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# CENTRA HEALTH, INC.

Compliance Reports

Year ended December 31, 2012

**CENTRA HEALTH, INC.**

**Table of Contents**

**KPMG LLP**
Suite 1010
10 S. Jefferson Street
Roanoke, VA 24011-1331

# Independent Auditors' 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*

The Board of Directors
Centra Health, Inc.:

We have audited, in accordance with the 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 Centra Health, Inc. and Subsidiaries (Centra), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 15, 2013.

## Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Centra'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 Centra's internal control. Accordingly, we do not express an opinion on the effectiveness of Centra'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 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 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 Centra's consolidated 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 Centra's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Centra's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Roanoke, Virginia
April 15, 2013

KPMG LLP
Suite 1010
10 S. Jefferson Street
Roanoke, VA 24011-1331

## Independent Auditors' Report on Compliance for the Major Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

The Board of Directors
Centra Health, Inc.:

### Report on Compliance for the Major Federal Program

We have audited Centra Health, Inc.'s (Centra) 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 Centra's major federal program for the year ended December 31, 2012. Centra's major federal program is identified in the summary of auditors' 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.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on compliance for Centra's major federal program 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 Centra'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 the major federal program. However, our audit does not provide a legal determination of Centra's compliance.

#### *Opinion on Each Major Federal Program*

In our opinion, Centra Health, Inc. complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2012.

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### *Other Matters*

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2012-001 and 2012-002. Our opinion on the major federal program is not modified with respect to these matters.

Centra's responses to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Centra's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

## Report on Internal Control over Compliance

Management of Centra 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 Centra's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the 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 Centra'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 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2012-001 and 2012-002, that we consider to be significant deficiencies.

Centra's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Centra's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

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.

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**Report on Schedule of Expenditures of Federal Awards by OMB Circular A-133**

We have audited the consolidated financial statements of Centra Health, Inc. and Subsidiaries as of and for the year ended December 31, 2012, and have issued our report thereon dated April 15, 2013, which contained an unmodified opinion on those financial statements. 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 is presented for purposes of additional analysis as required by OMB Circular A-133 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 expenditure of federal awards is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

Roanoke, Virginia

September 26, 2013, except for our report on the
Schedule of Expenditures of Federal Awards, for which the date is April 15, 2013.

**CENTRA HEALTH, INC.**

Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

| Grantor/pass-through grantor/program or cluster title | CFDA number | Pass-through entity identifying number | | Federal expenditures |
|---|---|---|---|---|
| Federal awards: | | | | |
| Student Financial Assistance Cluster: | | | | |
| U.S. Department of Education: | | | | |
| Federal Pell Grant Program | 84.063 | N/A | $ | 262,723 |
| Federal Direct Student Loans | 84.268 | N/A | | 537,724 |
| | | | | 800,447 |
| Department of Health and Human Services: | | | | |
| Ryan White Title II (passed through the Infectious Disease Center of Central Virginia) | 93.917 | * | | 189,440 |
| Fetal Infant Mortality Review | 93.994 | N/A | | 35,418 |
| National Bioterrorism Hospital Preparedness Program | 93.889 | N/A | | 18,188 |
| Ryan White Title III Outpatient EIS Program | 93.918 | N/A | | 144,454 |
| Total expenditures | | | $ | 1,187,947 |

* Contract numbers: VDH-DDP-AX-45416-2011-SUB (July 1, 2011 to March 31, 2012), VDH-DDP-611-45416-2011-SUB-CH (July 1, 2011 to March 31, 2012), and DDP-611-AX-45416-2011 (April 1, 2012 to March 31, 2013)

See accompanying note to schedule of expenditures of federal awards.

See accompanying Independent Auditors' Report on Compliance for the Major Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.*

**CENTRA HEALTH, INC.**

Note to Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

## (1) Presentation and Basis of Accounting

The accompanying schedule of expenditures of federal awards (the schedule) includes the federal grant activity of Centra Health, Inc. (Centra) and has been prepared on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in the schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

CENTRA HEALTH, INC.

Schedule of Findings and Questioned Costs

Year ended December 31, 2012

(1) **Summary of Auditors' Results**

(a) The type of report issued on the financial statements: **Unqualified opinion**

(b) Significant deficiencies in internal control over financial reporting disclosed by the audit of the financial statements that are not considered to be material weaknesses: **None reported**

Material weaknesses: **None**

(c) Noncompliance, which is material to the financial statements: **None**

(d) Significant deficiencies in internal control over major programs that are not considered to be material weaknesses: **Yes, findings 2012-001 and 2012-002**

Material weaknesses: None

(e) The type of report issued on compliance for major programs: **Unqualified opinion**

(f) Any audit findings, which are required to be reported under Section 510(a) of OMB Circular A-133: **Yes, findings 2012-001 and 2012-002**

(g) Major programs: **Student Financial Assistance Programs Cluster (CFDA Nos. 84.063 and 84.268)**

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$300,000**

(i) Auditee qualified as a low-risk auditee under Section 530 of OMB Circular A-133: Yes

(2) **Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*: None**

(3) **Findings and Questioned Costs Relating to Federal Awards**

***2012-001 Financial Reporting***

*Program* – Federal Pell Grant Program; 84.063

*Condition* – While performing testwork related to submission of Pell origination records and disbursement records to the Common Origination and Disbursement (COD) System, we noted that the School of Nursing uses an advance payment method and was under the impression that the section on reporting payment data within **30 calendar days after** the school makes a payment refers to those schools that operate on the reimbursement basis. Thus, the School of Nursing has not been submitting the required data to the COD System.

*Criteria* – All schools receiving Pell grants submit Pell payment data to the Department through the COD System. Institutions must report student payment data within 30 calendar days after the school makes a payment; or becomes aware of the need to make an adjustment to previously reported student payment data or expected student payment data. Schools may do this by reporting once every 30 calendar days, biweekly, weekly, or may set up their own system to ensure that changes are reported in a timely manner.

*Effect* – The School of Nursing is not in compliance with the requirements related to reporting student payment data.

*Questioned Costs* – Since the disbursements were properly made to the students, we do not believe this finding results in questioned costs.

*Recommendation* – We recommend that the School of Nursing ensure that student payment data is reported to the COD System within 30 calendar days after the school makes a payment, regardless of whether advance payment methods are used.

*Views of Responsible Officials* – Management agrees with this finding. The School of Nursing will review and develop a more detailed and accurate reporting method to ensure that student payment data is reported to the COD system within 30 calendar days after the school makes a payment. This review shall include the forming of an ad hoc committee to recommend procedural changes and the training of key personnel in revised procedures.

***2012-002 Special Tests and Provisions: Disbursements To or On Behalf of Students***

*Program* – Federal Direct Student Loans; 84.268

*Condition* – While performing testwork related to verification of notification to students of the criteria discussed below (as it relates to Direct Loans), we noted that the School of Nursing was not able to provide us with copies of the notification e-mails that were sent to the students through the Moodle system for each semester; thus, we could not substantiate that proper notification had been made timely or at all for Direct Loan disbursements. Management provided us with a date that the e-mail was sent, but indicated there was no verification as they did not keep record of these e-mails.

*Criteria* – If an institution credits a student's account at the institution with Direct Loan, FPL, TEACH, or FFEL funds, the institution must notify the student, or parent in writing of (1) the date and amount of the disbursement, (2) the student's right or parent's right to cancel all or a portion of that loan or loan disbursement and have the loan proceeds returned to the holder of that loan or the TEACH Grant payments returned to ED, and (3) the procedure and time by which the student or parent must notify the institution that he or she wishes to cancel the loan, TEACH Grant, or TEACH Grant disbursement. Institutions that do not implement an affirmative confirmation process must notify a student no earlier than 30 days before, but no later than 7 days after, crediting the student's account and must give the student 30 days (instead of 14) to cancel all or part of the loan. The requirement on FFEL funds applies only if the funds disbursed by electronic funds transfer payment or master check (34 CFR Section 668.165).

*Effect* – The School of Nursing is not in compliance with the requirements related to the required notification of Direct Loan disbursements.

*Questioned Costs* – Since the disbursements were properly made to the students, we do not believe this finding results in questioned costs.



(Continued)

*Recommendation* – We recommend that the School of Nursing ensure that students receive the required notification of Direct Loan disbursements within 30 days and that a copy of that notification be kept on file with the student's records.

*Views of Responsible Officials* – Management agrees with this finding. The School of Nursing will ensure that students will receive the required notification of Direct Loan disbursements within 30 days and a copy of the notification will be kept on file within the student's records.

**CENTRA HEALTH, INC.**

Schedule of Prior Year Audit Findings

Year ended December 31, 2012

**Prior Year Audit Findings**

There were no audit findings reported in the previous two years.

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# CENTRA HEALTH, INC. AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

## CENTRA HEALTH, INC AND SUBSIDIARIES

### Officers

| | |
|---|---|
| Kenneth S. White | Chairman of the Board |
| W. Michael Bryant | President/CEO |
| E.W. Tibbs | Senior Vice President/Secretary |
| Lewis C. Addison | Senior Vice President/Treasurer |

### Board of Directors

Terms Expiring in 2014

| | | |
|---|---|---|
| Sackett Wood | Chris Thomson, MD | Michael V Bradford |
| Kenneth S. White | Robert D. Cook, MD | Kristen L Huber, MD |
| Terry H. Jamerson | Augustus A. Petticolas, DDS | Walker P Sydnor, Jr. |

Terms Expiring in 2015

| | | |
|---|---|---|
| W. Michael Bryant | Stuart C. Fauber | Julie P. Doyle |
| Michael J. Diminick, MD | Charles W. Pryor, Jr. | Stephen C. Keith Ed. D |
| Rev. William Coleman | | J. Scott Wade, MD |

Terms Expiring in 2016

| | | |
|---|---|---|
| Albert M. Baker, MD | Laura L. Hamilton | Rodger W. Fauber |
| Sharon L. Harrup | Amy G. Ray | Marc A. Schewel |
| Daniel Carey, MD | | Consuella K. Woods |

**President of Medical Staff**
**Chris Thomson, MD**

**CENTRA HEALTH, INC. AND SUBSIDIARIES**

December 31, 2012 and 2011

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KPMG
**KPMG LLP**
Suite 1010
10 S. Jefferson Street
Roanoke, VA 24011-1331

# Independent Auditors' Report

The Board of Directors
Centra Health, Inc.:

We have audited the accompanying consolidated financial statements of Centra Health, Inc. and Subsidiaries (Centra), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements. The accompanying consolidated financial statements of Centra as of December 31, 2011, were audited by other auditors whose report thereon dated March 26, 2012, expressed an unqualified opinion on those statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; 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.

## Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 the auditors' 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, the auditor considers internal control relevant to the entity'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 the entity'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 financial position of Centra Health, Inc. and Subsidiaries as of December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

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As discussed in note 1(s) to the consolidated financial statements, Centra changed its presentation of provision for bad debts as a result of the adoption of Accounting Standards Update No. 2011-07, *Health Care Entities: Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities.*

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2013 on our consideration of the Centra's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Centra's internal control over financial reporting and compliance.

KPMG LLP

Roanoke, Virginia
April 15, 2013

## CENTRA HEALTH, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2012 and 2011

| Assets | | 2012 | 2011 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 46,996,922 | 46,383,385 |
| Patient accounts receivable, net | | 62,000,014 | 62,460,260 |
| Investments and assets whose use is limited | | 3,066,104 | 3,499,192 |
| Inventories | | 14,362,939 | 14,021,738 |
| Prepaid expenses and other current assets | | 12,866,089 | 10,812,939 |
| Total currents assets | | 139,292,068 | 137,177,514 |
| Investments and assets whose use is limited | | 391,783,073 | 334,496,186 |
| Property, plant and equipment, net | | 283,940,226 | 280,071,613 |
| Investments in joint ventures | | 14,729,184 | 15,172,613 |
| Other assets | | 7,707,709 | 8,541,876 |
| Total assets | $ | 837,452,260 | 775,459,802 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Accounts payable and accrued expenses | $ | 36,037,907 | 34,219,111 |
| Employee compensation and benefits | | 30,630,900 | 27,907,275 |
| Estimated settlements to third-party payors | | 15,388,995 | 8,942,574 |
| Current portion of long-term obligations | | 8,695,512 | 8,440,188 |
| Other current liabilities | | 1,638,678 | 2,118,374 |
| Total current liabilities | | 92,391,992 | 81,627,522 |
| Long-term obligations, net of current portion | | 221,319,034 | 230,782,894 |
| Interest rate swap agreements | | 27,322,431 | 27,730,118 |
| Retirement obligations | | 64,531,024 | 65,864,741 |
| Other long-term liabilities | | 21,108,125 | 21,077,100 |
| Total liabilities | | 426,672,606 | 427,082,375 |
| Net assets: | | | |
| Unrestricted | | 359,933,094 | 301,140,897 |
| Temporarily restricted | | 21,968,182 | 18,358,152 |
| Permanently restricted | | 28,878,378 | 28,878,378 |
| Total net assets | | 410,779,654 | 348,377,427 |
| Total liabilities and net assets | $ | 837,452,260 | 775,459,802 |

See accompanying notes to consolidated financial statements.

## CENTRA HEALTH, INC. AND SUBSIDIARIES

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| Operating revenues and other support: | | |
| Net patient service revenue (net of contractual allowances and discounts) | $ 653,414,435 | 642,976,677 |
| Provision for bad debts | (39,117,292) | (40,726,546) |
| Net patient service revenue less provision for bad debts | 614,297,143 | 602,250,131 |
| Outside lab revenue | 9,490,632 | 8,497,329 |
| Foundation revenue and support | 1,212,093 | 1,585,367 |
| Net assets released from restrictions for operations | 1,164,785 | 1,017,430 |
| Other operating revenue | 40,976,671 | 39,019,425 |
| Total operating revenues and other support | 667,141,324 | 652,369,682 |
| Operating expenses: | | |
| Salaries and wages | 292,357,701 | 281,130,674 |
| Benefits | 79,641,072 | 70,732,741 |
| Medical supplies and drugs | 78,089,137 | 77,778,793 |
| Professional services | 23,107,598 | 23,303,541 |
| Other purchased services | 66,291,414 | 64,346,124 |
| Other operating expenses | 55,578,847 | 53,619,919 |
| Depreciation and amortization | 41,776,088 | 40,519,511 |
| Interest | 5,850,778 | 6,334,609 |
| Total operating expenses | 642,692,635 | 617,765,912 |
| Net operating income | 24,448,689 | 34,603,770 |
| Nonoperating gains (losses): | | |
| Loss on extinguishment of debt | (446,844) | — |
| Investment income | 23,957,466 | 10,844,749 |
| Change in value of interest rate swap agreements | 407,687 | (14,765,514) |
| Other | (45,131) | 13,915 |
| Net nonoperating gains (losses) | 23,873,178 | (3,906,850) |
| Excess of revenues and other support over expenses | $ 48,321,867 | 30,696,920 |



(Continued)

**CENTRA HEALTH, INC. AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| Unrestricted net assets: | | | |
| Excess of revenues and other support over expenses | $ | 48,321,867 | 30,696,920 |
| Net unrealized gains (losses) on investments | | 8,441,934 | (4,421,006) |
| Change in funded status of defined benefit plan | | 207,444 | (41,352,922) |
| Net assets released from restrictions for capital acquisitions | | 1,820,952 | 781,802 |
| Change in unrestricted net assets | | 58,792,197 | (14,295,206) |
| Temporarily restricted net assets: | | | |
| Gifts and bequests | | 1,334,332 | 2,421,952 |
| Net unrealized gains (losses) on investments | | 2,007,780 | (2,477,149) |
| Net investment income | | 3,253,655 | 1,422,313 |
| Net assets released from restrictions | | (2,985,737) | (1,799,232) |
| Change in temporarily restricted net assets | | 3,610,030 | (432,116) |
| Change in net assets | | 62,402,227 | (14,727,322) |
| Net assets at beginning of year | | 348,377,427 | 363,104,749 |
| Net assets at end of year | $ | 410,779,654 | 348,377,427 |

See accompanying notes to consolidated financial statements.

**CENTRA HEALTH, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Change in net assets | $ 62,402,227 | (14,727,322) |
| Adjustments to reconcile changes in net assets to net cash provided by operations: | | |
| Depreciation and amortization | 41,776,088 | 40,519,511 |
| Net realized and unrealized (gains) losses on investments and assets whose use is limited | (36,784,369) | (4,724,981) |
| Provision for bad debts | 39,117,292 | 40,726,546 |
| Change in pension liability | (207,444) | 41,352,922 |
| Change in fair value of interest rate swap agreement | (407,687) | 14,765,514 |
| Gains on equity investments in joint ventures | (1,686,303) | (812,985) |
| (Gains) losses on sale of property, buildings and equipment | 55,476 | (12,237) |
| Loss on extinguishment of long-term debt | 446,844 | — |
| Changes in operating assets and liabilities: | | |
| Patient accounts receivable | (38,657,046) | (51,140,732) |
| Estimated settlements with third-party payors | 6,446,421 | 6,041,239 |
| Inventories | (341,201) | (740,319) |
| Prepaid expenses and other current assets | (2,053,150) | 1,038,170 |
| Other assets | (638,937) | (306,441) |
| Accounts payable and other accrued expenses | 2,201,950 | 4,704,004 |
| Employee compensation and benefits | 2,723,625 | 1,401,343 |
| Retirement obligations | (1,126,273) | (3,876,977) |
| Other liabilities | 1,295,229 | 2,860,164 |
| Net cash provided by operating activities | 74,562,742 | 77,067,419 |
| Cash flows from investing activities: | | |
| Net change in investments and assets whose use is limited | (20,069,430) | (23,259,551) |
| Acquisition of property, buildings and equipment | (45,983,840) | (31,857,953) |
| Proceeds on sale of property, buildings and equipment | — | 12,237 |
| Distributions from joint ventures | 2,129,732 | 1,735,073 |
| Net cash used in investing activities | (63,923,538) | (53,370,194) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term obligations | 9,455,000 | 9,619,940 |
| Principal payments on long-term obligations | (18,663,536) | (16,101,170) |
| Resident refunds | (817,131) | (1,126,747) |
| Net cash used in financing activities | (10,025,667) | (7,607,977) |
| Net increase in cash and cash equivalents | 613,537 | 16,089,248 |
| Cash and cash equivalents at beginning of year | 46,383,385 | 30,294,137 |
| Cash and cash equivalents at end of year | $ 46,996,922 | 46,383,385 |

See accompanying notes to consolidated financial statements.

## (1) Organization and Summary of Significant Accounting Policies

### *(a) Organization*

Centra Health, Inc. and Subsidiaries' (Centra) operations consist of three acute care hospitals, a long-term acute care hospital, three nursing homes, a continuing care retirement community, and a residential adolescent psychiatric facility. Centra is a not-for-profit corporation with a commitment to promote and develop health care services and the general well-being of the community. Centra also coordinates the activities and interactions of related entities.

### *(b) Principles of Consolidation*

The consolidated financial statements include the accounts of Centra Health, Inc. and its wholly owned taxable subsidiary, General Business Concerns, Inc. The consolidated financial statements also include the tax-exempt organizations of Centra Health Foundation (the Foundation), Centra Medical Group LLC, Centra Health Cardiovascular Services LLC, Centra Health Emergency Services LLC, Central Virginia Hospital for Restorative and Rehabilitative Care, LLC (Centra Specialty Hospital), Centra Southside Community Hospital, Inc., Lynchburg Family Practice Residency Program, Inc. (Lynchburg Family Medicine), which merged into Centra at the end of 2011, Centra Health Indemnity Company LLC, and CCRC, Inc., a majority-owned (91%) subsidiary of Centra. All significant intercompany transactions and account balances have been eliminated in consolidation.

### *(c) Use of Estimates*

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### *(d) Cash and Cash Equivalents*

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less when purchased. Centra will routinely invest its surplus funds in money market accounts. At various times throughout the year, Centra maintains deposits at financial institutions in excess of amounts covered by federal depository insurance (FDIC) limits.

### *(e) Assets Whose Use is Limited and Investments*

Assets whose use is limited include assets set aside by the Board of Directors for future capital improvements, assets held by the trustee under the Master Indenture, assets restricted by donors and funds designated for construction projects. The portion required for payment of current liabilities is classified as current.

Investments include marketable debt and equity securities and are carried at fair value. Fair value is based on quoted market prices. Realized gains and losses on the sale of investments are determined based on the cost of the specific investment sold.


(Continued)

### *(f) Perpetual and Charitable Remainder Trusts*

The Foundation has entered into several types of agreements with donors under which the Foundation will receive future benefits. The Foundation has two types of agreements: perpetual trusts held by a third party and charitable remainder trusts. Under the perpetual trusts, a donor establishes and funds a perpetual trust administered by a trustee other than the Foundation. The Foundation has the irrevocable right to receive the income earned on the trust assets in perpetuity but never receives the assets held in trust. Distributions received by the Foundation may be restricted by the donor. Under the charitable remainder trusts, the donor establishes and funds a trust with specified distributions to be made to a designated beneficiary or beneficiaries over the trust's term. Upon termination of the trust, the Foundation receives the assets remaining in the trust. The Foundation may ultimately have unrestricted use of those assets, or the donor may place permanent or temporary restrictions on their use. The Foundation's beneficial interest in trusts is recorded at fair value within assets whose use is limited and other assets.

### *(g) Interest Rate Swap Agreements*

Investments in interest rate swap agreements are carried at fair value, estimated using a discounted cash flow method at a rate commensurate with the risk involved. Changes in the fair value of the interest rate swap agreements are reported as nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. Net cash settlements are included in interest expense.

### *(h) Property, Buildings and Equipment*

Property, buildings and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The general range of estimated useful lives for buildings and land improvements is 20 – 40 years and the general range for equipment is 3 – 15 years. Leasehold improvements are depreciated over the life of the related lease, or the useful life of the asset, whichever is shorter.

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the costs of acquiring those assets. Revenue and maintenance is expensed as incurred. Gain or losses on disposal of property, plant and equipment are included in other operating revenue.

Gifts of long-lived operating assets such as land, buildings, or equipment are reported as an increase in unrestricted net assets, and excluded from excess of unrestricted revenues and other support over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted gifts.

### *(i) Inventories*

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

***(j) Deferred Financing Costs***

Costs of obtaining financing are deferred and amortized over the terms of the related indebtedness to which they apply.

***(k) Advance Fees and Deposits***

Under the CCRC, Inc. Residency Agreement, a reservation fee of 10% of the advance fee is required with each reservation. The reservation fee is refundable in full if, before the occupancy date, (i) the applicant terminates the Residency Agreement within seven days of either signing the Residency Agreement or making the reservation deposit, (ii) the applicant is not admitted or dies, or (iii) CCRC, Inc. terminates the Residency Agreement; otherwise, the reservation fee is refundable to the applicant net of a $500 administrative fee. Upon occupancy, reservation fees are reclassified as deferred revenue from advance fees in other liabilities.

The Residency Agreement provides for partial refunds of the advance fee under the circumstances outlined below. CCRC, Inc. offers residents a choice of one of the following two options:

1. Declining Refund Resident Fee – After the occupancy date, if the Residency Agreement is terminated for any reason, all fees are refundable less an amount equal to 2% of such fees per month of occupancy.

   Advance fees received under declining refund resident contracts are amortized into revenue over the actuarially determined life expectancy of each individual resident or couple, adjusted annually.

2. 90% Guaranteed Refund Resident Fee – After the occupancy date, if the Residency Agreement is terminated for any reason, 90% of the fee is refundable upon reoccupancy of the resident's unit.

   Advance fees received under the 90% guaranteed refund resident contracts are amortized into revenue as follows:

   - The nonrefundable portion is amortized over the actuarially determined life expectancy of each individual resident or couple adjusted annually.
   - The refundable portion is amortized over the remaining useful life of the facility on the straight-line method.

The portion of advance fees subject to refund provisions amounted to approximately $10,291,000 and $10,157,000 at December 31, 2012 and 2011, respectively.

***(l) Temporarily and Permanently Restricted Net Assets***

Net assets are classified based on the existence or absence of donor-imposed restrictions. Temporarily restricted net assets are those whose use by Centra has been limited by donors to a specific time period or propose. Permanently restricted net assets have been restricted by donors to be maintained by Centra in perpetuity. Related income is classified as temporarily restricted until expended.

***(m) Net Patient Service Revenue***

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments, including revisions to estimated settlements as a result of audits by the intermediary, are accrued on an estimated basis in the period their related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue was increased by approximately $3,500,000 and $1,670,000 for the years ended December 31, 2012 and 2011, respectively, as a result of changes in estimates associated with settlements and other revisions to prior years for third-party settlement accounts.

Centra recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, Centra recognizes revenue on the basis of its discounted rates. Uninsured patients receive a 30% discount from billed charges. On the basis of historical experience, a portion of the patients will be unable or unwilling to pay for the services provided. Thus, Centra records a provision for bad debts/charity related to patient responsibility in the period the services are provided.

***(n) Charity Care***

Centra provides care without charge to patients who meet certain criteria under its charity care policy. Because Centra does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient revenue. Centra maintains records to identify and monitor the level of charity care it provides. The cost to provide services and supplies furnished under Centra charity care policy was approximately $26,397,000 and $22,099,000 for 2012 and 2011, respectively. The estimated costs of providing charity services are based on a calculation, which applies a ratio of costs to charges to the gross uncompensated charges associated with providing charity to patients. The ratio of cost to charges is calculated based on Centra's total expenses (less bad debt expense) divided by gross patient service revenue.

The following information measures the level of charity care provided during the years ended December 31, 2012 and 2011:

| | 2012 | 2011 |
|---|---|---|
| Charges foregone, based on established rates | $ 54,308,949 | 45,826,209 |
| Equivalent percentage of charity care patients to all patients served | 4.1% | 3.6% |

***(o) Meaningful Use of Electronic Health Records (EHR)***

Centra recognizes revenues for incentives earned under the Medicare program in the period in which it is reasonably assured that it has complied with the applicable EHR meaningful use requirements. Incentive payments received under the Medicare program include a discharge-related portion, which is calculated by Centers for Medicare & Medicaid Services based on Centra's most recently filed cost report. Such amounts are subject to adjustment at the time of settling the 12-month cost report for Centra's fiscal year that begins after the beginning of the payment year. Centra achieved compliance with the Year 1 and Year 2 meaningful use requirements under the Medicare program during 2012 and 2011 and, accordingly, recognized other operating revenues of approximately $5,252,000 and $6,373,000 in the consolidated statements of operations for the years ended December 31, 2012 and 2011, respectively. Under the Medicaid program, Centra achieved compliance with the Year 1 meaningful use requirements and, accordingly, recognized other revenues of approximately $2,667,000 in the consolidated statements of operations for the year ended December 31, 2012.

### *(p) Donor-Restricted Gifts*

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

### *(q) Mission Statement and Nonoperating Gains and Losses*

Centra's primary mission is to provide the highest quality care based on the medical needs of the citizens of the communities served. Only those activities directly associated with the furtherance of this purpose are considered to be operating activities.

Other activities that result in gains or losses unrelated to Centra's primary mission are considered to be nonoperating. Nonoperating gains and losses include principally unrestricted contributions and grants, income and expenses associated with investments, realized gains and losses on sales of investments and other nonrecurring items that are considered extraordinary or unusual in nature.

Other changes in unrestricted net assets, which are excluded from excess of unrestricted revenues and other support over expenses include contributions of long-term assets, unrealized gains and losses on investments, changes related to the defined benefit plan and net assets released from restrictions for capital acquisitions.

### *(r) Defined Benefit Plan*

Accounting standards require Centra to: (a) recognize in its consolidated balance sheets an asset for the plan's over-funded status or a liability for the plan's under-funded status; (b) measure the plan's assets and its obligations that determine its funded status as of the end of Centra's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes are reported in other changes in unrestricted net assets in the consolidated statements of operations and changes in net assets.

***(s) Recently Issued Accounting Standards***

In July 2011, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) 2011-07, *Health Care Entities: Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. This ASU changed Centra's presentation of provision for doubtful accounts in the consolidated statements of operations and changes in net assets to a deduction from net patient service revenue. It also expanded disclosures regarding policies for recognizing revenue, assessing contra revenue line items, and activity in the allowance for doubtful accounts. Centra adopted ASU 2011-07 on January 1, 2012.

On January 1, 2013, Centra adopted the provisions of Accounting Standards Update No. 2012-01, Health Care Entities (Topic 954): *Continuing Care Retirement Communities – Refundable Advance Fees* (ASU No. 2012-01). ASU No. 2012-01 provides continuing care retirement communities with clarification that Centra should classify an advance fee as deferred revenue when a continuing care retirement community has a resident contract that provides for payment of the refundable advance fee upon reoccupancy by a subsequent resident, which is limited to the proceeds of reoccupancy. Refundable advance fees that are contingent upon reoccupancy by a subsequent resident but are not limited to the proceeds of reoccupancy should be accounted for and reported as a liability. The adoption of ASU No. 2012-01 will be accounted for as a change in accounting principle and applied retroactively to January 1, 2012. The retroactive effect of the change will increase the refundable entrance fee liability by $7,399,580, reduce deferred revenue – entrance agreements by $3,262,008 and reduce unrestricted net assets by $4,137,572 at January 1, 2012. The impact of the accounting change will also result in a reduction in amortization of entrance fees of $492,008 for the year ended December 31, 2012 and an increase in the deferred revenue – entrance agreements of $424,849 and an increase in the refundable entrance fee liability of $4,204,731 at December 31, 2012.

***(t) Reclassifications***

Certain reclassifications have been made to the 2011 consolidated financial statements to place them on a basis comparable with the 2012 consolidated financial statements. These reclassifications had no impact on previously reported changes in net assets or net assets.

***(u) Subsequent Events***

Centra evaluated subsequent events for potential recognition and/or disclosure in the December 31, 2012 consolidated financial statements through April 15, 2013, the date the consolidated financial statements were issued.

## (2) Net Patient Service Revenue

Net patient service revenue consists of the following for the years ended December 31:

| | 2012 | 2011 |
|---|---|---|
| Gross inpatient service revenue | $ 726,461,108 | 720,201,749 |
| Gross outpatient service revenue | 595,829,118 | 560,856,278 |
| Total gross patient service revenue | 1,322,290,226 | 1,281,058,027 |
| Deductions from patient service revenue: | | |
| Charity services | 54,308,949 | 45,826,209 |
| Contractual adjustments: | | |
| Medicare | 391,226,145 | 379,077,727 |
| Medicaid | 120,131,435 | 113,276,242 |
| Anthem | 52,047,361 | 52,559,603 |
| Other | 42,638,191 | 38,080,441 |
| Total contractual adjustments | 606,043,132 | 582,994,013 |
| Policy and administrative adjustments | 8,523,710 | 9,261,128 |
| Total deductions from patient service revenue | 668,875,791 | 638,081,350 |
| Net patient service revenue | $ 653,414,435 | 642,976,677 |

A summary of the payment arrangements with major third-party payors is as follows:

*Anthem*. Inpatient services rendered to Anthem subscribers are reimbursed at prospectively determined per case or per diem rates and outpatient services are reimbursed at prospectively determined discounted rates. The amounts reimbursed are not subject to retroactive adjustment.

*Medicare*. Inpatient acute care services, defined capital costs, and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services and certain outpatient services, related to Medicare beneficiaries are paid based on predetermined reimbursement methodologies. Centra is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Centra and audits thereof by the Medicare fiscal intermediary. Centra's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2007.

*Medicaid*. Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates based on a blend of per patient day and per discharge payments. Inpatient nonacute services and certain outpatient services rendered to Medicaid beneficiaries are paid based on a cost reimbursement methodology. Centra is reimbursed at a tentative rate with final settlements determined after submission of annual cost reports by Centra and audits thereof by

Medicaid. Centra's Medicaid cost reports have been desk settled by Medicaid through December 31, 2011.

Revenues from Anthem, and the Medicare and Medicaid programs, accounted for approximately 23%, 45%, and 11%, respectively, of Centra's net patient service revenue for the year ended December 31, 2012 (23%, 43%, and 11%, respectively, for the year ended December 31, 2011).

Patient service revenue, net of contractual allowances and discounts, but before the provision for bad debts, recognized in fiscal year 2012 from these major payor sources is as follows:

| | 2012 | Percentage | 2011 | Percentage |
|---|---|---|---|---|
| Commercial payors | $ 258,877,767 | 39.62% | 258,002,902 | 40.13% |
| Medicare | 293,037,946 | 44.85 | 276,661,489 | 43.03 |
| Medicaid | 73,907,454 | 11.31 | 73,215,466 | 11.39 |
| Other third-party payors | 27,591,268 | 4.22 | 35,096,820 | 5.46 |
| Total | $ 653,414,435 | 100.00% | 642,976,677 | 100.00% |

## (3) Patient Accounts Receivable

Patient accounts receivable, net at December 31 consists of the following:

| | 2012 | 2011 |
|---|---|---|
| Patient accounts receivable | $ 154,514,954 | 150,860,539 |
| Less: | | |
| Allowance for doubtful accounts | (15,662,312) | (20,132,518) |
| Allowance for charity | (12,877,513) | (9,390,117) |
| Allowance for contractual adjustments | (63,975,115) | (58,877,644) |
| Patient accounts receivable, net | $ 62,000,014 | 62,460,260 |

Patient accounts receivable are reduced by an allowance for bad debts. In evaluating the collectibility of accounts receivable, Centra analyzes historical collections and write-offs and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for bad debts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for bad debts. For receivables associated with services provided to patients who have third-party coverage, Centra analyzes contractually due amounts and provides an allowance for bad debts, allowance for contractual adjustments, provision for bad debts, and contractual adjustments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely. For receivables associated with self-pay patients or with balances remaining after the third-party coverage has already paid, Centra records a provision for bad debts in the period of service on the basis of its historical collections, which indicates that some patients are unwilling to pay the portion of their bill for which they are financially responsible. The difference between the discounted rates and the amounts collected after all reasonable collection efforts have been exhausted is charged off against the allowance for bad debt.

The activity in the allowance for bad debts is as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Beginning balance | $ | 20,132,518 | 17,042,604 |
| Provision for bad debts | | 39,117,292 | 40,726,546 |
| Less net write-offs | | (43,587,498) | (37,636,632) |
| Ending balance | $ | 15,662,312 | 20,132,518 |

Centra's net write-offs increased approximately $5,951,000 from fiscal year 2011 to fiscal year 2012. This increase in write-offs was mainly due to the increase in the uninsured and under insured patient population along with improvements in the revenue cycle. The Hospital has not changed its charity care or uninsured discount policies during fiscal year 2011 or 2012.

## (4) Fair Values of Assets and Liabilities

Fair value as defined under generally accepted accounting principles is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a measurement date. Generally accepted accounting principles establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1: Observable inputs such as quoted prices in active markets.
- Level 2: Inputs other than quoted prices in active markets that are either directly or indirectly observable.
- Level 3: Unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Centra's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value of assets and liabilities and their placement within the fair value hierarchy levels.

### *Assets and Liabilities at Fair Value on a Recurring Basis*

When quoted prices are available in active markets for identical instruments, investment securities are classified within Level 1 of the fair value hierarchy. Level 1 investments include common stocks, mutual funds, corporate bonds, and U.S. Treasury obligations which are valued based on prices readily available in the active markets in which those securities are traded, and money market funds, which are based on their transacted values. Level 2 investments include private pooled investments, government debt obligations, municipal bonds, hedge funds, and interest rate swap agreements, which are valued on a recurring basis based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Level 3 investments include private pooled investments in real estate, which are valued based on unobservable inputs about which little or no market data exists. There were no transfers in or out of Level 3 during 2012 or 2011.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Cash and cash equivalents | $ 12,729,032 | 12,729,032 | — | — |
| Money markets | 3,536,515 | 3,536,515 | — | — |
| Common stocks: | | | | |
| Consumer discretionary | 217,850 | 217,850 | — | — |
| Consumer staples | 157,791 | 157,791 | — | — |
| Energy sector | 362,194 | 362,194 | — | — |
| Financials | 430,438 | 430,438 | — | — |
| Health care sector | 441,616 | 441,616 | — | — |
| Industrials | 251,537 | 251,537 | — | — |
| Information technology | 481,115 | 481,115 | — | — |
| Materials | 92,680 | 92,680 | — | — |
| Telecommunication services | 130,787 | 130,787 | — | — |
| Utilities | 52,191 | 52,191 | — | — |
| Real estate | 126,701 | 126,701 | — | — |
| Other | 530,031 | 530,031 | — | — |
| Total common stocks | 3,274,931 | 3,274,931 | — | — |
| Mutual funds: | | | | |
| Domestic equity | 9,004,351 | 9,004,351 | — | — |
| International equity | 2,606,631 | 2,606,631 | — | — |
| Fixed income | 4,663,159 | 4,663,159 | — | — |
| Total mutual funds | 16,274,141 | 16,274,141 | — | — |
| Private pooled investments: | | | | |
| Domestic equity | 89,324,069 | — | 89,324,069 | — |
| International equity | 57,083,270 | — | 57,083,270 | — |
| Fixed income | 167,492,355 | — | 167,492,355 | — |
| Real estate | 19,287,234 | — | — | 19,287,234 |
| Total private pooled investments | 333,186,928 | — | 313,899,694 | 19,287,234 |
| Debt securities: | | | | |
| Corporate bonds | 1,960,030 | 1,960,030 | — | — |
| U.S. treasury obligations | 2,192,969 | — | 2,192,969 | — |
| Government debt obligations | 45,917 | — | 45,917 | — |
| Municipal bonds | 10,922 | — | 10,922 | — |
| Total debt securities | 4,209,838 | 1,960,030 | 2,249,808 | — |
| Beneficial interest in trusts | 21,637,792 | — | 21,637,792 | — |
| Total | $ 394,849,177 | 37,774,649 | 337,787,294 | 19,287,234 |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Liabilities: | | | | |
| Interest rate swap agreements | $ 27,322,431 | — | 27,322,431 | — |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Cash and cash equivalents | $ 22,639,726 | 22,639,726 | — | — |
| Money market | 5,158,740 | 5,158,740 | | |
| Common stocks: | | | | |
| Consumer discretionary | 454,515 | 454,515 | — | — |
| Consumer staples | 65,332 | 65,332 | — | — |
| Energy sector | 250,530 | 250,530 | — | — |
| Financials | 298,771 | 298,771 | — | — |
| Health care sector | 276,492 | 276,492 | — | — |
| Industrials | 363,847 | 363,847 | — | — |
| Information technology | 434,486 | 434,486 | — | — |
| Materials | 47,141 | 47,141 | — | — |
| Telecommunication services | 106,026 | 106,026 | — | — |
| Utilities | 46,891 | 46,891 | — | — |
| Real estate | 111,338 | 111,338 | — | — |
| Other | 304,691 | 304,691 | — | — |
| Total common stocks | 2,760,060 | 2,760,060 | — | — |
| Mutual funds: | | | | |
| Domestic equity | 7,521,937 | 7,521,937 | — | — |
| International equity | 3,549,085 | 3,549,085 | — | — |
| Fixed income | 1,493,149 | 1,493,149 | — | — |
| Total mutual funds | 12,564,171 | 12,564,171 | — | — |
| Private pooled investments: | | | | |
| Domestic equity | 71,544,368 | — | 71,544,368 | — |
| International equity | 44,016,233 | — | 44,016,233 | — |
| Fixed income | 135,373,563 | — | 135,373,563 | — |
| Real estate | 17,666,980 | — | — | 17,666,980 |
| Total private pooled investments | 268,601,144 | — | 250,934,164 | 17,666,980 |



(Continued)

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Debt securities: | | | | |
| Corporate bonds | $ 3,682,856 | 3,682,856 | — | — |
| U.S. Treasury obligations | 2,374,431 | 2,374,431 | — | — |
| Government debt obligations | 66,984 | — | 66,984 | — |
| Municipal bonds | 10,762 | — | 10,762 | — |
| Total debt securities | 6,135,033 | 6,057,287 | 77,746 | — |
| Beneficial interest in trusts | 20,136,504 | — | 20,136,504 | — |
| Total | $ 337,995,378 | 49,179,984 | 271,148,414 | 17,666,980 |
| Liabilities: | | | | |
| Interest rate swap agreements | $ 27,730,118 | — | 27,730,118 | — |

The following table illustrates the activity of Level 3 assets measured at fair value on a recurring basis from December 31, 2011 to December 31, 2012:

| | |
|---|---|
| Beginning balance | $ 17,666,980 |
| Net unrealized gains | 1,620,254 |
| Total | $ 19,287,234 |

## (5) Investments and Assets Whose Use is Limited

Investments and assets whose use is limited at December 31 comprised the following:

| | 2012 | 2011 |
|---|---|---|
| Internally designated by the Board of Directors for capital acquisition | $ 309,042,590 | 251,925,236 |
| Internally designated for self-insurance | 14,076,280 | 9,031,265 |
| Held by trustee under bond indenture agreement | 2,192,969 | 3,519,663 |
| Temporarily restricted by donor | 22,183,699 | 18,366,706 |
| Permanently restricted by donor | 29,798,378 | 29,798,378 |
| Designated for construction | 6,551,377 | 16,198,426 |
| Unrestricted | 10,822,018 | 8,976,789 |
| Other | 181,866 | 178,915 |
| | $ 394,849,177 | 337,995,378 |

Investment income at December 31 consists of the following:

| | 2012 | | |
|---|---|---|---|
| | Unrestricted | Temporarily restricted | Total |
| Investment income | $ 1,775,399 | 672,475 | 2,447,874 |
| Net realized gains | 23,361,703 | 2,972,952 | 26,334,655 |
| Net unrealized gains | 8,441,934 | 2,007,780 | 10,449,714 |
| Investment fees | (1,179,636) | (391,772) | (1,571,408) |
| | $ 32,399,400 | 5,261,435 | 37,660,835 |

| | 2011 | | |
|---|---|---|---|
| | Unrestricted | Temporarily restricted | Total |
| Investment income | $ 1,437,119 | 675,732 | 2,112,851 |
| Net realized gains | 10,432,149 | 1,190,987 | 11,623,136 |
| Net unrealized losses | (4,421,006) | (2,477,149) | (6,898,155) |
| Investment fees | (1,024,519) | (444,406) | (1,468,925) |
| | $ 6,423,743 | (1,054,836) | 5,368,907 |

Certain subsidiaries of Centra classify securities as trading securities if the activity is an integral part of operations. All other securities are classified as available for sale. In accordance with accounting standards, Centra periodically evaluates whether any declines in the fair value of investments that are not classified as trading securities are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer’s future earnings potential; the near term prospects for recovery of the fair value of a security; and the intent and ability of Centra to hold the security until the fair value recovers. Declines in fair value below cost that are deemed to be other-than-temporary are included in the accompanying consolidated statements of operations and changes in net assets as nonoperating losses.

The following tables show the gross unrealized losses and fair value of Centra's investments with unrealized losses that are not deemed to be other-than-temporarily impaired (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2012 and 2011:

| 2012 | | Less than 12 months | | More than 12 months | | Total | |
|---|---|---|---|---|---|---|---|
| Description of securities | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Private pooled investments | $ | 83,669 | (814) | — | — | 83,669 | (814) |

| 2011 | | Less than 12 months | | More than 12 months | | Total | |
|---|---|---|---|---|---|---|---|
| Description of securities | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Private pooled investments | $ | 103,220 | 10,979 | — | — | 103,220 | 10,979 |

Unrealized losses in 2011 on Centra's private pooled investments are related to the current economic conditions prevalent across the United States. As of December 31, 2012 and 2011, Centra has the ability to hold such investments until recovery of their fair value and intends to do so, and does not consider the investments to be other-than-temporarily impaired.

## (6) Property, Buildings and Equipment

Property, buildings and equipment at December 31 consist of the following:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Cost | Accumulated depreciation | Cost | Accumulated depreciation |
| Land | $ 12,710,964 | — | 8,661,416 | — |
| Land improvements | 15,503,163 | 9,453,385 | 14,722,204 | 8,619,995 |
| Buildings and leasehold improvements | 392,642,563 | 223,192,507 | 383,506,199 | 208,772,540 |
| Equipment | 338,714,398 | 260,465,570 | 316,109,004 | 235,677,963 |
| Construction in progress | 17,480,600 | — | 10,143,288 | — |
| | $ 777,051,688 | 493,111,462 | 733,142,111 | 453,070,498 |

Construction in progress primarily consists of various in-house construction projects along with the College of Nursing project, which began in late 2010. The estimated cost to complete this construction project as of December 31, 2012 is approximately $4,600,000.

## (7) Long-Term Obligations

Long-term obligations at December 31 consist of the following:

| | 2012 | 2011 |
|---|---|---|
| Mortgage note payable issued in December 2004 to the Industrial Development Authority of the City of Lynchburg, Virginia, who in turn issued tax-exempt Hospital Auction Rate Securities Revenue and Refunding Bonds (Series 2004 Bonds). The Series 2004 Bonds comprise serial bonds maturing in graduated annual amounts ranging from $2,225,000 in 2007 to $10,275,000 in 2035 and bear interest at market rates. In June 2008, Centra elected the conversion of these auction rate securities to variable rate demand securities. | $ 161,725,000 | 164,300,000 |
| Mortgage note payable issued in June 1998 to the Industrial Development Authority of the City of Lynchburg, Virginia, who in turn issued tax-exempt Healthcare Facilities Revenue and Refunding Bonds (Series 1998 Bonds). The Series 1998 Bonds comprise serial bonds maturing in graduated annual amounts ranging from $1,555,000 in 2007 to $600,000 in 2016 and bear interest at various rates, ranging from 4.40% to 5.375%. | 3,890,000 | 5,875,000 |
| Industrial Development Authority of the County of Campbell, Virginia, who in turn issued tax-exempt Healthcare Facilities Revenue Bond (Series 2007 Bond). The Series 2007 Bond bears interest at 4.13% until 2019 at which time the rate is reset. Payment of interest and principal is due quarterly for the 20 year term. | 6,034,260 | 6,325,981 |
| Mortgage note payable issued in June 2007 to the Industrial Development Authority of the Town of Amherst, Virginia, who in turn issued tax-exempt Healthcare Facilities Revenue Bond (Series 2007 Bond). The Series 2007 Bond bears interest at 4.13% until 2019 at which time the rate is reset. Payment of interest and principal is due quarterly for the 20 year term. | 6,435,336 | 6,746,503 |

| | | 2012 | 2011 |
|---|---|---|---|
| Mortgage note payable issued in November 2007 to the Industrial Development Authority of the County of Appomattox, Virginia, who in turn issued tax-exempt Healthcare Facilities Revenue Bond (Series 2007 Bond). The Series 2007 Bond bears interest at 4.13% until 2019 at which time the rate is reset. Payment of interest and principal is due quarterly for the 20 year term. | $ | 6,179,471 | 6,465,259 |
| Mortgage note payable issued in December 2010 to the Industrial Development Authority of the City of Lynchburg, Virginia, who in turn issued a tax-exempt Hospital Revenue Bond (Series 2010 Bond). The Series 2010 Bond bears interest at market rates. Payment of interest and principal is due monthly for the 15 year amortization schedule. At the end of 7 years, the terms of the loan will be renegotiated. | | 26,688,788 | 28,367,544 |
| Mortgage note payable issued in April 2002 by CCRC, Inc. to Industrial Development Authority of the City of Lynchburg, who in turn issued tax-exempt Residential Care Facility Mortgage Revenue Bonds (Series 2002 Bonds). The Series 2002 Bonds comprise $1,770,000 Serial Bonds, $4,490,000 Term Bonds and $5,000,000 Adjustable Rate Bonds. The Series 2002 Bonds mature in graduated annual amounts ranging from $160,000 in 2007 to $5,000,000 in 2034 and bear interest at various rates ranging from 4.75% to 6.25%. | | — | 10,380,000 |
| Notes payable issued in January 2012 by CCRC, Inc. to the Industrial Development Authority of the City of Lynchburg, who in turn issued tax-exempt Residential Care Facility Revenue Refunding Bonds ( The Summit, Series 2012 Bonds) Interest will be set the first day of each month and ending on the last day of the month. Interest is payable on the first of the month and principal on January 1 of each year. The bonds are due in full in 2034. | | 9,390,710 | — |
| Notes payable issued June 2011by Southside and Centra to the Industrial Development Authority of the Town of Farmville, who in turn issued tax-exempt Hospital Revenue Refunding Bonds (Series 2011 Bonds) and bearing interest at 2.89%. | | 8,426,225 | 9,268,847 |
| Other notes payable | | 1,244,756 | 1,493,948 |
| Total long-term obligations | | 230,014,546 | 239,223,082 |
| Less current portion of long-term obligations | | (8,695,512) | (8,440,188) |
| Total long-term obligations, net of current portion | $ | 221,319,034 | 230,782,894 |

The Series 1998 Bonds, Series 2004 Bonds, Series 2007 Bonds, Series 2010 Bonds, and Series 2011 Bonds are secured by substantially all property and equipment of the Obligated Group. The Series 2002 Bonds are secured by a Deed of Trust on the property and equipment of CCRC, Inc.

In June 2011, Southside issued $9,619,940 in Hospital Revenue Refunding Bonds (Series 2011). The proceeds of the sale of the 2011 Bonds were used to refund the outstanding principal balance of the Medical Facility Revenue Bonds Series 1997 and Series 1998 and to pay the costs of issuing the 2011 Series Bonds. The bond purchase and loan agreement between the Industrial Development Authority of the Town of Farmville, Southside Community Hospital, and Branch Banking and Trust Company (BB&T), as purchaser was entered into on June 1, 2011.

During December 2010, Centra issued $30,000,000 in Hospital Revenue Bond, 2010 Series. An interest rate swap agreement was also entered into at a fixed rate of interest of 2.85% for a period of seven years. The proceeds of the bonds are to be used for the purchase and construction of the School of Nursing, completion of the fifth floor of the bed tower at Lynchburg General, purchase of new information technology for the organization and to finance routine capital expenditures.

During 2007, Centra issued $23,000,000 in Healthcare Facilities Revenue Bonds, 2007 Series. The proceeds of the 2007 Series were used to help finance the construction of the Summit Assisted Living Facility, purchase of a physician office building and construction of the regional cancer center.

In December 2004, Centra issued $179,125,000 in Hospital Auction Rate Securities, (2004 Series A, 2004 Series B, 2004 Series C, 2004 Series D, 2004 Series E and 2004 Series F bonds, collectively, the 2004 Bonds). The proceeds of the sale of the 2004 Bonds were used together with other funds available, to (a) refund the outstanding principal of the VHA Note and to advance refund a portion of the 1998 bonds, (b) to finance the costs of acquisition and construction of improvements to the hospital facilities and the acquisition of equipment, and (c) to pay the costs of issuing the 2004 Bonds, including the premium for the issuance of the insurance policy by the bond insurer. In June 2008, Centra elected the conversion of each series of the 2004 Bonds (the Conversion) from auction rate securities to variable rate demand securities. The 2004 Bonds are payable from, and secured by, a pledge of payment to be made to the Industrial Development Authority of the City of Lynchburg, Virginia, under the original loan. In connection with the Conversions, each series of 2004 Bonds are payable from irrevocable direct-pay letters of credit issued by two financial institutions for a term to expire on December 16, 2016 and June 15, 2017, respectively, at which time or earlier, management intends to renew or extend the letters of credit.

In June 1998, Centra issued $70,745,000 in Healthcare Facilities Revenue and Refunding Bonds. The proceeds of the sale of the 1998 Bonds were used to finance new construction, renovation of existing facilities, and purchase of equipment along with the refunding of the Series 1988 Bonds. In conjunction with the issuance of the Series 2004 Bonds, $46,450,000 of the Series 1998 Bonds were refunded.

Pursuant to the Master Indenture, Centra agreed to certain operational and financial restrictions, which currently apply only to members of the Obligated Group. Each entity that becomes a member of the Obligated Group will be subjected to the Obligated Group restrictions. The operational and financial restrictions contained in the Master Indenture relate primarily to debt service coverage requirements; the incurrence, directly or by guaranteeing the debt of others, of additional indebtedness; the ability to transfer assets, including both physical and liquid assets; and the ability to affect mergers and consolidations. The

Master Indenture also creates a security interest in the unconditional promises to give revenues of the Obligated Group.

In addition to the operational and financial restrictions contained in the Master Indenture, Centra has entered into a Supplemental Indenture with the Master Trustee, in which it agreed to maintain days cash on hand of 60 days or greater at June 30 and December 31 of each year. Centra is required to report semi-annually to the Master Trustee on compliance with this provision. The Supplemental Indenture also requires Centra to deposit an amount equal to the maximum annual debt service if the Long-Term Debt Service Coverage Ratio falls below 1.35. As of December 31, 2012 and 2011, Centra is in compliance with these covenants.

During 2002, CCRC, Inc. issued Series 2002 Bonds to provide financial support for development and construction of the Summit, a senior living community. The Summit consists of 85 independent living apartments, 11 garden homes, and a community center.

On January 3, 2012, the CCRC issued $9,455,000 in Residential Care Facility Revenue Refunding Bonds (Series 2012). The proceeds of the sale of the 2012 Bonds, along with $720,000 from the Debt Service Reserve Fund, were used to refund the outstanding principal balance of the Series 2002 Bonds. A loss of $446,844 was recognized on the refunding. The interest rate for the 2012 Bonds will be set on the first day of each month and ending on the last day of the month as follows: interest rate shall be established at a rate equal to the sum of 75% of the one-month LIBOR rate plus 77.5 basis points (0.93% as of December 31, 2012).

Maturities of long-term obligations as of December 31, 2012 are as follows:

| | Centra Series 1998 Bonds | Centra Series 2004 | Local IDA 2007 | Local IDA 2010 | Capital Lease 2011 | CCRC Series 2002 Bonds | Total Southside Hospital | Total |
|---|---|---|---|---|---|---|---|---|
| Year: | | | | | | | | |
| 2013 | $ 2,090,000 | 2,625,000 | 942,561 | 1,721,618 | 239,597 | 215,000 | 861,735 | 8,695,511 |
| 2014 | 600,000 | 4,325,000 | 982,096 | 1,771,330 | 248,119 | 230,000 | 863,117 | 9,019,662 |
| 2015 | 600,000 | 4,500,000 | 1,023,289 | 1,822,478 | 256,943 | 240,000 | 864,599 | 9,307,309 |
| 2016 | 600,000 | 4,700,000 | 1,066,210 | 1,875,102 | 266,081 | 255,000 | 866,187 | 9,628,580 |
| 2017 | — | 5,525,000 | 1,110,931 | 1,929,246 | — | 270,000 | 867,891 | 9,703,068 |
| Thereafter | — | 140,050,000 | 13,523,980 | 17,569,014 | — | 8,180,710 | 4,336,712 | 183,660,416 |
| Balance December 31, 2012 | 3,890,000 | 161,725,000 | 18,649,067 | 26,688,788 | 1,010,740 | 9,390,710 | 8,660,241 | 230,014,546 |
| Less current | (2,090,000) | (2,625,000) | (942,562) | (1,721,617) | (239,597) | (215,000) | (861,736) | (8,695,512) |
| LT portion | $ 1,800,000 | 159,100,000 | 17,706,505 | 24,967,171 | 771,143 | 9,175,710 | 7,798,505 | 221,319,034 |

During the years ended December 31, 2012 and 2011, Centra paid approximately $6,180,000 and $6,331,000, respectively, in interest.

## (8) Interest Rate Swap Agreements

Centra entered into various interest rate swap agreements with certain investment companies, which reduce the exposure of volatility in interest rates on certain variable rate debt. As such, Centra pays a fixed rate of interest, as noted in the following table, while the investment company pays based on a floating London Inter-Bank Offered Rate (LIBOR). The floating rate resets every seven days for the 2004 swap agreements and monthly for the 2011 and 2012 swap agreement. The difference between the fixed and floating rates is accrued and recorded in interest expense in the accompanying consolidated statements of operations and changes in net assets beginning on the effective date.

The following are schedules outlining the terms and fair market values of the derivative instruments on December 31:

| | | Series 2004 Int Rate Swap | Series 2004 Int Rate Swap | Series 2004 Int Rate Swap | Series 2010 Int Rate Swap | Series 2011 Int Rate Swap |
|---|---|---|---|---|---|---|
| Notional amount – original | $ | 52,700,000 | 39,500,000 | 39,125,000 | 30,000,000 | 9,619,940 |
| Notional amount – 12/12 | | 49,275,000 | 39,475,000 | 34,125,000 | 26,688,786 | 8,426,225 |
| Trade date | | 11/10/04 | 11/10/04 | 11/10/04 | 12/14/10 | 06/22/11 |
| Effective date | | 12/08/04 | 12/08/04 | 12/08/04 | 12/17/10 | 06/30/11 |
| Termination date | | 01/01/28 | 01/01/35 | 01/01/35 | 12/17/17 | 12/15/22 |
| Fixed rate | | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% |
| Fair value at December 31, 2010 | $ | (4,570,798) | (4,723,177) | (3,328,519) | (342,110) | — |
| Unrealized losses | | (3,609,490) | (6,128,715) | (3,409,626) | (1,097,417) | (520,266) |
| Fair value at December 31, 2011 | | (8,180,288) | (10,851,892) | (6,738,145) | (1,439,527) | (520,266) |
| Change in fair value | | 13,880 | 406,255 | 172,077 | (144,273) | (40,252) |
| Fair value at December 31, 2012 | $ | (8,166,408) | (10,445,637) | (6,566,068) | (1,583,800) | (560,518) |

By using an interest rate swap to limit exposure to changes in interest rates, Centra exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with an interest rate swap is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Centra has included the fair market value of these derivative instruments of approximately $27,300,000 and $27,730,000 as a noncurrent liability in the accompanying consolidated balance sheets at December 31, 2012 and 2011, respectively. Unrealized gains (losses) on derivative instruments were approximately $408,000 and $(14,766,000) for the years ended December 31, 2012 and 2011, respectively, and are included with nonoperating losses on the consolidated statements of operations and changes in net assets.

Subsequent to year end, per the Series 2004 interest rate swap agreements, Centra posted collateral of approximately $4,500,000 in January 2013.

## (9) Retirement Plans

Centra and its not-for-profit subsidiaries (except Southside) have a defined benefit pension plan covering substantially all of its employees (the Plan). The benefits are based on years of service and the average compensation during the highest five consecutive calendar years of service. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. Centra elected to freeze the Plan as of December 31, 2009 to new participants and no future accruals will be earned.

A summary of the projected benefit obligation, change in plan assets and net periodic pension cost follows:

| | 2012 | 2011 |
|---|---|---|
| Change in benefit obligation: | | |
| Projected benefit obligation, beginning of year | $ 218,902,770 | 176,713,976 |
| Interest cost | 9,285,855 | 9,585,630 |
| Actuarial loss | 17,013,681 | 38,100,996 |
| Benefits paid | (5,904,167) | (5,497,832) |
| Projected benefit obligation, end of year | 239,298,139 | 218,902,770 |
| Change in plan assets: | | |
| Fair value of plan assets, beginning of year | 153,038,029 | 148,325,180 |
| Actual return on plan assets | 20,033,253 | 4,810,681 |
| Employer contributions | 7,600,000 | 5,400,000 |
| Benefits paid | (5,904,167) | (5,497,832) |
| Fair value of plan assets, end of year | 174,767,115 | 153,038,029 |
| Funded status of plan (under-funded) | $ (64,531,024) | (65,864,741) |
| Reconciliation of accrued pension costs: | | |
| Prepaid pension costs | $ 10,150,325 | 6,273,348 |
| Employer contributions | 7,600,000 | 5,400,000 |
| Net periodic pension costs | (6,473,727) | (1,523,023) |
| Prepaid pension costs, end of year | 11,276,598 | 10,150,325 |
| Amounts recognized as other change in net assets | (75,807,622) | (76,015,066) |
| Funded status of plan (under-funded) | $ (64,531,024) | (65,864,741) |

| | | 2012 | 2011 |
|---|---|---|---|
| Components of net periodic benefit cost: | | | |
| Interest cost | $ | 9,285,855 | 9,585,630 |
| Expected return on plan assets | | (9,943,208) | (9,895,312) |
| Amortization of net actuarial loss | | 7,131,080 | 1,832,705 |
| Net periodic pension cost | $ | 6,473,727 | 1,523,023 |
| Other changes in plan assets and benefit obligations recognized in other changes in net assets: | | | |
| Net actuarial loss | $ | 6,923,636 | 43,185,627 |
| Amortization of net actuarial loss | | (7,131,080) | (1,832,705) |
| Total recognized in other changes in net assets | $ | (207,444) | 41,352,922 |

Assumptions

Weighted average assumptions used to determine benefit obligations:

| | 2012 | 2011 |
|---|---|---|
| Discount rate | 3.85% | 4.30% |
| Expected long-term return on assets | 6.00 | 6.00 |
| Compensation rate increase | N/A | N/A |

Weighted average assumptions used to determine net periodic benefit cost:

| | 2012 | 2011 |
|---|---|---|
| Discount rate | 4.30% | 5.50% |
| Expected long-term return on assets | 6.00 | 6.00 |
| Compensation rate increase | N/A | N/A |

The expected long-term rate of return for the Plan’s total assets is based on an analysis of anticipated returns for equity and fixed income investments for the portfolio allocation.

### *(a) Plan Assets*

The asset allocation for Centra's funded retirement plan at December 31, 2012 and 2011, and the target allocation for 2013 by asset category are as follows:

| | Target allocation 2013 | Percentage of plan assets at year end 2012 | 2011 |
|---|---|---|---|
| Equity securities | 44.0% | 44.8% | 44.0% |
| Fixed income securities | 50.0 | 48.0 | 48.5 |
| Real estate | 6.0 | 7.2 | 7.5 |
| Total | 100.0% | 100.0% | 100.0% |

The policy, as established by the Investment Committee, is to provide for growth of capital with a moderate level of volatility by investing assets per the target allocations stated above. The assets will be reallocated quarterly to meet the above target allocations. The investment policy will be reviewed on a quarterly basis, under the advisement of a certified investment advisor to determine if the policy should be changed.

As disclosed in note 4, generally accepted accounting principles establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. Prices for certain common collective trusts are determined on a recurring basis based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets and are categorized as Level 2. Prices for real estate common collective trusts and hedge funds are classified as Level 3.

The following table sets forth by level the fair value hierarchy the Plan's financial assets accounted for at fair value as of December 31, 2012 and 2011, respectively. Investments are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Centra's assessment of the significance of a particular input to the fair value measurement for Plan assets requires judgment, and may affect the valuation of fair value of Plan investments and their placement within the fair value hierarchy levels.

| | December 31 2012 Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Common collective trusts: | | | | |
| Equity securities | $ 78,310,477 | — | 78,310,477 | — |
| Fixed income | 83,670,602 | — | 83,670,602 | — |
| Real estate | 12,584,924 | — | — | 12,584,924 |
| Total | $ 174,566,003 | — | 161,981,079 | 12,584,924 |

The Plan has $201,112 of cash included in plan assets as of December 31, 2012, which is not included in the fair value hierarchy.

| | December 31 2011 | | | |
|---|---|---|---|---|
| | Total | Level l | Level 2 | Level 3 |
| Common collective trusts: | | | | |
| Equity securities | $ 67,530,656 | — | 67,530,656 | — |
| Fixed income | 73,825,587 | — | 73,825,587 | — |
| Real estate | 11,530,910 | — | — | 11,530,910 |
| Total | $ 152,887,153 | — | 141,356,243 | 11,530,910 |

The Plan has $150,876 of cash included in plan assets as of December 31, 2012, which is not included in the fair value hierarchy.

A reconciliation of Plan assets held classified as Level 3 follows:

| | | |
|---|---|---|
| Balance, beginning of year | $ | 11,530,910 |
| Net unrealized gains | | 1,054,014 |
| Balance, end of year | $ | 12,584,924 |

### (b) *Cash Flows*

Centra expects to make contributions of $7,000,000 to the Plan during 2013.

Estimated Future Benefit Payments – The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | | |
|---|---|---|
| 2013 | $ | 6,952,000 |
| 2014 | | 7,598,000 |
| 2015 | | 8,247,000 |
| 2016 | | 8,990,000 |
| 2017 – 2021 | | 55,925,000 |

Centra and its not-for-profit subsidiaries have a tax sheltered annuity program qualified under Section 403(b) of the Internal Revenue Code covering all employees meeting age and service requirements. The program allows Centra to make discretionary contributions to the Plan, subject to certain limitations. Centra's contributions for 2012 and 2011 were approximately $16,257,000 and $16,217,000, respectively. As a result of the defined benefit plan freeze, Centra provided an additional annual contribution of 4% of base pay into each eligible employee's personal retirement savings account in 2012 and 2011. In addition, Centra continues to match up to 3% on employee contributions.

## (10) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31:

| | 2012 | 2011 |
|---|---|---|
| Indigent care | $ 961,014 | 950,376 |
| Capital acquisitions | 4,501,908 | 5,828,808 |
| Program services | 16,505,260 | 11,578,968 |
| | $ 21,968,182 | 18,358,152 |

Permanently restricted net assets at December 31 are restricted to:

| | 2012 | 2011 |
|---|---|---|
| Indigent care | $ 830,012 | 830,012 |
| Capital acquisitions | 1,800,730 | 1,800,730 |
| Program services | 20,907,781 | 20,907,781 |
| Endowment | 5,339,855 | 5,339,855 |
| | $ 28,878,378 | 28,878,378 |

During 2012 and 2011, net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes of indigent care, capital acquisitions and program expenses, which totaled approximately $2,986,000 and $1,799,000, respectively.

## (11) Endowment Funds

The Foundation's endowment consists of approximately 45 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. As required by generally accepted accounting principles (GAAP), net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

### *(a) Interpretation of Relevant Law*

The Board of Directors of the Foundation has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value 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, the Foundation 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. In accordance with SPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Foundation 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 Foundation
- The investment policies of the Foundation

Endowment Net Asset Composition by Type of Fund as of December 31, 2012:

| | | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|---|
| Endowment funds: | | | | | |
| Donor-restricted | $ | — | 8,454,024 | 28,878,378 | 37,332,402 |
| Board-designated | | 920,000 | — | — | 920,000 |
| Total funds | $ | 920,000 | 8,454,024 | 28,878,378 | 38,252,402 |


(Continued)

Changes in Endowment Net Assets for the year ended December 31, 2012:

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Endowment net assets, beginning of year | $ 920,000 | 5,329,050 | 28,878,378 | 35,127,428 |
| Investment returns: | | | | |
| Investment income | — | 293,321 | — | 293,321 |
| Net appropriations | — | 3,124,974 | — | 3,124,974 |
| Appropriation of endowment assets for expenditure | — | (293,321) | — | (293,321) |
| Endowment net assets, end of year | $ 920,000 | 8,454,024 | 28,878,378 | 38,252,402 |

Endowment Net Asset Composition by Type of Fund as of December 31, 2011:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment funds: | | | | |
| Donor-restricted | $ — | 5,329,050 | 28,878,378 | 34,207,428 |
| Board-designated | 920,000 | — | — | 920,000 |
| Total funds | $ 920,000 | 5,329,050 | 28,878,378 | 35,127,428 |

Changes in Endowment Net Assets for the year ended December 31, 2011:

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---|---|---|---|
| Endowment net assets, beginning of year | $ 920,000 | 7,401,463 | 28,878,378 | 37,199,841 |
| Investment returns: | | | | |
| Investment income | — | 374,984 | — | 374,984 |
| Net depreciation | — | (1,782,943) | — | (1,782,943) |
| Appropriation of endowment assets for expenditure | — | (664,454) | — | (664,454) |
| Endowment net assets, end of year | $ 920,000 | 5,329,050 | 28,878,378 | 35,127,428 |

### (b) *Return Objectives and Risk Parameters*

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Foundation must hold in perpetuity as well as board-designated funds. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. The Foundation expects its endowment funds, over time, to provide an average rate of return on equity investments of 6% and a fixed income yield of 2% annually. Actual returns in any given year may vary from this amount.

### (c) *Strategies Employed for Achieving Objectives*

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

### (d) *Spending Policy and How the Investment Objectives Relate to Spending Policy*

The Foundation has a policy of requesting for distribution each year either net income of the asset or a percentage of the assets average fair value, which results in an average net cash distribution of 2.4% of total assets. Accordingly, over the long term, the Foundation expects the current spending policy to allow its endowment to grow at an average of 4.3% annually. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment return.

## (12) Tax Status

Centra Health, Inc., Centra Health Foundation, CCRC, Inc., Southside Community Hospital, Inc., and Lynchburg Family Practice Residency Program, Inc. are exempt from income tax under Section 501 (a) of the Internal Revenue Code. Accordingly, no income taxes have been provided for these entities in the accompanying consolidated financial statements except for taxes related to certain unrelated business income engaged in by Centra.

Centra Medical Group LLC, Centra Health Cardiovascular Services LLC, Centra Health Emergency Services LLC, Centra Health Indemnity Company LLC, and Central Virginia Hospital for Restorative and Rehabilitative Care, LLC are disregarded for federal income tax purposes and therefore are included under Centra's tax return.

Centra has adopted relevant accounting standards related to taxes for its subsidiary, General Business Concerns, Inc. Under the asset and liability method for these standards, deferred tax assets and liabilities are recognized for the temporary differences between the financial statement carrying amounts and the tax basis of the subsidiary's assets and liabilities at income tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

Centra Health Indemnity Company LLC is wholly owned by Centra Health, Inc. Any liability for taxes are passed through to Centra Health, Inc. A provision will be made when operations of this subsidiary indicates a liability for taxes.

Effective January 1, 2009, Centra adopted the Financial Accounting Standards Board's (FASB) authoritative guidance on accounting for uncertainty in income taxes. The guidance clarifies the accounting for the recognition and measurement of the benefits of individual tax positions in the financial statements. Tax positions must meet a recognition threshold of more likely than not in order for the benefit of those tax positions to be recognized in the accompanying financial statements. Centra has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2012. The adoption of the guidance did not have a material effect on Centra's financial position or results of operations. Centra believes they are no longer subject to income tax examinations for years prior to December 31, 2009.

## (13) Functional Expenses

Centra provides a broad range of health care services to residents within its geographic location. Expenses related to providing these services are as follows:

| | 2012 | 2011 |
|---|---|---|
| Health care services | $ 572,257,049 | 553,359,503 |
| General and administrative | 70,435,586 | 64,406,409 |
| | $ 642,692,635 | 617,765,912 |

## (14) Investments in Joint Ventures

### *(a) Piedmont Community Health Plan*

Piedmont Community Health Plan (PCHP) is an organized network of health care providers established to offer health care services to the community. PCHP, a Virginia stock corporation, has two shareholders, Centra (50%) and Integrated Healthcare, Inc. (50%). Integrated Healthcare, Inc. is owned by physicians in the Lynchburg, Virginia, market. At December 31, 2012 and 2011, Centra was at risk for approximately $1,763,000 and $1,849,000, respectively, for amounts withheld from payments by PCHP for services provided by Centra to PCHP members. Centra's investment in PCHP is accounted for under the equity method. At December 31, 2012 and 2011, PCHP had total net assets of approximately $12,038,000 and $13,703,000, respectively.

### *(b) Central Virginia Imaging, L.L.C.*

Central Virginia Imaging, L.L.C. (CVI) is a Virginia nonstock corporation established June 8, 1998. This corporation has two members, Centra (50%), and Radiology Consultants of Lynchburg, Inc. (50%). The corporation was established to provide CT scanning and magnetic resonance imaging services. Centra's investment in CVI is accounted for under the equity method. At December 31, 2012 and 2011, CVI had total net assets of approximately $103,000 and $128,000, respectively.

### *(c) Bedford Memorial Hospital*

Bedford Memorial Hospital (Bedford) is a nonprofit, nonstock corporation, which operates an acute care hospital and a long-term care facility in Bedford, Virginia. Prior to July 9, 2001, Bedford was operated solely by Carilion Health System (Carilion). Effective July 9, 2001, Centra entered into a joint venture arrangement with Carilion to operate Bedford in order to maintain and strengthen a community hospital that effectively integrates the resources, efficiencies and capabilities of the two organizations to offer the best chance for Bedford to preserve its longstanding commitment of providing quality healthcare services to its community. In connection with the joint venture formation, Centra and Carilion each contributed $1,500,000 to Bedford. Centra and Carilion each have a 50% interest in Bedford. Centra's investment in Bedford is accounted for under the equity method. At December 31, 2012 and 2011, Bedford had total net assets of approximately $9,555,000 and $9,657,000, respectively.

### *(d) The Surgery Center of Lynchburg*

The Surgery Center of Lynchburg, L.L.C. (the Surgery Center) is a Virginia limited liability company organized on January 29, 1999 to provide outpatient surgical services in the central Virginia area. Centra owns 50% of the Surgery Center and the remaining 50% is owned by individual physicians. Centra's investment in the Surgery Center is accounted for under the equity method. At December 31, 2012 and 2011, the Surgery Center had total net assets of approximately $3,134,000 and $2,813,000, respectively.

## (15) Fair Value of Financial Instruments

The carrying amounts of Centra's financial instruments, excluding long-term obligations, approximate their fair values. The fair values of Centra's long-term obligations are estimated based on the quoted market prices for the same or similar issues or using discounted cash flow analyses.

The carrying amount and fair value of Centra's long-term obligations at December 31 are as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Fair value | Carrying value | Fair value | Carrying value |
| Long-term obligations | $ 230,255,206 | 230,014,546 | 239,557,138 | 239,223,082 |

## (16) Commitments and Contingencies

### *(a) Lease Commitments*

Total rental expense in 2012 and 2011 for all operating leases and software maintenance agreements was approximately $15,279,000 and $14,936,000, respectively.

Future minimum payments for the next five years on operating lease agreements at December 31, 2012 are as follows:

| | |
|---|---|
| 2013 | $ 2,510,070 |
| 2014 | 1,617,188 |
| 2015 | 1,107,164 |
| 2016 | 780,346 |
| 2017 | 661,902 |
| Thereafter | 1,660,721 |
| | $ 8,337,391 |

***(b) Compliance***

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Centra believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the consolidated financial statements. Compliance with such laws and regulations is subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Centra has identified potential violations of the Stark Law, which generally prohibits a financial relationship between a referring physician and healthcare facilities receiving any such referrals absent specific contractual language. Centra has self-disclosed these potential violations to relevant regulatory authorities, and expects to work collaboratively with these authorities to determine what, if any, fines and penalties might be appropriate. Management believes that the ultimate outcome to this matter will not have a material effect on Centra's consolidated financial statements.

***(c) Litigation***

Centra is subject to various legal proceedings and claims that are inherent to the provision of healthcare services. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on Centra's consolidated financial statements.

***(d) Affiliation Agreement***

On January 3, 2006, Centra entered into an affiliation agreement with Southside, a 116 bed hospital located in Farmville, Virginia. Under the terms of the affiliation agreement, Centra became the sole corporate member of Southside. Southside remains the licensed owner and operator of the hospital and its operating board continues to serve as the governing board of the hospital, subject to reserved powers maintained by Centra. Under the agreement, Centra agreed to make available $35,500,000 for capital expenditures over a period of ten years. In addition, Centra will provide Southside with funds to make the principal and interest payments on the outstanding bonds.



(Continued)

## (17) Concentrations of Credit Risk

Centra grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The approximate mix of receivables from patients and third-party payors at December 31 was as follows:

| | 2012 | 2011 |
|---|---|---|
| Medicare | 38% | 32% |
| Medicaid | 15 | 18 |
| Anthem | 9 | 12 |
| Commercial and managed care | 15 | 13 |
| Patients and other | 23 | 25 |
| Totals | 100% | 100% |

## (18) Self Insurance

### *(a) General Liability and Malpractice insurance*

Prior to December 31, 2002, Centra maintained professional liability insurance coverage with a reciprocal insurance company (the Insurer), which insured Centra and a coalition of other hospitals, physicians and attorneys. The Insurer experienced significant losses over the last few years and its risk-based capital dropped below specified levels, which has resulted in the State Corporation Commission and Bureau of Insurance of the Commonwealth of Virginia placing the Insurer into receivership and subsequently liquidation. Should the Insurer no longer be able to pay the claims of Centra, Centra would be required to purchase coverage to insure these claims. Centra elected not to purchase tail coverage to insure itself for incidents that occurred prior to December 31, 2002, but which may be reported subsequent to that date.

From January 1, 2003 through October 1, 2009, Centra was a member of Virginia Health Systems Alliance Inter-Insurance Exchange, a multi-provider captive insurance company. Effective October 1, 2009, Centra formed a single member limited liability company, Centra Health Indemnity Company, LLC (CHIC), that operates as an insurance company, whose sole purpose is to provide general, professional and excess liability along with terrorism risk coverage. Professional, general, and excess liability risks are primarily insured on a claims-made basis. CHIC policy limits are $32,050,000, $32,000,000, and $30,000,000 per occurrence for professional, general, and excess liability, respectively, and $36,000,000, $36,000,000, and 30,000,000 in the aggregate per year for professional, general, and excess liability, respectively. Accrued professional liability costs on a discounted basis as of December 31, 2012 and 2011 amounted to $8,504,000 and $8,233,344, respectively, and is included in other long-term liabilities on the consolidated balance sheets.

Centra's professional liability insurance coverage is on a claims-made basis with a retroactive coverage date of October 1, 1975. Should the claims-made policy not be renewed or replaced with equivalent insurance, occurrences during its term, but asserted subsequently, would be uninsured unless Centra obtains tail coverage. The basic level of coverage limits claims paid to $2,000,000 per occurrence and $6,000,000 in aggregate. Centra has recorded an actuarially determined liability of approximately $3,676,000 and $3,520,000 as of December 31, 2012 and 2011, respectively, for those claims incurred but not yet reported, and is included in other long-term liabilities on the consolidated balance sheets.

Professional liability policies entered into on a claims-made basis must be renewed or replaced with equivalent insurance if claims incurred during their term but asserted after their expiration are to be insured. The estimated liability for professional and general liability claims will be significantly affected if current and future claims differ from historical trends. While management monitors reported claims closely and considers potential outcomes as estimated by it actuaries when determining its professional and liability accruals, the complexity of the claims, the extended period of time to settle the claims, and the wide range of potential outcomes complicate the estimation. In the opinion of management, adequate provision has been made for the related risk.

***(b) Employee Health Benefits***

Centra is self-insured for employee health benefits. Payments under the plan are limited to $300 per participant per year. The liabilities associated with these claims totaled $3,851,000 and $4,432,000 at December 31, 2012 and 2011, respectively.

***(c) Workers' Compensation Insurance***

Centra is self-insured for workers' compensation insurance. The liability associated with these claims totaled $702,000 and $742,000 at December 31, 2012 and 2011, respectively.

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# Independent Auditors' 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*

The Board of Directors
Centra Health, Inc.:

We have audited, in accordance with the 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 Centra Health, Inc. and Subsidiaries (Centra), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 15, 2013.

## Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Centra'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 Centra's internal control. Accordingly, we do not express an opinion on the effectiveness of Centra'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 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 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 Centra's consolidated 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 Centra's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Centra's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Roanoke, Virginia
April 15, 2013