Total revenues, gains and other support</b>	<b>9,210,758</b>	<b>9,387,764</b>
<b>Expenses:</b>		
Salaries and wages	4,272,177	3,900,532
Payroll taxes and benefits	958,137	880,520
Contracted services	2,398,191	3,333,546
Medicaid enhancement tax	391,475	429,599
Travel	233,207	196,012
Day program expense	27,455	14,899
Utilities and telephone	45,178	40,918
Rent	137,451	136,091
Groceries	24,484	23,678
Parking	5,550	2,973
Supplies and other	342,742	282,816
Professional fees	107,378	70,937
Insurance	37,437	37,725
Interest	4,162	4,911
Depreciation and amortization	20,938	29,191
Provision for bad debts	310,426	30,836
<b>Total expenses</b>	<b>9,316,388</b>	<b>9,415,184</b>
<b>Deficiency of revenues over expenses and Decrease in unrestricted net assets</b>	<b>(105,630)</b>	<b>(27,420)</b>
<b>Net assets, beginning of year</b>	<b>304,461</b>	<b>331,881</b>
<b>Net assets, end of year</b>	<b>\$ 198,831</b>	<b>\$ 304,461</b>

See Notes to Financial Statements

## THE ARC OF THE THREE RIVERS, INC.

STATEMENTS OF CASH FLOWS  
Years Ended December 31, 2011 and 2010

	2011	2010
<b>Cash Flows from Operating Activities</b>		
Decrease in net assets	\$ (105,630)	\$ (27,420)
Adjustments to reconcile increase (decrease) in unrestricted net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	20,938	29,191
Provision for bad debts	310,426	30,836
(Increase) decrease in:		
Patient accounts receivables	(370,607)	241,409
Grant receivables	(20,053)	(14,760)
Prepaid expenses and other	26,814	(33,327)
Increase (decrease) in:		
Accounts payable and accrued expenses	28,967	(61,212)
<b>Net cash provided by (used in) operating activities</b>	<u>(109,145)</u>	<u>164,717</u>
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(12,588)	(7,406)
Net change in assets limited as to use	(1,096)	(8,290)
<b>Net cash used in investing activities</b>	<u>(13,684)</u>	<u>(15,696)</u>
<b>Cash Flows from Financing Activities</b>		
Net proceeds (repayment) on line of credit	-	(94,850)
Principal payments on long-term obligations	(2,137)	(791)
Proceeds from long-term obligations	-	-
<b>Net cash used in financing activities</b>	<u>(2,137)</u>	<u>(95,641)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	(124,966)	53,380
Cash and cash equivalents, beginning of year	<u>502,676</u>	<u>449,296</u>
Cash and cash equivalents, end of year	<u>\$ 377,710</u>	<u>\$ 502,676</u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash payments for interest	<u>\$ 4,162</u>	<u>\$ 4,911</u>
<b>Supplemental Disclosure of Noncash Investing and Financing Activities</b>		
Direct financing of vehicle acquisitions	<u>\$ 20,000</u>	<u>\$ -</u>

See Notes to Financial Statements

## THE ARC OF THE THREE RIVERS, INC.

NOTES TO FINANCIAL STATEMENTS

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**Note 1. Nature of Operations and Significant Accounting Policies**

**Nature of operations:** The Arc of the Three Rivers, Inc. (the "Arc") is a not-for-profit, nonstock corporation organized and existing under the laws of West Virginia and located in Charleston, West Virginia. The Arc provides services to individuals with mental retardation and developmental disabilities in Kanawha, Putnam, Clay and Boone counties in West Virginia.

**A summary of significant accounting policies is as follows:**

**Use of estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates used in preparing these financial statements include those assumed in determining the allowance for doubtful accounts. It is at least reasonably possible that the significant estimates used will change within the next year.

**Cash and cash equivalents:** Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

**Patient accounts receivable:** Patient accounts receivable are carried at the original charge less an estimate made for doubtful or uncollectible accounts. The allowance is based upon a review of the outstanding balances aged by financial class. Management uses collection percentages based upon historical collection experience to determine collectibility. Management also reviews troubled, aged accounts to determine collection potential. Patient accounts receivable are written off when deemed uncollectible. Recoveries of accounts previously written off are recorded as a reduction to bad debt expense when received. Interest is not charged on patient accounts receivable.

**Supplies inventory:** Supplies inventory is stated at latest invoice cost, which approximates lower of cost (first-in, first-out method) or market.

**Investments:** Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess (deficiency) of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess (deficiency) of revenues over expenses unless the investments are trading securities.

**Assets limited as to use:** Assets limited as to use include designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes.

**Property and equipment:** Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of the depreciable assets and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements.

**Net assets:** Unrestricted net assets are those assets presently available for use by the Arc at the discretion of the Board of Directors.

## THE ARC OF THE THREE RIVERS, INC.

NOTES TO FINANCIAL STATEMENTS

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Temporarily restricted net assets are those assets, which have been contributed with donor imposed time or purpose restrictions. When a stipulated time restriction expires or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of operations as net assets released from restrictions (None at December 31, 2011 and 2010.)

Permanently restricted net assets are resources subject to donor imposed restrictions that they be maintained permanently by the Arc. (None at December 31, 2011 and 2010.)

**Excess (deficiency) of revenues over expenses:** The statement of operations includes *excess (deficiency) of revenues over expenses*. Changes in unrestricted net assets which are excluded from *excess (deficiency) of revenues over expenses*, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets) and pension-related changes for other than net periodic pension cost

**Net patient service revenue:** The Arc has agreements with third-party payors that provide for payments to the Arc at amounts different from its established rates. 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. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**Charity care:** The Arc provides care to patients who meet certain criteria under its charity care policy, without charge or at amounts less than its established rates. Because the Arc does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Charity care, based on charges foregone, for the years ended December 31, 2011 and 2010 amounted to \$80,620 and \$58,832, respectively. The total cost of charity care provided for the years ended December 31, 2011 and 2010 approximated the charges foregone. The Arc received grant funding of \$80,620 and \$58,832 restricted for charity care for the years ended December 31, 2011 and 2010, respectively.

**Donor-restricted gifts:** Unconditional promises to give cash and other assets to the Arc are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Gifts of land, buildings and equipment are reported at fair value and are presented as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Arc reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

**Income taxes and unrelated business income:** The Arc, which is not classified as a private foundation, is exempt from Federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and similar state statutes relating to not-for-profit organizations

There is currently very little guidance in the IRS Code on what activities should be subject to unrelated business income tax (UBIT). The IRS has indicated that they are studying the issue and may issue additional guidance. As a result, at this time there is uncertainty regarding whether the Arc should pay income tax on certain types of net taxable income from activities that may be considered by taxing



**THE ARC OF THE THREE RIVERS, INC.****NOTES TO FINANCIAL STATEMENTS**

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authorities as unrelated to the purpose for which the Arc was granted non-taxable status. In the opinion of management, any liability resulting from taxing authorities imposing income taxes on the net taxable income from activities deemed to be unrelated to the Arc's non-taxable status is not expected to have a material effect on the Arc's financial position or results of operations.

The Arc is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The management of the Arc believes it is no longer subject to income tax examinations for years prior to the fiscal year ended December 31, 2008.

**Advertising:** Advertising costs are expensed as incurred.

**Subsequent Events:** The Arc has evaluated subsequent events through June 11, 2012, the date on which the financial statements were available to be issued.

**Reclassifications:** Certain amounts in the 2010 financial statements have been reclassified to conform to the 2011 presentation. The reclassifications have no impact on previously reported change in net assets.

**New or recent accounting pronouncements:** Health Care Entities Topic 954 (Accounting Standards Update No. 2010-23) of the FASB Accounting Standards Codification Measuring Charity Care for Disclosure is effective for fiscal years beginning after December 15, 2010. Management's policy for providing charity care, as well as the level of charity care provided, shall be disclosed in the financial statements. Such disclosure shall be measured based on the provider's costs of providing charity care services. If costs cannot be specifically attributed to services provided to charity care patients (for example, based on a cost accounting system), management may estimate the costs of those services using reasonable techniques. This should be applied retrospectively to all prior periods presented. The Arc adopted the amended disclosure requirements on January 1, 2011. Note 1 reflects the amended disclosure requirements. Since the new guidance amends disclosure requirements only, its adoption did not impact the Arc's balance sheet, statement of operations, or cash flow statement.

Health Care Entities Topic 954 (Accounting Standards Update No. 2010-24) of the FASB Accounting Standards Codification Presentation of Insurance Claims and Related Insurance Recoveries is effective for fiscal years beginning after December 15, 2010. A health care entity should not net insurance recoveries for medical malpractice claims against a related medical malpractice claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. A cumulative-effect adjustment should be recognized in opening net assets in the period of adoption if a difference exists between any liability and insurance receivables recorded as a result of application. The Arc adopted Topic 954 (No. 2010-24) requirements on January 1, 2011. The effects of implementing this standard did not impact the Arc's balance sheet, statement of operations, or cash flow statement.

On July 25, 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The amendments in this Update, which become effective for fiscal years ending after December 15, 2012, require certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. The amendments also require disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. The Arc will be required to adopt Topic 954 (No. 2011-07) in its 2013 annual financial statements. Management does not believe this new standard will have a material impact on the financial statements.

## THE ARC OF THE THREE RIVERS, INC.

## NOTES TO FINANCIAL STATEMENTS

**Note 2. Credit Risk Related to Cash and Cash Equivalents**

Included with cash and cash equivalents are demand deposits and short-term investments with financial institutions, the bank balances of which generally exceed Federally insured amounts. However, management believes these financial institutions are financially sound and these concentrations do not represent a significant risk to the Arc

**Note 3. Property and Equipment**

A summary of the components of property and equipment as of December 31, 2011 and 2010 follows:

	2011	2010
Land	\$ 5,000	\$ 5,000
Leasehold improvements	49,712	49,712
Building	54,900	54,900
Furniture and fixtures	10,180	5,615
Equipment and vehicles	246,086	219,033
	<u>365,878</u>	<u>334,260</u>
Less accumulated depreciation and amortization	<u>(309,950)</u>	<u>(289,982)</u>
Property and equipment, net	<u>\$ 55,928</u>	<u>\$ 44,278</u>

**Note 4. Assets Limited As to Use**

**Assets limited as to use:** The composition of assets limited as to use at December 31, 2011 and 2010, is set forth in the following table. Investments are stated at fair value

	2011	2010
<b>By Board for capital improvements:</b>		
Cash and cash equivalents	\$ 43,721	\$ 42,658
Certificates of deposit	<u>22,388</u>	<u>22,355</u>
<b>Total assets limited as to use</b>	<b>66,109</b>	<b>65,013</b>
Less assets limited as to use that are required for current liabilities	<u>-</u>	<u>-</u>
<b>Noncurrent assets limited as to use</b>	<u><b>\$ 66,109</b></u>	<u><b>\$ 65,013</b></u>

Investment income and gains for assets limited as to use, cash and cash equivalents for the years ended December 31, 2011 and 2010, follows:

	2011	2010
Other Income:		
Interest income	<u>\$ 418</u>	<u>\$ 807</u>

## THE ARC OF THE THREE RIVERS, INC.

## NOTES TO FINANCIAL STATEMENTS

**Fair Value of Financial Instruments**

The *Fair Value Measurements and Disclosures* Topic 820 of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements

This Topic defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. This Topic also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Topic describes three levels of inputs that may be used to measure fair value:

- Level 1:** Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date
- Level 2:** Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets and liabilities.
- Level 3:** Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability

**Fair Value Measurements**

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

**Investments and Assets Limited as to Use:** Investment securities and assets limited as to use are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating. Level 1 securities include those traded by dealers or brokers in active over-the-counter markets and money market funds.

**Assets at Fair Value on a Recurring Basis**

The tables below present the recorded amount of assets measured at fair value on a recurring basis.

	Total at December 31, 2011	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalent assets limited as to use	\$ 66,109	\$ 66,109	\$ -	\$ -
<b>Assets:</b>				
	Total at December 31, 2010	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Cash equivalent assets limited as to use	\$ 65,013	\$ 65,013	\$ -	\$ -

## THE ARC OF THE THREE RIVERS, INC.

## NOTES TO FINANCIAL STATEMENTS

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

The Arc has no assets or liabilities that are recorded at fair value on a nonrecurring basis.

**Note 5. Line of Credit**

At December 31, 2010, the Arc had open lines of credit with financial institutions of \$150,000 and \$60,000, with interest rates of 1.00% plus the Bank's prime rate. During 2011, the Arc closed the \$150,000 line of credit and opened a \$400,000 line of credit with an interest rate of 0.50% plus the Bank's prime rate, which is secured by substantially all assets of the Arc. The Arc had outstanding borrowings on the line of credit of \$0 at December 31, 2011 and 2010.

**Note 6. Long-Term Obligations**

A summary of long-term obligations at December 31, 2011 and 2010 follows:

	2011	2010
Note payable, bank, due in monthly installments of \$381, including Interest at 5.25%, through 2016, secured by vehicle	\$ 17,863	\$ -
Less current maturities	3,804	-
Long-term obligations	\$ 14,059	\$ -

Scheduled principal payments on long-term obligations is as follows:

Year ending December 31,	
2012	\$ 3,804
2013	3,988
2014	4,181
2015	4,383
2016	1,507
	<u>\$ 17,863</u>

**Note 7. Net Patient Service Revenue**

The Arc has agreements with third-party payors that provide for payments to the Arc at amounts different from its established rates.

Virtually all of the Arc's net patient service revenue is derived under the Title XIX MR/DD Waiver Program. Consequently, the Arc is significantly dependent on reimbursement by the Medicaid program for services rendered. Any future modifications to laws and regulations relating to participation in this program or reimbursement by this program for services rendered could have a significant impact on the financial condition and operating results of the Arc.

## THE ARC OF THE THREE RIVERS, INC.

## NOTES TO FINANCIAL STATEMENTS

**Note 8. Retirement Plan**

The Arc has a 403(b) contributory defined contribution retirement plan covering all full time employees. The Arc's contribution expense is computed as a match of the amount contributed by employees, limited to 5% of each employees' compensation. The Plan was amended effective March 1, 2010, to remove the employer match. The Arc's expense was \$0 for both the years ended December 31, 2011 and 2010

**Note 9. Rental Expense**

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred

Future minimum lease payments under operating leases as of December 31, 2011 that have initial or remaining lease terms in excess of one year are as follows:

Year ending December 31,	
2012	\$ 110,956
2013	17,456
2014	<u>7,478</u>
	<u>\$ 135,890</u>

Total rental expense in 2011 and 2010 for all operating leases was approximately \$137,000 and \$136,000, respectively.

**Note 10. Professional Liability Insurance**

The Arc maintains claims made coverage for professional liability of up to \$1,000,000 for individual claims with a total annual aggregate up to \$3,000,000. Incidents occurring through December 31, 2011, may result in the assertion of a claim and other claims may be asserted arising from past services provided

The Arc is a defendant in various lawsuits wherein various amounts for damages are claimed. In the opinion of management, the likelihood of an unfavorable outcome in excess of insurance coverage is remote and the judgments, if unfavorable, would not have a material adverse effect on the Arc's financial statements. Some of these claims would be subject to deductibles should the ultimate outcome be adverse. The aggregate of all potential deductibles would not have a material adverse effect on the Arc's financial statements

**Note 11. Concentrations of Credit Risk**

The Arc is located in Charleston, West Virginia. The Arc grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net receivables from the Arc's patients and third-party payors is as follows:

	<u>2011</u>	<u>2010</u>
Medicaid	<u>100%</u>	<u>100%</u>
	<u>100%</u>	<u>100%</u>

## THE ARC OF THE THREE RIVERS, INC.

## NOTES TO FINANCIAL STATEMENTS

**Note 12. Classification of Expenses**

Operating expense by functional category is as follows:

	2011	2010
Patient care	\$ 8,560,378	\$ 8,651,157
General and administrative	756,010	764,027
	<u>\$ 9,316,388</u>	<u>\$ 9,415,184</u>

**Note 13. Commitments, Contingencies and Subsequent Events**

In August 2010, a complaint investigation performed by the Office of Health Facility Licensure and Certification (OHFLAC) uncovered improper use of consumer funds from accounts for which the Arc is the representative payee. These funds are included in cash held for others in the accompanying balance sheets. Management of the Arc performed an internal review of the above mentioned accounts and identified employee embezzlement from the funds. The information was turned over to local authorities and the Medicaid Fraud Investigation Unit. The employee was terminated, arrested and the case went to trial which resulted in a guilty plea by the former employee on May 23, 2011. The accounts of the consumers affected by the embezzlement have been repaid by the Arc and the funds have been reimbursed by the Arc's insurer in 2011. At December 31, 2010, the Arc has recorded a liability of \$53,678 in accounts payable and accrued expenses and a corresponding receivable from the insurance carrier in prepaid expenses and other in the accompanying balance sheets. Although the Arc was a victim of a criminal act, the Social Security Administration has indicated that there exists a possibility that the income retained by the Arc for the services rendered as a representative payee may be requested by the Social Security Administration to be repaid. At this time, it is unclear whether the Social Security Administration will follow through on its comment and whether it can prevail on its possible claim for reimbursement as the basis for recovery is unclear. The potential repayment obligation is unknown by management and legal counsel.

In 2011, a provider review of the MR/DD Waiver program was performed by APS Healthcare for the period January 7, 2010 to December 21, 2010. A potential disallowance of approximately \$190,000 was identified by APS Healthcare related to missing documentation for the services provided. The Arc has responded to the review and is waiting on response from APS Healthcare. Management believes that the actual liability will be approximately \$112,000 based upon information they have subsequently provided to APS Healthcare. A liability of \$112,000 is recorded in the financial statements at December 31, 2010 and is included within accounts payable and accrued expenses.

**Note 14. Health Insurance Plan**

Effective November 1, 2010, the Arc became partially self-insured with respect to employee health insurance. The program is used to pay ordinary health care claims of qualified participants. To protect themselves against extraordinary claims of their employees, the Arc has purchased stop-loss insurance. The Arc's cost is limited to \$35,000 per participant per plan year. Amounts payable under this plan approximated \$23,000 and \$44,000 as of December 31, 2011 and 2010, respectively. Total health insurance expense for the years ended December 31, 2011 and 2010 was approximately \$494,000 and \$495,000, respectively.

THE ARC OF THE THREE RIVERS, INC.

SCHEDULE OF EXPENDITURES OF STATE AWARDS  
For the Year Ended December 31, 2011

State Grantor/Program Title	Grant Number	Grant Period	Grant Award	1/1/11-12/31/11 Receipts	1/1/11-12/31/11 Expenditures	2011 Receivable
West Virginia Department of Health and Human Resources-Office of Behavioral Health						
Developmental Disabilities (DD) Core Support & Alternative Grant	G110016	07/01/10-06/30/11	\$ 244,988	\$ 183,972	\$ 139,812	\$ -
Developmental Disabilities (DD) Core Support & Alternative Grant	G120084	07/01/11-06/30/12	244,988	64,894	129,107	64,213
<b>Total</b>			<b>\$ 489,976</b>	<b>\$ 248,866</b>	<b>\$ 268,919</b>	<b>\$ 64,213</b>



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
The Arc of the Three Rivers, Inc.  
Charleston, West Virginia

We have audited the financial statements of The Arc of the Three Rivers, Inc. as of and for the year ended December 31, 2011 and have issued our report thereon dated June 11, 2012. We conducted our audit 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

Internal Control Over Financial Reporting

Management of The Arc of the Three Rivers, Inc., is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered The Arc of the Three Rivers, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of The Arc of the Three Rivers, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of The Arc of the Three Rivers, Inc.'s internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, as described in the accompanying schedule of findings and responses at finding 2011-1, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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AF Center · 101 Washington Street, East · P.O. Box 2629 · Charleston, West Virginia 25329  
304/346-0441 · 800/642-3601  
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Compliance and Other Matters

As part of obtaining reasonable assurance about whether The Arc of the Three Rivers, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and which is described in the accompanying schedule of findings and responses as finding 2011-1.

The Arc of the Three Rivers, Inc.'s response to the findings identified in our audits are described in the accompanying schedule of findings and responses. We did not audit The Arc of the Three Rivers, Inc.'s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, Federal and State awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties

ARNETT & FOSTER, P.L.L.C.

*Arnett + Foster, P. L. L. C.*

Charleston, West Virginia  
June 11, 2012

DHHR - Finance

JAN 31 2013

Date Received

**THE ARC OF THE THREE RIVERS, INC.****SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended December 31, 2011**

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**2011-01 Timely Reconciliation of Funds Held for Others**Condition

The Arc has the fiduciary responsibility for approximately \$350,000 of funds held for others, and acts as the representative payee for certain consumers. An employee embezzlement involving these funds amounting to approximately \$50,000 occurred over several years but was not discovered until 2010.

Cause

A small number of persons have had the primary responsibility for performing most of the accounting and financial reporting duties of the Arc limiting the separation of incompatible duties. Policies and procedures related to dual controls as well as appropriate supervision and review control over the administration of the funds held for others was implemented in 2011.

Criteria

Chapter 31E, Article 15, Section 1501, paragraph (b) of the West Virginia Code requires that nonprofit corporations incorporated in West Virginia are to maintain appropriate accounting records. Further, the Legislative Rules under the Title 64, Series 11, for the Division of Health, Behavioral Health Centers Licensure, requires the Arc to act as a fiduciary on behalf of its beneficiary consumers, and to maintain appropriate, separate records of account for them when handling their funds. Crucial to the propriety of such accounting records is the maintenance of internal accounting controls that ensures that no one person can have access to the assets as well as the accounting records of the organization, and that no one person can control transactions of the organization from inception to completion and recording such transactions in the accounting records, as such conditions provide the opportunity for fraud to occur within the organization and go undetected. Ideally, internal controls should be designed to safeguard assets and minimize the risk of loss from employee dishonesty or error, and fundamental to adequate internal controls is the segregation of incompatible duties. Consequently, the Arc should have internal controls in place that contemplate an appropriate segregation of duties in all areas to the fullest extent possible, particularly in the area of payments to providers and representative payees.

Effect

The Policies and Procedures manual over funds held for others implemented by the Arc in 2011 states that all representative payee accounts will be reconciled no later than seven days after receipt of the monthly bank statements. During audit testing of these accounts, it was noted that the reconciliation of these accounts for the month ended December 31, 2011 was not completed until April 2012.

Failure to perform timely reconciliations of the fiduciary accounts could result in improperly recorded and undetected transactions or fraud may occur and be undetected.

Response

The Arc hired a Director for the Representative Payee Department in 2011 who has implemented improvements to the internal control. Direct deposit of funds for all payees and segregation of duties within that department, have strengthened the internal controls. These improvements provide the framework to enhanced customer service and minimize potential errors. The Arc agrees to maintain a detail of outstanding checks and deposits for the fiduciary accounts and to reconcile the accounts to the general ledger on a monthly basis in a timely manner.