

Cape Cod Healthcare, Inc. and Affiliates

**Report on Federal Awards in
Accordance with OMB Circular A-133
September 30, 2014
EIN: 22-2600704**

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Part I

**Financial Statements and Schedule of Expenditures of
Federal Awards**



Independent Auditor's Report

To the Board of Trustees of
Cape Cod Healthcare, Inc. and Affiliates

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Cape Cod Healthcare, Inc. and Affiliates ("Healthcare"), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated 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 consolidated financial statements are free from material misstatement.

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



Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Healthcare at September 30, 2014 and 2013 and the results of their operations, their changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying schedule of expenditures of federal awards for the year ended September 30, 2014 is presented for purposes of additional analysis as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 federal awards is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 16, 2015 on our consideration of Healthcare'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. 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Healthcare's internal control over financial reporting and compliance.


January 16, 2015

Cape Cod Healthcare, Inc. and Affiliates
Consolidated Balance Sheets
September 30, 2014 and 2013

	2014	2013
Assets		
Current assets		
Cash and cash equivalents	\$ 50,121,651	\$ 44,960,636
Short-term investments	23,472,893	22,589,911
Patient accounts receivable, less allowance for doubtful accounts of \$26,720,604 and \$24,789,366 in 2014 and 2013, respectively	75,163,877	73,140,356
Current portion of pledges receivable, net	4,290,685	4,042,879
Other receivables, net	15,602,877	9,664,661
Current portion of funds whose use is limited or restricted	21,674,598	16,935,201
Supplies	9,871,301	9,497,008
Prepaid expenses and other current assets	<u>9,720,789</u>	<u>8,221,360</u>
Total current assets	209,918,671	189,052,012
Long-term investments	270,151,964	235,220,631
Funds whose use is limited or restricted	46,320,775	47,215,926
Property and equipment, net	302,944,886	294,672,218
Deferred financing costs, net	3,542,466	3,484,797
Pledges receivable, net of current portion	7,900,561	10,343,401
Goodwill and intangible assets	22,778,859	7,978,952
Other assets	<u>21,090,707</u>	<u>19,097,083</u>
Total assets	<u>\$ 884,648,889</u>	<u>\$ 807,065,020</u>
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt and capital lease obligations	\$ 9,629,202	\$ 9,016,117
Accounts payable and accrued expenses	107,181,334	91,643,492
Estimated settlements with third-party payors	16,762,521	17,121,517
Other current liabilities	<u>529,849</u>	<u>558,254</u>
Total current liabilities	134,102,906	118,339,380
Interest rate swap liabilities	2,585,149	2,971,303
Other liabilities	27,033,320	25,349,918
Long-term debt and capital lease obligations, net of current portion	<u>186,384,142</u>	<u>170,947,364</u>
Total liabilities	<u>350,105,517</u>	<u>317,607,965</u>
Net assets		
Unrestricted	465,949,029	424,844,954
Temporarily restricted	37,281,235	35,937,257
Permanently restricted	<u>31,313,108</u>	<u>28,674,844</u>
Total net assets	<u>534,543,372</u>	<u>489,457,055</u>
Total liabilities and net assets	<u>\$ 884,648,889</u>	<u>\$ 807,065,020</u>

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

Cape Cod Healthcare, Inc. and Affiliates
Consolidated Statements of Operations
Years Ended September 30, 2014 and 2013

	2014	2013
Operating Revenue		
Net patient service revenue	\$ 723,319,909	\$ 670,934,360
Less: provision for bad debts	<u>8,344,071</u>	<u>10,702,957</u>
Net patient service revenue after provision for bad debts	714,975,838	660,231,403
Other revenue	13,958,648	11,477,268
Net assets released from restrictions used for operations	<u>1,371,900</u>	<u>2,028,166</u>
Total operating revenue	<u>730,306,386</u>	<u>673,736,837</u>
Operating Expenses		
Salaries and wages	280,594,617	267,157,113
Physicians' salaries and fees	77,033,210	69,823,245
Employee benefits	102,996,917	87,724,003
Supplies and other	207,726,342	189,413,292
Depreciation and amortization	28,100,301	26,718,466
Interest	<u>7,512,543</u>	<u>7,203,912</u>
Total operating expenses	<u>703,963,930</u>	<u>648,040,031</u>
Income from operations	<u>26,342,456</u>	<u>25,696,806</u>
Nonoperating gains (losses)		
Investment income	1,479,254	1,951,417
Realized gains on investments, net	6,265,413	5,791,482
Net contributions	1,524,380	3,939,096
Change in fair value of interest rate swaps	386,154	1,294,824
Other nonoperating losses	<u>(623,976)</u>	<u>(1,240,983)</u>
Total nonoperating gains, net	<u>9,031,225</u>	<u>11,735,836</u>
Excess of revenue and gains over expenses and losses	35,373,681	37,432,642
Change in net unrealized gains on investments	3,682,803	2,054,930
Net assets released from restrictions used for purchase of property and equipment	<u>2,047,591</u>	<u>3,357,216</u>
Increase in unrestricted net assets	<u>\$ 41,104,075</u>	<u>\$ 42,844,788</u>

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

Cape Cod Healthcare, Inc. and Affiliates
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2014 and 2013

	2014	2013
Unrestricted net assets		
Excess of revenue and gains over expenses and losses	\$ 35,373,681	\$ 37,432,642
Change in net unrealized gains on investments	3,682,803	2,054,930
Net assets released from restrictions used for purchase of property and equipment	2,047,591	3,357,216
Increase in unrestricted net assets	<u>41,104,075</u>	<u>42,844,788</u>
Temporarily restricted net assets		
Net contributions	2,570,224	11,063,705
Investment income	149,063	184,691
Net realized and change in net unrealized gains on investments	815,639	658,714
Net assets released from restrictions	(3,419,491)	(5,385,382)
Change in value of split interest agreements	1,228,543	808,400
Increase in temporarily restricted net assets	<u>1,343,978</u>	<u>7,330,128</u>
Permanently restricted net assets		
Net contributions	1,925,651	60,508
Change in value of beneficial interest in perpetual trusts	614,318	640,364
Change in value of split interest agreements	98,295	(9,312)
Increase in permanently restricted net assets	<u>2,638,264</u>	<u>691,560</u>
Increase in net assets	45,086,317	50,866,476
Net assets		
Beginning of year	<u>489,457,055</u>	<u>438,590,579</u>
End of year	<u>\$ 534,543,372</u>	<u>\$ 489,457,055</u>

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

Cape Cod Healthcare, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities		
Increase in net assets	\$ 45,086,317	\$ 50,866,476
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Change in fair value of interest rate swaps	(386,154)	(1,294,824)
Loss on disposal of property and equipment	195,230	109,725
Impairment of computer software	3,120,863	-
Receipt of noncash contributions	(1,772,201)	(1,409,817)
Loss on extinguishment of debt	-	1,122,667
Premium received upon issuance of debt	-	831,729
Depreciation and amortization	28,100,301	26,718,466
Restricted contributions received and investment income	(5,382,147)	(7,531,449)
Net realized and change in net unrealized gains on investments	(10,444,724)	(9,484,869)
Provision for bad debts	8,291,709	10,907,131
Increase (decrease) in cash resulting from a change in		
Patient accounts receivable	(9,247,825)	(12,202,821)
Pledges and other receivables	(3,690,820)	(6,488,932)
Supplies	(374,293)	(985,002)
Prepaid expenses and other current assets	(1,499,429)	(2,394,375)
Other assets	(417,347)	(655,876)
Accounts payable and accrued expenses	15,804,647	(6,545,801)
Estimated settlements with third-party payors	(358,996)	(1,526,221)
Other liabilities	1,654,997	1,724,930
Net cash provided by operating activities	<u>68,680,128</u>	<u>41,761,137</u>
Cash flows from investing activities		
Acquisition of business, net of cash acquired	(22,323,075)	-
Additions to property and equipment	(33,710,774)	(37,757,672)
Proceeds from sale of equipment	399,027	326,491
Purchase of investments	(159,891,771)	(166,425,803)
Proceeds from sale of investments	131,184,325	138,115,312
Net cash used in investing activities	<u>(84,342,268)</u>	<u>(65,741,672)</u>
Cash flows from financing activities		
Use of proceeds to refinance debt	(16,429,265)	(23,175,300)
Proceeds from issuance of debt	41,200,000	50,000,000
Repayment of long-term debt and capital leases	(9,006,582)	(9,297,830)
Restricted contributions received and investment income	5,382,147	7,531,449
Payments of debt issuance costs	(323,145)	(496,315)
Net cash provided by financing activities	<u>20,823,155</u>	<u>24,562,004</u>
Net increase in cash and cash equivalents	5,161,015	581,469
Cash and cash equivalents		
Beginning of year	44,960,636	44,379,167
End of year	<u>\$ 50,121,651</u>	<u>\$ 44,960,636</u>
Supplemental disclosure of noncash activities		
Purchases of property and equipment included in accounts payable	\$ 535,473	\$ 701,920
Cash paid for interest	7,192,057	7,191,909

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

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

1. Organization

The consolidated financial statements include the accounts of Cape Cod Healthcare, Inc. ("CCHC") and its controlled affiliates (collectively, "Healthcare"). Transactions and balances between entities have been eliminated in consolidation. The following is a summary of affiliated organizations which are controlled by Healthcare and included in the consolidated financial statements:

Cape Cod Healthcare, Inc.	A not-for-profit corporation that serves as the parent company of various entities providing health care services to the population of Cape Cod, Massachusetts.
Cape Cod Hospital ("CCH")	A not-for-profit acute care hospital located in Hyannis, Massachusetts. Consolidated in CCH is the not-for-profit Cape Cod Cardiology Services LLC.
Cape Cod Healthcare Foundation, Inc. ("CCHC Foundation")	A not-for-profit corporation organized to provide development and fundraising support to Healthcare.
Cape and Islands Health Services II, Inc. ("Cape & Islands")	A not-for-profit corporation organized to provide various nonhospital health care services.
Medical Affiliates of Cape Cod, Inc. ("MACC")	A not-for-profit medical group practice. Consolidated within MACC are the not-for-profit The Cardiovascular Specialists, LLC ("TCS") and the for-profit Emerald Physicians Member Trust (the "Trust") and Emerald Physician Services, LLC ("Emerald"). The Trust is the sole shareholder of Emerald. MACC is the sole investor / beneficiary of the Trust.
Visiting Nurse Association of Cape Cod, ("VNA of Cape Cod")	A not-for-profit provider of home health services.
Cape Cod Human Services, Inc. ("Human Services")	A not-for-profit provider of outpatient mental health services.
Falmouth Hospital Association, Inc. ("Falmouth Hospital")	A not-for-profit acute care hospital located in Falmouth, Massachusetts. Consolidated within Falmouth Hospital is the not-for-profit Bayside Surgical Center.
Falmouth Assisted Living, Inc., d/b/a Heritage at Falmouth ("Assisted Living")	A not-for-profit corporation that owns an assisted living facility.
JML Care Center, Inc. ("JML Center")	A not-for-profit skilled nursing and rehabilitation facility.
Cape Health Insurance Company ("CHICO")	A for-profit captive insurance company that provides medical professional and general liability insurance to Healthcare.
Cape Cod Hospital Medical Office Building ("MOB")	A for-profit provider of leased and subleased space to CCH and related affiliations.

Assets of individual organizations within the consolidated group may not be available to satisfy the obligations of other members of the consolidated group.

On January 10, 2014 Healthcare acquired Emerald, a primary care practice located on Cape Cod. The acquisition will provide additional access to care to the residents of the Cape. Emerald is wholly owned by the Trust and the MACC is the sole beneficiary of the Trust. Both Emerald and the Trust are taxable entities; Emerald is taxed as a subchapter S corporation and the Trust is taxed as an electing small business trust.

Cape Cod Healthcare, Inc. and Affiliates
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September 30, 2014 and 2013

MACC recorded the fair value of assets acquired and liabilities assumed, including \$12,139,000 of goodwill and \$1,482,000 of indefinite-life intangible assets.

On May 31, 2014, Healthcare purchased substantially all of the assets owned by TCS, a cardiology practice that owned and operated accredited nuclear, vascular and echocardiogram laboratories in Hyannis, Massachusetts. Healthcare recorded the fair value of the assets acquired and liabilities assumed, including goodwill of \$1,179,000.

The following summarizes the assets acquired and the liabilities assumed in connection with both acquisitions:

	Emerald	TCS	Total
Assets			
Patient accounts receivable, net	\$ 1,119,767	\$ -	\$ 1,119,767
Property, plant and equipment	537,142	6,110,170	6,647,312
Other Assets	310,467	-	310,467
Goodwill	12,139,131	1,178,877	13,318,008
Intangibles - tradename	1,481,899	-	1,481,899
Total assets acquired	<u>\$ 15,588,406</u>	<u>\$ 7,289,047</u>	<u>\$ 22,877,453</u>
Liabilities			
Accounts payable and accrued expenses	268,726	-	268,726
Notes payable	285,652	-	285,652
Total liabilities assumed	<u>\$ 554,378</u>	<u>\$ -</u>	<u>\$ 554,378</u>
Equity			
Unrestricted	15,034,028	7,289,047	22,323,075
Total liabilities and equity	<u>\$ 15,588,406</u>	<u>\$ 7,289,047</u>	<u>\$ 22,877,453</u>

A summary of the financial results of Emerald from the period January 10, 2014 through September 30, 2014 and of TCS from the period May 31, 2014 through September 30, 2014 that is included in the consolidated statement of operations is as follows:

	Emerald	TCS	Total
Total operating revenues	\$ 12,046,661	\$ 1,085,140	\$ 13,131,801
Total operating expenses	<u>12,580,192</u>	<u>757,973</u>	<u>13,338,165</u>
(Deficit) excess of revenue and gains over expenses and losses	\$ (533,531)	\$ 327,167	\$ (206,364)

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Notes to Consolidated Financial Statements
September 30, 2014 and 2013

A summary of the consolidated financial results of CCHC for the years ended September 30, 2014 and 2013, as if the acquisitions had occurred on October 1, 2012 is as follows (unaudited):

	2014	2013
Total revenue	\$ 748,245,268	\$ 693,675,719
Total expenses	<u>721,672,401</u>	<u>667,748,502</u>
Income from operations	26,572,867	25,927,217
Non-operating gains	<u>9,031,225</u>	<u>11,735,836</u>
Excess of revenue and gains over expenses and losses	\$ 35,604,092	\$ 37,663,053
Change in net unrealized gains and losses on investments	3,682,803	2,054,930
Net assets released from restrictions used for purchase of property and equipment	<u>2,047,591</u>	<u>3,357,216</u>
Increase in unrestricted net assets	<u>\$ 41,334,486</u>	<u>\$ 43,075,199</u>

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting.

Revenue Recognition

Healthcare has entered into payment agreements with Medicare, Medicaid, and various commercial insurance carriers, health maintenance organizations ("HMOs"), and preferred provider organizations. The basis for payment to Healthcare under these agreements includes prospectively determined rates per discharge, per day, and per visit, discounts from established charges, cost (subject to limits), and fee screens. 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 statutes, 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 reasonable possibility that recorded estimates will change by a material amount 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. During 2014 and 2013, changes in prior year estimates increased net patient service revenue by approximately \$5,959,000 and \$4,298,000, respectively.

Free care services are partially reimbursed to acute care hospitals through the statewide Health Safety Net (HSN, formerly known as the Uncompensated Care Pool) established by the Massachusetts Health Care Reform Law (Chapter 58 of the Acts of 2006). A portion of the funding for the HSN is paid by hospitals through a statewide hospital assessment levied each year by the Massachusetts Legislature. All acute care hospitals in the state are assessed their share of this total statewide hospital assessment amount based on each hospital's charges for private sector payors. Hospitals are reimbursed for free care based on claims for eligible patients that are submitted to, and adjudicated, by the HSN. Rates of payment are based on Medicare rates and payment policies.

Cape Cod Healthcare, Inc. and Affiliates

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Healthcare has recorded its assessment to the HSN as a deduction from net patient service revenue of \$3,315,000 and \$3,125,000 for the years ended September 30, 2014 and 2013, respectively, in the consolidated statements of operations. Reimbursement for uncompensated care has been allocated to bad debts and free care based on hospital-specific experience. The reimbursement allocated for bad debts is recorded as a reduction of the uncompensated care pool assessment, while the reimbursement allocated for charity care is recorded as net patient service revenue.

Other Revenue

Other revenue consists principally of investment income, distributions from perpetual trusts, grant revenue, rental income and revenue from nonpatient-related services.

Use of Estimates

The preparation of the accompanying consolidated financial statements in accordance 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, pledges receivable, investments, goodwill, interest rate swap liabilities, accrued expenses and estimated settlements with third-party payors.

Excess of Revenue and Gains Over Expenses and Losses

The consolidated statements of operations include excess of revenue and gains over expenses and losses. Changes in unrestricted net assets which are excluded from excess of revenue and gains over expenses and losses, consistent with industry practice, include the changes in unrealized gains and losses on investments, 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 net assets released from restriction used for purchase of property and equipment.

Consolidated Statements of Operations

In the accompanying consolidated statements of operations, transactions deemed by management to be ongoing to the provision of health care services are reported as operating revenue and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

Endowment

Healthcare has an endowment spending policy, as approved by the Board of Trustees, which aims to preserve the purchasing power of the endowment. Under this policy, 4% of a three-year moving average of market values can be expended for operations. The long-term performance objective of the endowment portfolio is to attain an average annual total return that exceeds Healthcare's spending rate plus inflation within acceptable levels of risk over a full market cycle. To achieve its long-term rate of return objectives, Healthcare relies on a total return strategy in which investment returns are achieved through both capital appreciation and current yield.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Healthcare has been limited by donors to a specific time period or purpose. Such funds are generally restricted for health care services and the purchase of property and equipment. In accordance with Healthcare policies and the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") enacted by the Commonwealth of Massachusetts, Healthcare includes accumulated realized and unrealized net gains on investments of permanently restricted net assets, which are available for Board appropriation, within temporarily restricted net assets. Temporarily restricted net assets also include approximately \$12,191,000 and \$14,386,000 at

Cape Cod Healthcare, Inc. and Affiliates

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

September 30, 2014 and 2013, respectively, related to unconditional promises to give with payments due in future periods, and other funds whose use has been limited by donors.

Permanently restricted net assets at September 30, 2014 and 2013, include only the historical dollar amount of gifts which are required by donors to be held in perpetuity, the income from which is expendable to support indigent care, health care services, purchases of property and equipment. The earnings from the perpetual trusts are recorded in other revenue as they are available and used for health care services.

Healthcare has interpreted state law as requiring realized and unrealized gains of permanently restricted net assets to be retained in a temporarily restricted net asset classification until appropriated by the Board and expended. State law allows the Board to appropriate so much of the net appreciation of permanently restricted net assets as is prudent considering Healthcare's long- and short-term needs, present and anticipated financial requirements, expected total return on investments, price-level trends, and general economic conditions. Amounts appropriated during the years ended September 30, 2014 and 2013, amounted to approximately \$729,000 and \$713,000, respectively. These amounts are included in net assets released from restrictions in the accompanying consolidated financial statements.

Gifts

Unconditional promises to give cash and other assets to Healthcare 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 conditions are met. 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 consolidated statements 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 gifts in the accompanying financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less at the date of purchase, excluding funds whose use is limited or restricted.

Funds Whose Use is Limited or Restricted

Funds whose use is limited or restricted include funds held by trustees under bond indenture agreements and funds contributed by donors for specific purposes, perpetual trusts and permanent endowment funds.

Derivative Instruments

All derivatives are recognized on the balance sheet at fair value. Healthcare designates at inception whether the derivative contract is considered hedging or nonhedging in accordance with existing accounting guidance for derivative instruments and hedging activities. For those instruments designated as hedges, Healthcare formally documents at inception all relationships between the hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various accounting hedges. Healthcare's derivatives are used to minimize the variability in cash flows of interest-bearing liabilities caused by changes in interest rates. Changes in the fair value of derivatives designated for hedging activities that are highly effective are recorded as a component of other changes in net assets. Hedge ineffectiveness, if any, is recorded in excess of revenue and gains over expenses and losses. For those instruments not designated as hedges, changes in the fair value of derivatives are recorded in nonoperating gains (losses).

Cape Cod Healthcare, Inc. and Affiliates

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Patient Accounts Receivable

Healthcare receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), managed care payors, commercial insurance companies, and patients. Patient accounts receivable are reported net of contractual allowances and reserves for denials, uncompensated care, and doubtful accounts. The level of reserves is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental and private employer health care coverage and other collection indicators.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the accompanying consolidated balance sheets. Investments for which a market value is not readily determinable, including investments in collective trusts, limited liability companies, limited partnerships and private equity partnerships, are either recorded at cost or at their reported fair value based on information provided by the trust manager, and are reviewed by management for reasonableness and approved by the Investment Committee. Investments held to satisfy current liabilities, generally understood to be those liabilities to be paid within one year, are classified as current and investments intended to be held greater than one year are classified as long term. Investment income or loss (including realized gains and losses on investments, interest and dividends) for assets under Healthcare's control is included in the excess of revenue and gains over expenses and losses, unless the income is restricted by donor or law. The change in unrealized gains and losses on investments is excluded from the excess of revenue and gains over expenses and losses. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on funds whose use is limited for capital purchases are generally reported as other revenue or as a change in temporarily restricted net assets. All other unrestricted investment income and unrestricted realized gains and losses on investments are reported as nonoperating gains (losses).

A write-down in the cost basis of investments is recorded when the decline in fair value of investments below cost has been judged to be other-than-temporary. Depending on any donor-imposed restrictions on the investments, the amount of the write-down is reported as a realized loss in either temporarily restricted net assets or in excess of revenue and gains over expenses and losses as a component of income from investments, with no adjustment to the cost basis for subsequent recoveries of fair value.

Investments, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets. When applicable, fair value is based on quoted market prices.

Supplies

Supplies are stated at the lower of cost (first-in, first-out method) or market.

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Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Gifts of long-lived assets such as land, buildings, or equipment are reported at fair value at the date of the contribution as unrestricted support and are excluded from the excess of revenue and gains over expenses and losses, unless explicit donor stipulations specify how the assets are to be used. 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 assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

Buildings	40 years
Building improvements	5-20 years
Furniture and equipment	3-20 years
Software	3 years

Equipment leased under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included within depreciation expense.

Goodwill

Healthcare's goodwill primarily relates to the acquisitions of Emerald, TCS, Cape Cod Cardiology, LLC and Bayside Surgical Center. Goodwill is recorded when the fair value of the assets acquired is less than the fair value of the liabilities assumed plus consideration transferred, if any, as detailed under ASC 958, *Not-for-Profit Entities: Mergers and Acquisitions*. Healthcare assesses goodwill at least annually for impairment or more frequently if certain events or circumstances warrant and recognizes an impairment charge for the amount by which the carrying amount of goodwill exceeds its fair value. There was no impairment charge recorded for the years ended September 30, 2014 and 2013.

Asset Retirement Obligations

Asset retirement obligations reported in accounts payable and accrued expenses are legal obligations associated with the retirement of long-lived assets. The liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Healthcare records changes in the liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Healthcare reduces the liabilities when the related obligations are settled.

Costs of Borrowing

Interest cost incurred on borrowed funds, net of interest income earned on such funds, during the period of construction of capital assets is capitalized as a component of the costs of acquiring those assets. Capitalized interest costs of \$628,000 and \$348,000 were recorded for the years ended September 30, 2014 and 2013, respectively.

Deferred Financing Costs

Deferred financing costs consist of legal, financing, and other related costs incurred in connection with the issuance of outstanding bonds. Deferred financing costs are being amortized using the straight-line method, which approximates the effective-interest method, over the term of the bonds. Original issue discount, which is recorded as a reduction of the long-term debt, is being amortized using the

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straight-line method, which approximates the effective-interest method, over the term of the related bonds.

Professional Liability Costs

Healthcare is self-insured for certain professional liability claims. Estimated losses and claims are accrued as incurred. Healthcare has provided for the cost of claims paid during the current period, as well as estimates of the liability for claims incurred but not yet paid, in the accompanying consolidated financial statements. The liability for professional liability losses and loss-adjustment expenses includes an amount, based on an independent actuarial study discounted at a rate of 3%, for losses determined from loss reports, individual cases, and based on past experience, adjusted for the risk of adverse deviation. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Self-Insurance Reserves

Healthcare is generally self-insured for employee healthcare, workers' compensation and certain other employee benefits. These costs are accounted for on an accrual basis to include estimates of future payments for claims incurred prior to year end.

Income Taxes

CCHC and its affiliates, other than MOB, CHICO, the Trust and Emerald, have been recognized by the Internal Revenue Service as tax-exempt nonprofit organizations under Section 501(c)(3) of the Internal Revenue Code (the "Code"), and accordingly, are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Income tax provisions have not been provided on the operating results of the MOB or Emerald due to current-period operating losses.

CHICO has received an undertaking from the Cayman Islands Government exempting it from taxes on income until June 8, 2024.

Fair Value Measurements

Healthcare follows accounting guidance which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

The estimated fair value amounts reported in the accompanying consolidated financial statements and related notes have been determined by Healthcare using available market information and valuation methodologies described below. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein may not be indicative of the amounts that Healthcare could realize in a current market exchange. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

Reclassifications

Certain amounts in the accompanying 2013 financial statements have been reclassified in order to be consistent with the 2014 presentation.

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3. Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, Healthcare analyzes its past history and identifies trends for each of its major categories of revenue (inpatient, outpatient, and professional) to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major categories of revenue in evaluating the sufficiency of the allowance for doubtful accounts. Throughout the year, Healthcare, after all reasonable collection efforts have been exhausted, will write off the difference between the standard rates (or discounted rates if negotiated) and the amounts actually collected against the allowance for doubtful accounts. In addition to the review of the categories of revenue, management monitors the write offs against established allowances as of a point in time to determine the appropriateness of the underlying assumptions used in estimating the allowance for doubtful accounts.

Accounts receivable, prior to adjustment for doubtful accounts, is summarized as follows at September 30, 2014 and 2013:

	2014	2013
Receivables		
Patients	\$ 11,802,969	\$ 8,263,758
Third-party payors	<u>90,081,512</u>	<u>89,665,964</u>
	101,884,481	97,929,722
Allowance for doubtful accounts	<u>(26,720,604)</u>	<u>(24,789,366)</u>
	<u>\$ 75,163,877</u>	<u>\$ 73,140,356</u>

Net patient service revenue before the provision for bad debts for the years ended September 30, 2014 and 2013 is summarized as follows:

	2014	2013
Net patient service revenue		
Patients	\$ 14,534,980	\$ 15,789,185
Third-party payors	<u>708,784,929</u>	<u>655,145,175</u>
	<u>\$ 723,319,909</u>	<u>\$ 670,934,360</u>

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4. Charity Care

Healthcare provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Healthcare does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as net revenue. The charity care policy is based on the poverty income guidelines established by the Massachusetts Division of Healthcare Finance and Policy. If a patient is ineligible because his or her income exceeds the eligibility guidelines, any uncollectible accounts receivable balance is written off to bad debt. During 2014 and 2013, Healthcare provided approximately \$6,184,000 and \$7,418,000 in charity care, respectively. The estimated costs of providing charity care services are based on data derived from Healthcare's ratio of cost to charges. During 2014 and 2013, Healthcare received approximately \$3,339,000 and \$2,741,000, respectively, from the HSN for reimbursement of charity care.

5. Property and Equipment

Property and equipment at September 30, 2014 and 2013 consisted of the following:

	2014	2013
Land	\$ 22,740,222	\$ 22,080,743
Land improvements	12,623,019	12,117,909
Buildings and improvements	333,885,265	317,837,095
Fixed equipment	52,177,063	50,955,425
Major movable equipment	214,400,249	212,282,813
Assets under capital leases	11,581,599	11,581,599
	<u>647,407,417</u>	<u>626,855,584</u>
Accumulated depreciation and amortization	<u>(361,541,212)</u>	<u>(341,031,922)</u>
Property and equipment, net	285,866,205	285,823,662
Construction in progress	<u>17,078,681</u>	<u>8,848,556</u>
	<u>\$ 302,944,886</u>	<u>\$ 294,672,218</u>

At September 30, 2014 and 2013, Healthcare had commitments totaling approximately \$20,133,000 and \$21,781,000, respectively, related to construction projects. Depreciation expense for the years ended September 30, 2014 and 2013 was \$27,835,000 and \$26,454,000, respectively. During the year ended September 30, 2014, Healthcare disposed of \$10,955,000 of gross property, plant and equipment. In conjunction with these disposals, Healthcare recorded a \$3,316,000 loss within supplies and other expense.

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6. Investments

Investments and investments limited as to use are reported at either fair value or at cost in accordance with the appropriate guidance for healthcare organizations. At September 30, 2014 and 2013, the composition of these investments is as follows:

	September 30, 2014			
	Cost	Carrying Value		Total
		At Fair Value	At Cost	
Cash and temporary investments	\$ 25,275,920	\$ 25,275,920	\$ -	\$ 25,275,920
Mutual funds	164,565,270	179,711,182	-	179,711,182
U.S. government securities	9,829,765	9,814,150	-	9,814,150
Common and preferred stock	13,003	26,473	-	26,473
Private equity partnerships	1,031,400	-	1,031,400	1,031,400
Pooled income fund	429,839	445,941	-	445,941
Collective trusts	47,931,927	54,066,014	-	54,066,014
Limited liability companies and limited partnerships	71,984,132	-	71,984,132	71,984,132
	<u>321,061,256</u>	<u>269,339,680</u>	<u>73,015,532</u>	<u>342,355,212</u>
Perpetual trusts held by third party	-	19,265,018	-	19,265,018
	<u>\$321,061,256</u>	<u>\$288,604,698</u>	<u>\$ 73,015,532</u>	<u>\$361,620,230</u>

	September 30, 2013			
	Cost	Carrying Value		Total
		At Fair Value	At Cost	
Cash and temporary investments	\$ 26,255,077	\$ 26,255,077	\$ -	\$ 26,255,077
Mutual funds	154,228,081	166,181,081	-	166,181,081
U.S. government securities	10,560,801	10,637,880	-	10,637,880
Common and preferred stock	18,000	29,112	-	29,112
Private equity partnerships	1,046,400	-	1,046,400	1,046,400
Pooled income fund	490,883	484,831	-	484,831
Collective trusts	42,810,181	47,318,495	-	47,318,495
Limited liability companies and limited partnerships	53,130,293	-	53,130,293	53,130,293
	<u>288,539,716</u>	<u>250,906,476</u>	<u>54,176,693</u>	<u>305,083,169</u>
Perpetual trusts held by third party	-	16,878,500	-	16,878,500
	<u>\$288,539,716</u>	<u>\$267,784,976</u>	<u>\$ 54,176,693</u>	<u>\$321,961,669</u>

For the limited liability companies and the limited partnerships reflected in the balance sheet at cost, the difference between the value reported by the investment managers and the cost for these investments was \$17,710,000 and \$12,045,000 as of September 30, 2014 and 2013, respectively.

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The fair value and unrealized depreciation of investments with a fair value less than cost for greater than twelve months, that are not deemed to be other-than-temporarily impaired was \$0 at September 30, 2013. At September 30, 2014, the investments with a fair value less than cost were as follows:

	12 Months or Greater	
	Fair Value	Unrealized Depreciation
At September 30, 2014		
Mutual funds	\$ 37,845,514	\$ (980,015)
Collective trusts	7,353,585	(1,108,716)
	<u>\$ 45,199,099</u>	<u>\$ (2,088,731)</u>

At September 30, 2014 and 2013, investments are reported in the accompanying consolidated balance sheets as follows:

	2014	2013
Short-term investments	\$ 23,472,893	\$ 22,589,911
Funds whose use is limited or restricted		
Current portion	21,674,598	16,935,201
Noncurrent portion	46,320,775	47,215,926
Long-term investments	<u>270,151,964</u>	<u>235,220,631</u>
	<u>\$ 361,620,230</u>	<u>\$ 321,961,669</u>

For the years ended September 30, 2014 and 2013, investment income, gains, and losses consisted of the following:

	2014	2013
Investment return recorded in unrestricted net assets		
Nonoperating gains and losses		
Investment income	\$ 1,479,254	\$ 1,951,417
Realized gains on investments, net	<u>6,265,413</u>	<u>5,791,482</u>
	7,744,667	7,742,899
Changes in net unrealized gains on investments	<u>3,682,803</u>	<u>2,054,930</u>
Total investment return recorded within unrestricted net assets	<u>11,427,470</u>	<u>9,797,829</u>
Investment return recorded in temporarily restricted net assets		
Investment income	149,063	184,691
Net realized and change in net unrealized gains on investments	802,797	648,560
Change in value of split interest agreements	<u>12,842</u>	<u>10,154</u>
Total investment return recorded within temporarily restricted net assets	<u>964,702</u>	<u>843,405</u>
Investment return recorded in permanently restricted net assets		
Change in value of beneficial interest in perpetual trusts	<u>614,318</u>	<u>640,364</u>
Total investment return recorded within permanently restricted net assets	<u>614,318</u>	<u>640,364</u>
	<u>\$ 13,006,490</u>	<u>\$ 11,281,598</u>

Cape Cod Healthcare, Inc. and Affiliates
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Securities with unrealized depreciation are reviewed each quarter to determine whether these investments are other-than-temporarily impaired. Marketable investments with fair value below cost are considered to be other-than-temporarily-impaired and a realized loss is recorded if management has outsourced the ability to purchase and sell investments to Healthcare's fund managers. All other investments are subject to further review, which considers factors including the anticipated holding period for the investment, extent and duration of below cost valuation, and the nature of the underlying holdings as applicable. A similar writedown is recorded when the impairment on these investments has been judged to be other-than-temporary.

There were no recorded realized losses associated with marketable investments for which the fair value was below cost as of September 30, 2014 or September 30, 2013.

Funds whose use is limited consist of the following:

	September 30, 2014		September 30, 2013	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Externally designated funds				
Funds whose use is limited	\$ 18,675,152	\$ 6,842,534	\$ 16,935,201	\$ 7,187,472
Temporarily restricted investments	2,999,446	8,602,801	-	11,706,627
Permanently restricted investments	-	11,610,422	-	11,443,327
Perpetual trusts held by third party	-	19,265,018	-	16,878,500
	<u>\$ 21,674,598</u>	<u>\$ 46,320,775</u>	<u>\$ 16,935,201</u>	<u>\$ 47,215,926</u>

As of September 30, 2014 and 2013, Healthcare has outstanding commitments of approximately \$203,000 and \$338,000, respectively, to fund certain private equity and real asset funds.

7. Fair Value Measurements

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement date (also referred to as "exit price"). Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. In determining fair value, the use of various valuation approaches, including market, income and cost approaches, is permitted.

Fair Value Hierarchy

A fair value hierarchy has been established based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. The fair value hierarchy requires the reporting entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. In addition, for hierarchy classification purposes, the reporting entity should not look through the form of an investment to the nature of the underlying securities held by an investee.

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The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by Healthcare for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level 1 Valuations using quoted prices in active markets for identical assets or liabilities. Valuations of these products do not require a significant degree of judgment.
- Level 2 Valuations using observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; broker or dealer quotations; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities.
- Level 3 Valuations using unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value:

Cash and Temporary Investments

Cash and temporary investments include short-term, highly liquid investments and the fair values are based on quoted market prices.

Mutual Funds, U.S. Government Securities, Common and Preferred Stock, and Pooled Income Fund

The fair values of mutual funds, estimated fair values of U.S. government securities, the fair values of common and preferred stock, and the fair value of the pooled income fund are based on quoted market prices for identical or similar assets in active markets.

Collective Trusts

The estimated fair values of collective trusts are determined based upon the net asset value provided by the fund managers and assessed for reasonableness by management. Such information is generally based on Healthcare's pro-rata interest in the net assets of the underlying investments.

Beneficial Interest Lead Trusts Held by Third Party

Charitable lead trust assets are valued using Healthcare's pro-rata interest in the current fair value of the underlying assets, less estimated future payments discounted to a single present value using market rates at the date of the contribution adjusted for a market risk premium, based on the expected date of the transfer of the remaining assets to Healthcare.

Perpetual Trusts Held by Third Party

The estimated fair values of Healthcare's perpetual lead trust, where Healthcare does not serve as trustee, is determined based upon information provided by the trustee and assessed for reasonableness by management. Such information is generally based on Healthcare's pro-rata interest in the net assets of the underlying investments to be received in perpetuity as distributions from the trust.

Interest Rate Swaps

The valuation of interest rate swaps is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market based inputs, including interest rate curves and implied volatilities.

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The following tables summarize fair value measurements at September 30, 2014 and 2013 for financial assets and liabilities measured at fair value on a recurring basis:

	2014			
	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value at September 30, 2014
Assets				
Investments				
Cash and temporary investments	\$ 25,275,920	\$ -	\$ -	\$ 25,275,920
Mutual funds	156,575,298	23,135,884	-	179,711,182
U.S. government securities	9,814,150	-	-	9,814,150
Common and preferred stock	26,473	-	-	26,473
Pooled income fund	445,941	-	-	445,941
Collective trusts	-	54,066,014	-	54,066,014
Total investments, fair value	<u>192,137,782</u>	<u>77,201,898</u>	<u>-</u>	<u>269,339,680</u>
Perpetual trusts held by third party	-	-	19,265,018	19,265,018
Beneficial interest lead trusts held by third party	-	-	11,723,788	11,723,788
Total assets, fair value	<u>\$ 192,137,782</u>	<u>\$ 77,201,898</u>	<u>\$ 30,988,806</u>	<u>\$ 300,328,486</u>
Liabilities				
Interest rate sw aps	\$ -	\$ 2,585,149	\$ -	\$ 2,585,149
Total liabilities, fair value	<u>\$ -</u>	<u>\$ 2,585,149</u>	<u>\$ -</u>	<u>\$ 2,585,149</u>
	2013			
	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value at September 30, 2013
Assets				
Investments				
Cash and temporary investments	\$ 26,255,077	\$ -	\$ -	\$ 26,255,077
Mutual funds	144,411,090	21,769,991	-	166,181,081
U.S. government securities	10,637,880	-	-	10,637,880
Common and preferred stock	29,112	-	-	29,112
Pooled income fund	484,831	-	-	484,831
Collective trusts	-	47,318,495	-	47,318,495
Total investments, fair value	<u>181,817,990</u>	<u>69,088,486</u>	<u>-</u>	<u>250,906,476</u>
Perpetual trusts held by third party	-	-	16,878,500	16,878,500
Beneficial interest lead trusts held by third party	-	-	10,457,978	10,457,978
Total assets, fair value	<u>\$ 181,817,990</u>	<u>\$ 69,088,486</u>	<u>\$ 27,336,478</u>	<u>\$ 278,242,954</u>
Liabilities				
Interest rate sw aps	\$ -	\$ 2,971,303	\$ -	\$ 2,971,303
Total liabilities, fair value	<u>\$ -</u>	<u>\$ 2,971,303</u>	<u>\$ -</u>	<u>\$ 2,971,303</u>

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The following table is a rollforward of investments classified by Healthcare within Level 3 as defined previously for the year ended September 30, 2014 and 2013:

Balances at September 30, 2012	\$26,210,659
Change in value of beneficial interest in trusts held by third party	485,455
Change in value of beneficial interest in perpetual trusts	<u>640,364</u>
Balances at September 30, 2013	27,336,478
Change in value of perpetual trust held by third party	2,386,518
Change in value of beneficial lead trusts held by third party	<u>1,265,810</u>
Balances at September 30, 2014	<u>\$30,988,806</u>

Split-interest agreements held by third parties are valued based on the group annuity mortality table and the risk-free rate of return. As of September 30, 2014 and 2013, the discount rate used in performing the present value calculations at each measurement date ranged from 1% to 4%.

There were no significant transfers into or out of Levels 1 and 2 for the years ended September 30, 2014 or 2013.

The following table summarizes all investments recorded at net asset value ("NAV") at September 30, 2014, categorized based on the risk and return characteristics of the investments, and excluding Level 1 investments based on their daily redemption feature.

	Fair Value	Redemption Frequency	Redemption Notice Period
Collective trusts	\$ 54,066,014	Monthly	5-10 days
Equity mutual funds	9,869,828	Weekly	None
Bond mutual funds	<u>13,266,056</u>	Weekly	5 days
	<u>\$ 77,201,898</u>		

8. Employee Retirement Plans

Healthcare sponsors several defined contribution plans which generally cover employees who have completed the minimum service requirements defined by the plans. The contributions vary by plan but generally approximate 2% of eligible wages. Certain of the plans allow for employee contributions which are matched by Healthcare up to certain limits. Pension expense under the defined contribution plans totaled approximately \$9,731,000 and \$9,027,000 in 2014 and 2013, respectively, and was recorded within employee benefits expense on the consolidated statements of operations.

9. Lines of Credit

Healthcare has a line of credit available that provides for advances of up to \$15,000,000 for working capital needs. Amounts borrowed are due on demand and bear interest at the applicable LIBOR interest rate in effect at the time of the borrowing. Borrowings under the line of credit are guaranteed by the following affiliated entities: CCHC Foundation, CCH, Falmouth Hospital, JML Center, Human Services, and VNA of Cape Cod. There were no amounts outstanding under this line-of-credit agreement at September 30, 2014 and 2013, respectively.

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10. Long-term Debt, Capital Leases and Interest Rate Swaps

Long-term debt at September 30, 2014 and 2013 consisted of the following:

Issue	2014 Rate	2013 Rate	Final Maturity	2014	2013
Massachusetts Development Finance					
Agency ("MDFA") Hospital Revenue Bonds					
Fixed Rate					
Cape Cod Healthcare Obligated Group—Series D	2.5-6%	2.5-6%	2036	56,530,000	58,090,000
Cape Cod Healthcare Obligated Group—Series 2012A	2.66%	2.66%	2022	20,640,000	23,220,000
Cape Cod Healthcare Obligated Group—Series 2013	4-5.25%	4-5.25%	2042	50,000,000	50,000,000
Cape Cod Healthcare Obligated Group—Series 2014	3.37%	n/a	2029	24,000,000	-
Variable Rate direct placement with commercial lender					
Cape Cod Healthcare Obligated Group—Series E	1.04%	1.04%	2022	21,589,333	24,533,333
Notes payable					
Cape Cod Hospital	3.65	3.65%	2022	1,662,885	1,851,104
Cape Cod Healthcare Obligated Group	n/a	3.15-3.56%	n/a	-	10,204,475
Falmouth Hospital	n/a	5.96%	n/a	-	4,615,460
Cape Cod Healthcare (variable rate)	n/a	2.26%	n/a	-	2,526,157
Cape Cod Healthcare	3.53%	n/a	2024	17,200,000	-
Capital Lease obligations	n/a	n/a	n/a	3,284,457	3,778,464
				<u>194,906,675</u>	<u>178,818,993</u>
Unamortized premium (original issue discount), net				1,106,669	1,144,488
Current portion				<u>(9,629,202)</u>	<u>(9,016,117)</u>
Total long-term debt				<u>\$ 186,384,142</u>	<u>\$ 170,947,364</u>

On December 23, 2004, the Cape Cod Healthcare Obligated Group issued \$65,000,000 of MDFA Series D Variable Rate Demand Revenue Bonds (the "Series D Bonds"). The Series D Bonds were collateralized by a bond insurance policy issued by Assured Guaranty. Proceeds from the Series D Bonds were used to satisfy a number of capital improvements at CCH, including an inpatient bed tower and cardiac catheterization facilities.

On February 16, 2010, Healthcare converted the Series D Bonds from variable rate demand bonds to fixed rate bonds in the amount of \$62,400,000. The fixed rate Series D Bonds continue to be collateralized by a bond insurance policy issued by Assured Guaranty.

On June 18, 2008, the Cape Cod Healthcare Obligated Group issued \$36,710,000 of MDFA Series E Variable Rate Bonds (the "Series E Bonds"). The bond proceeds, net of issuance costs of \$262,000, were used to refund the majority of a bridge loan Healthcare issued in March 2008 totaling \$38,925,000. On February 12, 2009, the Series E Bonds were increased by \$2,215,000 in order to repay the bridge loan that was outstanding as of September 30, 2008. The Series E Bonds are collateralized by a pledge of gross receipts and mortgages on the property and equipment of the core hospital campuses.

On January 12, 2012, Healthcare fully converted its Series E Variable Rate Bonds in the amount of \$29,440,000 via a direct placement with a commercial lender. The direct placement is a LIBOR-based loan with a ten year term. The loan amount is fully amortized upon final maturity in 2022. Healthcare recorded a nonoperating loss on the extinguishment of this debt in 2012 of \$574,000 related to this transaction.

On February 24, 2012, Healthcare issued ten year direct placement Series 2012A bonds with a commercial bank at a fixed rate of 2.66%. The bonds are fully amortized upon final maturity in 2022.

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

The proceeds were used to retire Series B Bonds of \$11,435,000 and to partially retire \$13,890,000 of Series C Bonds. Healthcare recorded a nonoperating loss on the extinguishment of this debt in 2012 of \$1,025,000 related to this transaction.

On July 11, 2013, the Cape Cod Healthcare Obligated Group issued \$50,000,000 of Series 2013 MDFA Hospital Revenue Bonds with a final maturity date of November 2041. Bond issuance costs of \$496,000 are recorded in prepaid expenses and other current assets and will be amortized over the life of the bonds. The Series 2013 bonds were issued with an original issue premium totaling \$832,000 which is recorded in long-term debt. The premium will be amortized using the effective interest method over the life of the bonds. A loss on extinguishment of \$1,123,000 was recorded as a result of this extinguishment. The bonds are collateralized by an interest in the Obligated Group's gross receipts and the mortgages on core hospital campuses.

Proceeds from the Series 2013 bonds were used in part to refund the outstanding 2001 Series C bonds of \$23,060,000, which were retired with an additional premium of \$115,000. The remaining proceeds were used to satisfy a number of capital improvements at CCH and Falmouth Hospital including emergency room expansions.

On September 23, 2014, the Cape Cod Healthcare Obligated Group entered into a 10 year, \$17,200,000 term loan agreement with a commercial bank at a fixed rate of 3.53%. The proceeds net of issuance costs of \$76,000 were used to refinance three outstanding notes totaling \$16,429,000. Healthcare reported a nonoperating loss for the pre-payment penalty on the extinguishment of debt of \$670,000.

On September 29, 2014, the Cape Cod Healthcare Obligated group issued 15 year, \$24,000,000 direct placement Series 2014 bonds with a fixed rate of 3.37%. The bonds are fully amortized upon final maturity in 2029. Bond issuance costs of \$243,000 are recorded in prepaid expenses and other current assets and will be amortized over the life of the bonds.

The fair value of interest rate swap agreements at September 30, 2014 and 2013 are as follows:

	2014	2013
Series A Swap	<u>\$ (2,585,149)</u>	<u>\$ (2,971,303)</u>

The effects of interest rate swap arrangements on the consolidated statements of operations and changes in net assets for 2014 and 2013 are as follows:

Location of Gain (Loss) in Statements of Operations	Amount of Gain (Loss) Recognized in Excess of Revenues and Gains Over Expenses and Losses for Years Ended September 30,	
	2014	2013
Series A Swap Change in fair value of interest rate sw ap	\$ 386,154	\$ 1,275,084
Series C Swap Change in fair value of interest rate sw ap	-	19,740
	<u>\$ 386,154</u>	<u>\$ 1,294,824</u>

Cape Cod Healthcare, Inc. and Affiliates

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Healthcare and its swap counterparties are exposed to credit risk in the event of nonperformance or early termination of the agreements. In accordance with the guidance on fair value measurements, Healthcare recorded a nonperformance risk adjustment which reduced the interest rate liability by approximately \$34,000 and \$51,000 in 2014 and 2013, respectively.

Loan Covenants

Several of the loan agreements contain covenants and financial ratios which require compliance by the various organizations. Certain of the agreements also provide for restrictions on, among other things, transfers, additional indebtedness, and dispositions of property, the most restrictive of which is the ratio of income available for debt service.

The Obligated Group

The Series D, E, 2012A, 2013 and 2014 Bonds are equally and ratably collateralized under the loan and trust agreements. At September 30, 2014, the Cape Cod Healthcare Obligated Group consisted of CCHC, CCHC Foundation, CCH and Falmouth Hospital.

All obligations issued under the Cape Cod Healthcare Obligated Group debt agreements or the Falmouth Hospital debt agreements will be joint and several obligations of the Cape Cod Healthcare Obligated Group, and equally and ratably collateralized by interests in the gross receipts of the Cape Cod Healthcare Obligated Group and the property subject to the mortgages.

Future Maturities

Aggregate future maturities of long-term obligations, including capital lease obligations:

2015	\$ 9,629,202
2016	9,684,953
2017	9,952,490
2018	10,207,794
2019	10,424,160
Thereafter	<u>145,008,076</u>
	<u>\$ 194,906,675</u>

Fair Value of Long-Term Debt

The fair value of Healthcare's long-term debt is estimated based on quoted market prices for the same or similar issues. The estimated fair value of Healthcare's long-term debt was approximately \$204,521,000 and \$181,078,000 at September 30, 2014 and 2013, respectively. The long-term debt is considered a Level 2 instrument.

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

11. Funds Held by Trustee Under Bond Indenture Agreements

At September 30, 2014 and 2013, under the terms of the agreements with MDFA, investments are being held in escrow for debt service and to fund future property and equipment additions.

These funds are invested primarily in certificates of deposit and U.S. government securities and are held in the following funds:

	2014	2013
Debt service fund	\$ 3,203,815	\$ 4,324,343
Debt service reserve fund	6,842,534	7,187,472
Project and construction funds	<u>15,471,337</u>	<u>12,610,858</u>
	<u>\$ 25,517,686</u>	<u>\$ 24,122,673</u>

12. Split Interest Agreements and Outside Trusts

Healthcare is obligated to make quarterly distributions to the beneficiaries of certain gift annuities (split-interest arrangements). The estimated net present value of these obligations totaled \$1,852,000 and \$1,935,000 at September 30, 2014 and 2013, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. Upon the death of each of the beneficiaries, the related obligations of Healthcare terminate.

Healthcare is the trustee of a pooled income fund. This fund is divided into units, and contributions of donors' life income gifts are pooled and invested as a group. Donors are assigned a specific number of units based on the proportion of the fair value of their contributions to the total fair value of the pooled income fund on the date of the donors' entry into the pool. Each donor receives the actual income earned on those units until his/her death. Upon the death of the donor, the donor's interest in the trust will revert to Healthcare and will be unrestricted. The estimated net present value of these obligations totaled \$273,000 and \$303,000 at September 30, 2014 and 2013, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

Healthcare holds beneficial interests in certain irrevocable charitable remainder trusts for which Healthcare does not serve as trustee. Healthcare records its beneficial interest in those trusts as contribution revenue and other assets at the present value of the expected future cash inflows. Such trusts are recorded at the date Healthcare has been notified of the trust's existence and sufficient information regarding the trust has been accumulated to form the basis for an asset. Changes in the value of these assets related to the amortization of the discount or revisions in the income beneficiary's life expectancy are recorded as a change in value of split interest agreements within temporarily or permanently restricted net assets.

Healthcare is also the beneficiary of certain perpetual trusts held and administered by others. The present values of the estimated future cash receipts from the trusts are recognized as beneficial interests in those assets as investments and contribution revenues at the date Healthcare is notified of the establishment of the trust and sufficient information regarding the trust has been obtained by Healthcare. Distributions from the trusts are recorded as investment income in the period they are received. Changes in fair value of the trusts are recorded as a change in beneficial interest in perpetual trusts within permanently restricted net assets.

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

13. Pledges Receivable

Pledges receivable represent unconditional promises to give. These amounts are reported at their present value, discounted at rates ranging from 1.25% to 4.88% at both September 30, 2014 and 2013, and are recorded net of an allowance for uncollectible amounts. Pledges receivable at September 30, 2014 and 2013 are expected to be collected as follows:

	2014	2013
Amounts due		
Within one year	\$ 4,681,991	\$ 4,517,318
In one to five years	7,715,527	10,195,310
In more than five years	646,000	800,000
	<u>13,043,518</u>	<u>15,512,628</u>
Present value discount	(460,966)	(651,909)
Allowance for uncollectible amounts	<u>(391,306)</u>	<u>(474,439)</u>
	<u>\$ 12,191,246</u>	<u>\$ 14,386,280</u>

14. Restricted Net Assets

Restricted net assets are available for the following purposes:

	2014	2013
Temporarily restricted		
Healthcare services	\$ 23,435,785	\$ 19,217,803
Buildings	13,572,998	16,513,838
Purchase of equipment	272,452	205,616
	<u>\$ 37,281,235</u>	<u>\$ 35,937,257</u>
Permanently restricted		
Healthcare services	<u>\$ 31,313,108</u>	<u>\$ 28,674,844</u>

Endowment

Healthcare's endowment consists of approximately 41 individual donor restricted endowment funds for a variety of purposes plus split interest agreements, and other net assets. The endowments are classified and reported based on the existence of donor imposed restrictions.

Healthcare has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Healthcare classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Healthcare in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Healthcare considers the following factors in making a determination to appropriate or

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

accumulate endowment funds: the duration and preservation of the fund; the purposes of the organization and the donor-restricted endowment fund; general economic conditions; the possible effect of inflation and deflation; the expected total return from income and the appreciation of investments; other resources of the organization; and the investment policies of the organization.

The following presents the endowment net asset composition by type of fund as of September 30, 2014 and 2013 and the changes in endowment assets for the years ended September 30, 2014 and 2013:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at September 30, 2012	\$ 7,492,189	\$ 27,983,284	\$ 35,475,473
Investment return			
Investment income	116,169	-	116,169
Net realized and unrealized depreciation	490,873	631,052	1,121,925
Total investment return	607,042	631,052	1,238,094
Gifts	-	60,508	60,508
Appropriation of endowment assets for expenditure	(713,089)	-	(713,089)
Endowment net assets at September 30, 2013	<u>7,386,142</u>	<u>28,674,844</u>	<u>36,060,986</u>
Investment return			
Investment income	100,878	-	100,878
Net realized and unrealized depreciation	800,508	712,613	1,513,121
Total investment return	901,386	712,613	1,613,999
Gifts	-	1,925,651	1,925,651
Appropriation of endowment assets for expenditure	(728,633)	-	(728,633)
Endowment net assets at September 30, 2014	<u>\$ 7,558,895</u>	<u>\$ 31,313,108</u>	<u>\$ 38,872,003</u>

Endowment Funds With Deficits

From time to time, the fair value of net assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction to unrestricted net assets. This deficit was immaterial to the financial statements as of September 30, 2014 and 2013.

15. Functional Expenses

Total operating expenses by function are as follows:

	2014	2013
Healthcare services	\$ 620,068,260	\$ 570,942,803
General and administrative	83,895,670	77,097,228
	<u>\$ 703,963,930</u>	<u>\$ 648,040,031</u>

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

16. Commitments and Contingencies

Leases

Healthcare has entered into operating leases for certain office equipment and office space. Certain leases provide for renewal options and some contain provisions requiring the affiliates to pay their proportionate share of operating costs in addition to base rent. Rent expense under the operating leases amounted to approximately \$8,156,000 and \$5,345,000 in 2014 and 2013, respectively.

At September 30, 2014, the aggregate future rental commitments under noncancelable leases were:

	Capital Leases	Operating Leases
2015	\$ 1,197,579	\$ 4,180,314
2016	914,748	3,877,933
2017	380,990	2,644,293
2018	281,664	1,365,231
2019	246,948	145,758
Thereafter	<u>1,061,804</u>	<u>47,507</u>
Total lease payments	<u>4,083,733</u>	<u>\$ 12,261,036</u>
Less: Amount representing interest	<u>(799,276)</u>	
Capital lease obligations at September 30, 2014	<u>\$ 3,284,457</u>	

Malpractice Insurance

Healthcare is self-insured for professional and general liability insurance coverage as funded through CHICO, a wholly-owned CCHC affiliate domiciled in the Cayman Islands. CHICO provides the professional liability insurance coverage on a modified claims-made basis, and the general liability claims on an occurrence basis. Liability limits are set annually at \$2,000,000 per medical incident and \$6,000,000 in the aggregate. Effective for the policy year starting June 1, 2008, CHICO's maximum retention in any one policy year is \$8,000,000; for all prior policy years maximum retention is \$10,000,000. Since June 1, 2008, CHICO has maintained reinsurance for 100% of the losses above the underlying policy limits/retention, up to a maximum limitation of \$25,000,000 per policy year. For all policy years prior to June 1, 2008, CCHC maintained excess insurance coverage with a maximum limitation up to \$25,000,000 per policy year. Under the claims-made policies, coverage is provided by CHICO when a claim is first reported during a policy term and its incident date is on or after the retroactive date. The reserves for outstanding losses at Healthcare have been discounted at a rate of 3% at both September 30, 2014 and 2013, resulting in a recorded professional liability reserve of \$24,296,000 and \$21,749,000 at September 30, 2014 and 2013, respectively.

Workers' Compensation

Healthcare provides certain workers' compensation coverage on a self-insured basis. The liability, including an estimate for claims incurred but not reported, at September 30, 2014 and 2013, of approximately \$7,955,000 and \$7,518,000, respectively, is included in accounts payable and accrued expenses.

Health Insurance Plan

Healthcare is self-insured for its employee health insurance plan. As such, Healthcare recorded a liability of \$11,480,000 and \$7,924,000 for claims incurred but not reported at September 30, 2014 and 2013, respectively, which is included in accounts payable and accrued expenses.

Cape Cod Healthcare, Inc. and Affiliates
Notes to Consolidated Financial Statements
September 30, 2014 and 2013

Other Contingencies

CCHC and its affiliates are parties in various legal proceedings and potential claims arising in the ordinary course of its business. In addition, the health care industry as a whole is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to government review and interpretation as well as regulatory actions, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue from patient services. Management believes that CCHC and its affiliates are in compliance with current laws and regulations and does not believe that these matters will have a material adverse effect on CCHC and its affiliates' consolidated financial statements.

17. Concentration of Credit Risk

Financial instruments that potentially subject Healthcare to concentrations of credit risk are patient and other accounts receivable, cash and cash equivalents, derivatives, and investments. CCHC and its affiliates are located in the Cape Cod area of Massachusetts. The entities grant credit without collateral to their patients, many of whom are local residents and are insured under third-party payor agreements.

Accounts receivable from patients and third-party payors at September 30, 2014 and 2013, were as follows:

	2014	2013
BlueCross and BlueShield	10 %	11 %
Medicare	36	34
Medicaid	6	10
Other third-party payors	36	37
Patients	12	8
	<u>100 %</u>	<u>100 %</u>

A significant portion of the accounts receivable from other third-party payors (commercial insurance companies and HMOs) is derived from two Massachusetts managed care companies. Although management expects amounts recorded as net accounts receivable at September 30, 2014, to be collectible, this concentration of credit risk is expected to continue in the near term.

18. Subsequent Events

Healthcare has assessed the impact of subsequent events through January 16, 2015, the date that the financial statements were issued, and has concluded that there were no events that require adjustment to the audited financial statements or disclosure in the footnotes to the audited financial statements, other than the items as described above.

Cape Cod Healthcare, Inc. and Affiliates
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2014

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Grant/ Pass-Through Number	Federal Expenditures
U.S. Department of Health and Human Services			
Direct Programs			
Grants to provide Outpatient Early Intervention Services with respect to HIV Disease	93.918	2H76HA00764-04-C0	\$ 552,850
Total Direct Programs			<u>552,850</u>
Pass-Through from the Commonwealth of Massachusetts			
National Bioterrorism Hospital Preparedness Program	93.889	1U3RHS05952-01-00	83,576
National Emergency Hospital Preparedness Program	93.069	U3RHS05952	32,885
HIV Care Formula Grants	93.917	INTF4943MM3200120008	107,876
HIV Prevention Activities - Health Department Based	93.940	INTF4942MM3100119023	53,431
Total Pass-Through from the Commonwealth of Massachusetts			<u>277,768</u>
Total U.S. Department of Health and Human Services			<u>830,618</u>
Section 8 Project Based Cluster			
Section 8 Housing Assistance Payments Program	14.195	MA06T791001	57,153
Total Section 8 Project Based Cluster			<u>57,153</u>
Total Expenditures of Federal Awards			<u>\$ 887,771</u>

The accompanying notes are an integral part of the schedule of expenditures of federal awards.

Cape Cod Healthcare, Inc. and Affiliates

Notes to Schedule of Expenditures of Federal Awards

September 30, 2014

1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the expenditures of Cape Cod Healthcare, Inc. and Affiliates ("Healthcare") under programs of the federal government for the year ended September 30, 2014. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and expenditures are presented on the accrual basis of accounting.

2. Facilities and Administrative Costs

Healthcare does not have a federal facilities and administrative cost rate. Healthcare charges administrative costs to certain grants in accordance with the terms and agreements of the respective grants.

3. Pass-Through Funds From the Commonwealth of Massachusetts

Healthcare receives pass-through funds from the Commonwealth of Massachusetts (the "Commonwealth") for the HIV Care Formula Grants (93.917) and HIV Prevention Activities – Health Department Based (93.940) awards which are partially funded by the Commonwealth. Of these expenditures, the Commonwealth is unable to identify to Healthcare what portion of the October 1, 2013 through September 30, 2014 expenditures are related to federal funding as the Commonwealth's fiscal year is from July 1, 2013 through June 30, 2014. As the level of federal funding remains consistent from year to year, an allocation has been performed to determine the level of federal funding for inclusion on the accompanying Schedule for the period from October 1, 2013 through September 30, 2014.

Federal pass-through funds for the Commonwealth's fiscal year (July 1, 2013 through June 30, 2014) amount to \$103,654 for the HIV Care Formula Grants award out of total grant expenditures of \$153,654 and were obtained directly from the POS Expenditure and Federal Funds Listing – Fiscal Year 2014 provided to Healthcare by the Commonwealth. Total grant expenditures (Federal and Commonwealth) by Healthcare for the period from October 1, 2013 through September 30, 2014 were \$159,913. Historically, Healthcare has received a consistent level of federal funding from month to month each fiscal year. The accompanying Schedule includes \$107,876 as the federal portion of these expenditures for this award based upon the percentage of the federal portion to the total as reported on a June fiscal year end basis by the Commonwealth.

Federal pass-through funds for the Commonwealth's fiscal year (July 1, 2013 through June 30, 2014) amount to \$56,853 for the HIV Prevention Activities – Health Department based award out of total grant expenditures of \$365,000 and were obtained directly from the POS Expenditure and Federal Funds Listing – Fiscal Year 2014 provided to Healthcare by the Commonwealth. Total grant expenditures (Federal and Commonwealth) by Healthcare for the period from October 1, 2013 through September 30, 2014 were \$343,032. Historically, Healthcare has received a consistent level of federal funding from month to month each fiscal year. The accompanying Schedule includes \$53,431 as the federal portion of these expenditures for this award based upon the percentage of the federal portion to the total as reported on a June fiscal year end basis by the Commonwealth.

Part II

Reports on Internal Controls and Compliance



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 Trustees of
Cape Cod Healthcare, Inc. and Affiliates

We have audited, 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, the consolidated financial statements of Cape Cod Healthcare, Inc. and Affiliates ("Healthcare"), which comprise the consolidated balance sheet as of September 30, 2014, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 16, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Healthcare's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Healthcare's internal control. Accordingly, we do not express an opinion on the effectiveness of Healthcare's internal control.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Healthcare's financial statements are free from 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Healthcare's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PricewaterhouseCoopers LLP

January 16, 2015



**Independent Auditor's Report on Compliance with Requirements
That Could Have a Direct and Material Effect on Each Major Program and on Internal
Control Over Compliance in Accordance with OMB Circular A-133**

To the Board of Trustees of
Cape Cod Healthcare, Inc. and Affiliates

Report on Compliance for Each Major Federal Program

We have audited Cape Cod Healthcare, Inc. and Affiliates' ("Healthcare") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Healthcare's major federal programs for the year ended September 30, 2014. Healthcare's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Healthcare's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Healthcare's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Healthcare's compliance.

Opinion on Each Major Federal Program

In our opinion, Healthcare complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2014.



Report on Internal Control Over Compliance

Management of Healthcare is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Healthcare's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Healthcare's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

PricewaterhouseCoopers LLP

June 23, 2015

Part III
Findings

Cape Cod Healthcare, Inc. and Affiliates
Schedule of Findings and Questioned Costs
Year Ended September 30, 2014

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unmodified
Internal control over financial reporting	
Material weakness(es) identified?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no
Significant deficiency(ies) identified that are not considered to be material weaknesses?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> none reported
Noncompliance material to the financial statements noted?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no

Federal Awards

Internal control over major programs	
Material weakness(es) identified?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no
Significant deficiency(ies) identified that are not considered to be material weaknesses?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> none reported
Type of auditor's report issued on compliance for major programs	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no

**Identification of major programs
CFDA Number(s)**

93.918

Name of Federal Program or Cluster

Grants to provide Outpatient Early Intervention Services with respect to HIV Disease

Dollar threshold used to distinguish between Type A and Type B programs

\$300,000

Auditee qualified as low-risk auditee?

yes no

Cape Cod Healthcare, Inc. and Affiliates
Schedule of Findings and Questioned Costs
Year Ended September 30, 2014

II. Financial Statement Findings

None noted.

III. Federal Awards Findings and Questioned Costs

None noted.

Cape Cod Healthcare, Inc. and Affiliates
Summary Schedule of Prior Audit Findings
Year Ended September 30, 2014

There are no findings from prior years that require an update.