Report of Independent Auditors
and Consolidated Financial Statements

Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers

August 31, 2014 and 2013

MOSS ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

The Board of Trustees
Community Hospitals of Central California and Affiliated Corporations
dba Community Medical Centers

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers (CMC), which comprise the consolidated balance sheets as of August 31, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 auditor's 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 obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated balance sheets of CMC as of August 31, 2014 and 2013, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by *Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*, 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 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated November 24, 2014, on our consideration of CMC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CMC's internal control over financial reporting and compliance.

Moss Adams LLP

Stockton, California
November 24, 2014

CONSOLIDATED FINANCIAL STATEMENTS

COMMUNITY HOSPITALS OF CENTRAL CALIFORNIA
AND AFFILIATED CORPORATIONS
dba COMMUNITY MEDICAL CENTERS
CONSOLIDATED BALANCE SHEETS (In thousands)

ASSETS

	AUGUST 31, 2014	AUGUST 31, 2013
Current assets:		
Cash and equivalents	$ 64,134	$ 37,984
Short-term investments	3,168	12,056
Patient accounts receivable (less allowance for doubtful accounts of $83,205 in 2014 and $125,307 in 2013)	179,114	166,016
Estimated third-party settlements	8,837	-
Due from State of California for supplemental funding	14,700	18,953
Other receivables	4,227	60,194
Inventories	11,714	10,572
Prepaid expenses and other	25,644	15,606
	311,538	321,381
Assets limited as to use:		
Board-designated assets	316,160	295,315
Assets held by trustee for:		
Debt service	35,556	35,600
Self-insurance in captive insurance company	9,864	12,703
Project funds	-	-
Donor-restricted assets	18,137	17,694
	379,717	361,312
Property, plant, and equipment, net	795,796	732,033
Construction in progress	45,308	77,420
Other assets	96,772	74,269
	$ 1,629,131	$ 1,566,415

LIABILITIES AND NET ASSETS

	2014	2013
Current liabilities:		
Accounts payable	$ 70,645	$ 68,836
Accrued compensation and employee benefits	68,028	61,749
Estimated third-party settlements	-	8,287
Other accrued liabilities and deferred revenue	34,096	33,659
Current maturities of long-term debt	8,301	10,695
	181,070	183,226
Long-term debt, less current maturities	510,735	515,683
Pension benefit obligation	23,203	33,957
Other long-term obligations	60,116	50,714
	775,124	783,580
Net assets:		
Unrestricted	835,870	765,141
Temporarily and permanently restricted	18,137	17,694
	854,007	782,835
	$ 1,629,131	$ 1,566,415

See accompanying notes

COMMUNITY HOSPITALS OF CENTRAL CALIFORNIA
AND AFFILIATED CORPORATIONS
dba COMMUNITY MEDICAL CENTERS
CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands)

	YEARS ENDED AUGUST 31,	
	2014	2013
Unrestricted revenues, gains, and other support:		
Net patient service revenues	$ 1,303,294	$ 1,401,939
Less: Provision for bad debts	(129,577)	(174,206)
	1,173,717	1,227,733
Premium revenue	1,286	1,342
Investment income	22,237	10,169
Other revenue	48,736	36,887
	1,245,976	1,276,131
Expenses:		
Salaries, wages, and benefits	620,342	565,721
Supplies	200,693	198,573
Outside services	204,475	186,546
Insurance	6,334	3,731
Depreciation and amortization	61,026	54,434
Rental and lease	10,422	11,057
Interest	23,255	21,075
Utilities	12,736	11,945
Other	40,718	122,183
	1,180,001	1,175,265
Excess of revenues, gains, and other support over expenses	65,975	100,866
Net change in unrealized gains and losses on investments	(311)	(571)
Net assets released from restrictions for equipment acquisition	2,009	1,426
Change in unfunded accumulated pension benefit obligation	3,056	41,322
Other	-	66
Change in unrestricted net assets	$ 70,729	$ 143,109

COMMUNITY HOSPITALS OF CENTRAL CALIFORNIA
AND AFFILIATED CORPORATIONS
dba COMMUNITY MEDICAL CENTERS
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (In thousands)

	Unrestricted	Temporarily and permanently restricted	Total
Balance at August 31, 2012	$ 622,032	$ 13,110	$ 635,142
Excess of revenues, gains, and other support over expenses	100,866	-	100,866
Net change in unrealized gains and losses on investments	(571)	-	(571)
Donor-restricted contributions	-	7,276	7,276
Net assets released from restrictions and used for operations	-	(1,266)	(1,266)
Net assets released from restrictions for equipment acquisition	1,426	(1,426)	-
Change in unfunded accumulated pension benefit obligation	41,322	-	41,322
Other	66	-	66
	143,109	4,584	147,693
Balance at August 31, 2013	765,141	17,694	782,835
Excess of revenues, gains, and other support over expenses	65,975	-	65,975
Net change in unrealized gains and losses on investments	(311)	-	(311)
Donor-restricted contributions	-	3,596	3,596
Net assets released from restrictions and used for operations	-	(1,144)	(1,144)
Net assets released from restrictions for equipment acquisition	2,009	(2,009)	-
Change in unfunded accumulated pension benefit obligation	3,056	-	3,056
Other	-	-	-
	70,729	443	71,172
Balance at August 31, 2014	$ 835,870	$ 18,137	$ 854,007

CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands)

	YEARS ENDED AUGUST 31, 2014	2013
Cash flows from operating activities:		
Change in net assets	$ 71,172	$ 147,693
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net unrealized losses and gains on investments	311	571
Donor-restricted contributions	(3,901)	(4,249)
Provision for bad debts	129,577	174,206
Depreciation and amortization	61,026	54,434
Amortization of bond discount/premium	(132)	(178)
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	(86,708)	(170,637)
Due from State of California for supplemental funding	4,253	(5,231)
Inventories, prepaid expenses, and other	(40,932)	(14,222)
Accounts payable and other accrued liabilities	5,202	(15,141)
Accrued compensation and employee benefits	6,279	(123)
Pension benefit obligation	(10,754)	(44,304)
Estimated third-party settlements	(17,124)	(7,718)
	118,269	115,101
Cash flows from investing activities:		
Purchases of property, plant, and equipment, net	(75,239)	(109,867)
Purchase of investments	(234,530)	(230,969)
Proceeds from sales of investments	210,193	208,205
Cash and cash equivalents movements in assets limited as to use	14,466	(8,077)
Change in assets under bond indenture agreements	43	(27)
	(85,067)	(140,735)
Cash flows from financing activities:		
Repayments of long-term debt	(11,053)	(11,843)
Proceeds from long-term debt	100	912
Proceeds from restricted contributions	3,901	4,249
	(7,052)	(6,682)
	26,150	(32,316)
Cash and equivalents, beginning of year	37,984	70,300
Cash and equivalents, end of year	$ 64,134	$ 37,984
Supplemental disclosure of cash flow information:		
Interest paid	$ 26,284	$ 26,519

NOTE 1 – ORGANIZATION

Community Hospitals of Central California and Affiliated Corporations, dba Community Medical Centers (CMC), is a not-for-profit multifacility integrated healthcare organization located in Fresno, California. CMC has established an Obligated Group to access capital markets. Obligated Group members are jointly and severally liable for the long-term debt outstanding under the Obligated Group's master trust indenture. The Obligated Group members are denoted with an asterisk (*). CMC includes the following consolidated entities:

Acute care services – Acute care services consist of a single corporate entity, Fresno Community Hospital and Medical Center*, which operates as two general acute care hospitals that provide a full range of medical, surgical, intensive care, emergency room, burn and trauma, and obstetric services. These facilities also offer home health, psychiatric, rehabilitation, and a variety of other services. The acute care hospitals are:

- Community Regional Medical Center (CRMC)
- Clovis Community Medical Center (CCMC)

California Imaging Institute LLC (CII), operates two freestanding outpatient imaging centers that provide comprehensive imaging services. It is owned in partnership with a physician-owned radiology medical group. Fresno Community Hospital and Medical Center accounts for this investment using the equity method.

Corporate activities – Corporate activities consist of centralized shared services, real estate activities, and retail pharmacy operations.

- Community Hospitals of Central California* (CHCC)
- Community Health Enterprises (CHE)

Fresno Heart and Surgical Hospital* – The Fresno Heart and Surgical Hospital provides cardiac-related services and bariatric and other minimally invasive surgeries.

Deran Koligian Ambulatory Care Center – Deran Koligian Ambulatory Care Center, LLC (DKACC) is a not-for-profit single member LLC, whose sole member is Fresno Community Hospital and Medical Center.

Community Insurance Services Company – Community Insurance Services Company (CISC), is a wholly owned captive insurance company that maintains professional and general liability coverage and has no income tax obligation.

Community Care Health Plan – Community Care Health Plan (CCHP), is a wholly owned Knox-Keene licensed Health Maintenance Organization that provides health insurance coverage to the employees of CMC and entities partially owned by CMC.

NOTE 1 – ORGANIZATION (CONTINUED)

Physician management services – Physician management services consist of Santé Health System (Santé), which is a management service organization (MSO) providing independent physician association and physician practice management services. CMC accounts for the investment in Santé using the equity method.

Development activities – Development activities consist of a single corporate entity, Community Hospitals of Central California Foundation, which conducts fundraising activities for the not-for-profit organizations within the health system.

Obligated Group members – Obligated Group members are the parent corporations of certain consolidated entities that are not Obligated Group members. Accounting principles generally accepted in the United States of America (U.S. GAAP) require consolidation of all controlled subordinate corporations. Accordingly, the consolidated financial statements of CMC are the same as the Obligated Group financial statements under U.S. GAAP.

NOTE 2 – AGREEMENT WITH THE COUNTY OF FRESNO

Effective October 7, 1996, CMC, through one of its affiliates (Fresno Community Hospital and Medical Center), entered into a series of agreements (the Transaction Agreements) with the County of Fresno (the County). The Transaction Agreements were amended in 1998 and again in 2003 related to a University Medical Center (UMC) lease. The principal ongoing provision of the Transaction Agreements are as follows:

- CMC is required to provide comprehensive medical care to certain classes of indigent persons and inmates within the County for a period of 30 years in return for certain payments. Payments received under this agreement totaled approximately $21,375,000 and $21,065,000 for the years ended August 31, 2014 and 2013, respectively. CMC was notified in August, 2014 that the County was terminating the contract effective November 30, 2014.

As security for CMC's performance under the terms of the Transaction Agreements, the County was granted a first-priority lien on CCMC and an adjoining medical office building. In addition, during the 30-year period commencing October 7, 1996, (a) the County is entitled to nominate 27% of the members of CMC's (and certain of its affiliates') board of trustees and related subcommittees and (b) CMC and its affiliates are precluded, with certain specified exceptions, from making any net asset transfers outside of CMC.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation – The consolidated financial statements include the accounts of CMC and affiliates as listed under Organization in Note 1. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates – The preparation of 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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and equivalents – Cash and equivalents include all highly liquid investments with an original maturity of three months or less when purchased. Cash and equivalents purchased by CMC's investment managers as part of their investment strategies are included in assets limited as to use and short-term investments. CMC regularly maintains balances in depository accounts in excess of the FDIC insurance limit.

Accounts receivable – CMC's primary concentration of credit risk is patient accounts receivable and SB855 and SB1255 disproportionate share funds receivable, which consist of amounts owed by various government agencies, insurance companies, and private patients. CMC manages the receivables by regularly reviewing its accounts and contracts and by providing appropriate allowances for uncollectible amounts. CMC provides for estimated losses on patient accounts receivable based on prior bad debt experience. Uncollectible receivables are charged-off when deemed uncollectible. Recoveries from previously charged-off accounts are recorded when received. The mix of receivables from third-party payors and patients at August 31, 2014 and 2013, is as follows:

	2014	2013
Medicare	15%	15%
Medi-Cal and managed Medi-Cal	24%	20%
Contracted rate payors	52%	51%
Commercial insurance and other payors	9%	14%
Total	100%	100%

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Allowance for doubtful accounts – Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, CMC analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, CMC analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments 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 and non-contracted insurance (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), CMC records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

CMC's allowance for doubtful accounts for self-pay patients decreased from 84.8 percent of self-pay accounts receivable at August 31, 2013, to 76.1 percent of self-pay accounts receivable at August 31, 2014. In addition, CMC's write-offs were approximately $129,577,000 for fiscal year 2014 and $174,206,000 for fiscal year 2013. Decreased write-offs were the result of decreased self-pay revenue of 34.5 percent in fiscal year 2014. The decrease in self pay revenue was primarily the result of implementation of the Medicaid expansion on insurance marketplace components of the Affordable Care Act (see Note 4) in 2014. CMC maintained allowances for doubtful accounts from third-party payors of $7,745,000 in fiscal year 2014 and $8,750,000 in fiscal year 2013.

Inventories – Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

Assets limited as to use and short-term investments – Assets limited as to use consist principally of corporate debt securities, equity securities, and U.S. government and agency securities, all of which are available for sale and carried at fair market value. The fair values for these investments are based on quoted market prices. Investments also include repurchase agreements. Certain marketable securities are designated as assets held in trust. These include assets held by trustees in accordance with the indentures relating to long-term debt. In addition, certain investments are set aside by the board of trustees for future capital improvements.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Assets limited as to use and short-term investments (continued) – Investment income is included in the excess of revenues, gains, and other support over expenses unless the income is restricted by donor or law.

For investments purchased prior to September 1, 2008, unrealized gains and losses on investments are excluded from the excess of revenues, gains, and other support over expenses unless the investments are trading securities, or an unrealized loss is determined to be other than temporary for any security that is available for sale. Management routinely evaluates its investments in marketable securities for other than temporary impairment.

CMC has elected to report investments in debt and equity securities purchased on or after September 1, 2008 under Accounting Standards Codification (ASC) 825, *Financial Instruments*, such that unrealized gains and losses on such securities are included in the excess of revenues, gains, and other support over expenses unless the income is restricted by donor or law.

CMC has discretion to establish policies regarding which portion of assets limited as to use is classified as short-term investments. The amount classified as short-term investments consists of available cash held in investment accounts, money markets balances, and highly liquid investment securities with an original maturity of three months or less.

Property, plant, and equipment – Property, plant, and equipment are stated at cost, or in the case of donated items, at fair market value at the date of donation. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities, or extend useful lives are capitalized, as is interest for significant construction projects. In 2014 and 2013, $3,121,000 and $5,380,000, respectively, of net interest expense was capitalized for construction projects.

Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 10 to 25 years for land improvements, 5 to 40 years for buildings and improvements, and an average of 8 years for equipment.

CMC's management regularly reviews long-lived assets for indications of impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Management estimates the fair value of legal asset retirement obligations that are conditional on a future event if the amount can be reasonably estimated, in accordance with Financial Accounting Standards Board (FASB). Estimates are developed through the identification of applicable legal requirements, identification of specific conditions requiring incremental cost at time of asset disposal, estimation of costs to remediate conditions, and estimation of remaining useful lives or date of asset disposal.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Self-insurance and other benefit plans – CMC is self-insured for workers compensation claims and maintains a self-insured medical, dental, and vision care plan as an option for its employees. Claims are accrued under these plans as the incidents that give rise to them occur. Unpaid claim accruals are based on the actuarially estimated ultimate cost of settlement, including claim settlement expenses. CMC has reinsurance arrangements with insurance companies to limit its losses on claims for medical and workers compensation expenses. The portion not expected to be paid within one year is included within other long-term obligations. As of August 31, 2014, CMC has a claims liability of $62,353,000 and a corresponding insurance recovery receivable of $2,640,000 for medical and workers compensation claims that are insured by a third party excess loss policy. As of August 31, 2013, CMC has a claims liability of $54,299,000 and a corresponding insurance recovery receivable of $1,894,000 for medical and workers compensation claims that are insured by a third party excess loss policy. The claims liability is classified in other accrued liabilities and long-term obligations and the insurance recovery receivable is classified in prepaids and other assets, respectively, in the accompanying balance sheet.

Professional liability insurance – Community Insurance Services Company (CISC), CMC wholly owned captive insurance company, has issued claims-made policies to insure the medical and general liability risks of CMC's affiliates. CISC retains $2,000,000 per incident and $15,000,000 in the aggregate and is reinsured up to $90,000,000 per incident and in the aggregate with third-party reinsurers. As of August 31, 2013, CMC had recorded estimated liabilities for claims incurred and reported of $6,115,000, and a corresponding insurance recovery receivable of $341,000. These amounts are included within the accompanying consolidated balance sheets. As of August 31, 2014, CMC had recorded estimated liabilities for claims incurred and reported of $6,504,000, and a corresponding insurance recovery receivable of $3,098,000. These amounts are included within the accompanying consolidated balance sheets.

Should the reinsurance policies not be renewed or replaced with equivalent insurance, claims related to occurrences during the term of the claims-made policy but reported subsequent to its termination may be uninsured. Liabilities of $3,146,000 and $2,983,000 have been recorded for the actuarially estimated incurred but not reported liability at August 31, 2014 and 2013, respectively. These liabilities are included within other long-term obligations in the accompanying consolidated balance sheets.

Income taxes – Most entities included in CMC are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code and are generally not subject to federal or state income taxes. However, the exempt organizations are subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the basic financial statements taken as a whole. CMC includes entities that are subject to income taxes; however, such income tax activities are not significant to the consolidated financial statements.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Donor gifts – Unconditional promises to give cash and other assets to CMC are reported at fair market value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair market value at the date the gift is received and any conditions are substantially met. 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, restricted net assets are reclassified as unrestricted net assets.

Fair value of financial instruments – Unless otherwise indicated, the fair value of all reported assets and liabilities, which represent financial instruments, approximate their carrying values. CMC's policy is to recognize transfers in and transfers out of Levels 1 and 2 as of the end of the reporting period.

Excess of revenues, gains, and other support over expenses – Excess of revenues, gains, and other support over expenses reflected in the accompanying consolidated statements of operations includes all changes in unrestricted net assets other than changes in unrealized gains on certain marketable securities, net assets released from restrictions for equipment acquisition, and changes in pension benefit obligation.

Reclassifications – Certain amounts in the 2013 financial statements have been reclassified to conform to the 2014 presentation.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. CMC recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. CMC's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheet but arose after the balance sheet date and before the consolidated financial statements are issued. CMC has evaluated subsequent events through November 24, 2014, which is the date the consolidated financial statements are issued.

NOTE 4 – NET PATIENT SERVICE AND PREMIUM REVENUES

Net patient service revenues – Net patient service revenues are 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. Estimated settlements under third-party reimbursement agreements are accrued in the period in which the related services are rendered and adjusted in future periods, based on updated information and as a result of final settlements.

Gross patient charges comprise usual and customary charges for services provided to all patients. The composition of consolidated net patient revenue by major payor group as of the years ended August 31, 2014 and 2013, is as follows:

	2014	2013
Medicare	23%	21%
Medi-Cal and managed Medi-Cal	29%	32%
Contracted rate payors	37%	33%
Commercial insurance and other payors	10%	13%
Medically Indigent Services Program (MISP)	1%	1%
Total	100%	100%

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

CMC is evaluating whether it received overpayments, and whether any such overpayments should be reported to the payer and repaid, pertaining to certain patient services provided. CMC has recorded an estimated liability of $14,549,000 in its 2014 financial statements related to this matter. CMC will continue to evaluate the matter but management does not believe that the ultimate outcome will have a materially adverse impact on the financial position or operations of CMC.

Medicare – Inpatient acute care services, skilled nursing services, rehabilitation services, and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per diagnosis. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost-based reimbursement methodology. Professional services are reimbursed based on a fee schedule.

NOTE 4 – NET PATIENT SERVICE AND PREMIUM REVENUES (CONTINUED)

Medi-Cal – Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed primarily at prospectively determined rates per diagnosis. Additionally, CMC is allocated certain funds available from a pool of State of California funds for disproportionate share hospital services under the SB855 and SB1255/Private Hospital Fund programs based upon an annual determination for eligibility. Revenues under the SB855 program and SB1255/Private Hospital Fund totaled $47,543,000 and $8,528,000, respectively, for the year ended August 31, 2014 and $46,826,000 and $8,250,000, respectively, for the year ended August 31, 2013. As of August 31, 2014 and 2013, CMC recorded receivables of $15,501,000 and $18,953,000, respectively, for amounts due from the State of California for SB855, SB1255, and other programs (Note 14).

Cost reports filed under the Medicare and Medi-Cal programs for services based on cost reimbursement are subject to audit. The estimated amounts due to or from the programs are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net revenue in the year in which the examination is completed. Net patient service revenue increased $677,000 and $4,164,000 in 2014 and 2013, respectively, related to updates of prior years' cost report reserves and increased by $10,733,000 and $8,832,000, respectively, related to successful appeals of prior years' cost report settlements.

Other – CMC has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations (HMOs), and preferred provider organizations. The basis for payment to CMC under these agreements includes prospectively determined rates per diagnosis, discounts from established charges, and prospectively determined daily rates. CMC also receives State of California funds pursuant to Proposition 99.

Premium revenue – CMC has an agreement with an independent physician association (IPA) to provide medical services to certain IPA members. Under this agreement, CMC receives monthly capitation payments and recognizes as revenue during the period regardless of whether services actually performed by CMC.

Charity care – Healthcare services are provided to patients who meet certain criteria under CMC's charity care policies without charge or at amounts less than established rates. Traditional charity care covers services provided to persons who meet certain criteria and cannot afford to pay. Unpaid costs of charity are the estimated costs of services provided to such patients. The estimated cost of providing these services was $6,242,000 and $6,665,000 for the years ended August 31, 2014 and 2013, respectively, calculated by multiplying the ratio of cost to gross charges by the gross uncompensated charges associated with providing charity care to patients.

NOTE 4 – NET PATIENT SERVICE AND PREMIUM REVENUES (CONTINUED)

Hospital fee program – In November 2009, the California Hospital Fee Program (the Program) was signed into California state law. The Program provides supplemental Medi-Cal payments to certain California hospitals. The Program is funded by a quality assurance fee (the Fee) paid by participating hospitals and by matching federal funds. Hospitals receive supplemental payments from either the California Department of Health Care Services (DHCS), managed care plans or a combination of both.

California enacted a thirty-month quality assurance fee program (30-month Program) for the period July 1, 2011 through December 31, 2013. Final approval by CMS for the fee for service portion of this program occurred on June 22, 2012. For the fee for service portion for the year ended August 31, 2014 and 2013, estimated supplemental payments of $25,972,000 and $77,915,000, respectively, are included in net patient service revenue. For the years ended August 31, 2014 and 2013, estimated fees and pledge expense of $15,031,000 and $93,108,000, respectively, are included in other expenses. At August 31, 2014, CMC has a receivable of $6,767,000 and a liability of $2,047,000 relating to the 30-month Program. At August 31, 2013, CMC had a receivable of $52,317,000 and a liability of $19,376,000 relating to the 30-month Program. The final six months of the managed care portion of this program has not yet received final approval from CMS. CMC did not record any activity relating to the managed care portion in the year ended August 31, 2014. For the year ended August 31, 2013, CMC recognized $82,968,000 in net patient service revenue related to the approved portion of the managed care portion of this program.

In March 2010, President Obama signed the Health Care Reform legislation into law. The new law will result in sweeping changes across the health care industry. The primary goal of this comprehensive legislation is to extend coverage to approximately uninsured legal U.S. residents through a combination of public program expansion and private sector health insurance reforms. To fund the expansion of insurance coverage, the legislation contains measures designed to promote quality and cost efficiency in health care delivery and to generate budgetary savings in the Medicare and Medicaid programs.

NOTE 5 – ASSETS LIMITED AS TO USE

Assets limited as to use include marketable securities that are carried at fair value, based on quoted market prices. Pledges receivable are carried at net realizable value. The composition of assets limited as to use at August 31, 2014 and 2013 is as follows (in thousands):

	2014		2013	
	Cost	Fair value and carrying value	Cost	Fair value and carrying value
Cash and equivalents	$ 36,110	$ 36,110	$ 54,384	$ 54,384
U.S. Treasury bills and notes	17,696	17,696	35,980	35,980
U.S. government agency debt	32,178	32,366	33,818	34,041
Corporate debt securities	168,756	168,759	142,048	142,056
Equity securities	53,176	57,814	43,284	48,122
Mutual funds	42,091	42,091	30,737	30,737
Repurchase agreements	19,393	19,393	19,394	19,394
Total cash and marketable securities	369,400	374,229	359,645	364,714
Less amounts classified as short-term investments	(3,168)	(3,168)	(12,056)	(12,056)
Pledges receivable, net	8,656	8,656	8,654	8,654
	5,488	5,488	(3,402)	(3,402)
Total assets limited as to use	$ 374,888	$ 379,717	$ 356,243	$ 361,312

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

CMC adopted ASC 820, *Fair Value Measurements and Disclosure*, on September 1, 2008 for fair value measurements of financial assets and liabilities. ASC 820 established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that CMC has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 inputs are inputs that are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement entirely falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

The following table presents financial assets measured at fair value as of August 31, 2014 (in thousands):

	2014			
Investments	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Fair value total
Cash and equivalents	$ 3,168	$ -	$ -	$ 3,168
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	17,696	-	-	17,696
U.S. government agency debt	-	26,744	-	26,744
	17,696	26,744	-	44,440
Corporate debt securities:				
Health care	-	16,002	-	16,002
Energy	-	10,368	-	10,368
Financials	-	97,764	-	97,764
Industrials	-	6,800	-	6,800
Information technology	-	5,398	-	5,398
Telecommunications	-	7,659	-	7,659
Consumer discretionary	-	10,763	-	10,763
Consumer staples	-	9,243	-	9,243
Other	-	4,762	-	4,762
	-	168,759	-	168,759
Equity securities:				
Health care	9,258	-	-	9,258
Financials	7,955	-	-	7,955
Consumer staples	5,568	-	-	5,568
Consumer discretionary	6,538	-	-	6,538
Materials	2,206	-	-	2,206
Energy	5,204	-	-	5,204
Information technology	12,156	-	-	12,156
Industrials	6,886	-	-	6,886
Telecommunications	747	-	-	747
Other	1,296	-	-	1,296
	57,814	-	-	57,814
Mutual funds:				
Mid cap core	7,560	-	-	7,560
Small cap core	8,554	-	-	8,554
International core	13,214	-	-	13,214
Emerging markets	2,950	-	-	2,950
Specialty-real estate	1,923	-	-	1,923
Other	2,430	-	-	2,430
	36,631	-	-	36,631
	115,309	195,503	-	310,812
Funds held by trustees				
Repurchase agreements	-	19,393	-	19,393
U.S. government agency debt	-	5,622	-	5,622
Mutual funds	5,460	-	-	5,460
Cash and equivalents	32,942	-	-	32,942
	38,402	25,015	-	63,417
Total	$ 153,711	$ 220,518	$ -	$ 374,229

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

The following table presents financial assets measured at fair value as of August 31, 2013(in thousands):

	2013			
Investments	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Fair value total
Cash and equivalents	$ 9,056	$ -	$ -	$ 9,056
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	35,980	-	-	35,980
U.S. government agency debt	-	24,600	-	24,600
	35,980	24,600	-	60,580
Corporate debt securities:				
Health care	-	11,963	-	11,963
Energy	-	12,188	-	12,188
Financials	-	73,879	-	73,879
Industrials	-	7,725	-	7,725
Information technology	-	9,064	-	9,064
Telecommunications	-	6,589	-	6,589
Consumer discretionary	-	5,832	-	5,832
Consumer staples	-	5,113	-	5,113
Other	-	9,703	-	9,703
	-	142,056	-	142,056
Equity securities:				
Health care	6,643	-	-	6,643
Financials	6,063	-	-	6,063
Consumer staples	6,261	-	-	6,261
Consumer discretionary	3,440	-	-	3,440
Materials	2,654	-	-	2,654
Energy	4,673	-	-	4,673
Information technology	9,814	-	-	9,814
Industrials	6,286	-	-	6,286
Telecommunications	1,455	-	-	1,455
Other	833	-	-	833
	48,122	-	-	48,122
Mutual funds:				
Mid cap core	7,789	-	-	7,789
Small cap core	8,098	-	-	8,098
International core	7,627	-	-	7,627
Emerging markets	1,405	-	-	1,405
Specialty-real estate	2,053	-	-	2,053
Other	2,134	-	-	2,134
	29,106	-	-	29,106
	122,264	166,656	-	288,920
Funds held by trustees				
Repurchase agreements	-	19,394	-	19,394
U.S. government agency debt	-	9,441	-	9,441
Mutual funds	1,631	-	-	1,631
Cash and equivalents	45,328	-	-	45,328
	46,959	28,835	-	75,794
Total	$ 169,223	$ 195,491	$ -	$ 364,714

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

The scheduled maturities of the debt securities as of August 31, 2014 are as follows:

	Amortized cost basis	Estimated fair value
Due within 1 year or less	$ 15,570	$ 15,098
Due after 1 year through 5 years	152,689	153,376
Due after 5 years	17,213	17,147
	185,472	185,621
Mortgage-backed securities, accrued interest, and other	27,163	27,578
	$ 212,635	$ 213,199

The scheduled maturities of the debt securities as of August 31, 2013 are as follows:

	Amortized cost basis	Estimated fair value
Due within 1 year or less	$ 14,588	$ 14,588
Due after 1 year through 5 years	95,092	95,092
Due after 5 years	67,058	67,106
	176,738	176,786
Mortgage-backed securities, accrued interest, and other	25,643	25,852
	$ 202,381	$ 202,638

Investment income is composed of the following for the years ended August 31, 2014 and 2013 (in thousands):

	2014	2013
Interest income	$ 4,705	$ 4,088
Net realized gains/losses on sales of securities and other-than-temporary impairment	16,155	4,650
Dividends	1,377	1,431
	$ 22,237	$ 10,169

NOTE 6 – PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following as of August 31, 2014 and 2013 (in thousands):

	2014	2013
Land and land improvements	$ 32,703	$ 32,405
Buildings and improvements	764,455	690,274
Equipment	542,541	503,566
	1,339,699	1,226,245
Accumulated depreciation	(543,903)	(494,212)
	$ 795,796	$ 732,033

NOTE 7 – OTHER ASSETS

Other assets consist of the following as of August 31, 2014 and 2013 (in thousands):

	2014	2013
Loan receivable from DKACC Lenders (Note 8)	$ 18,844	$ 18,844
Investment in rental properties	32,713	11,911
Real estate held for development	14,559	10,307
Intangible assets, net	3,968	3,543
Unamortized financing costs, net	7,383	7,694
Investment in joint ventures	10,842	11,456
Loan receivable (Note 10)	4,872	4,539
Equipment held for sale	-	3,500
Other	3,591	2,475
	$ 96,772	$ 74,269

NOTE 7 – OTHER ASSETS (CONTINUED)

CMC owns rental properties, recorded at cost, net of accumulated depreciation. Investments in rental properties consist of the following as of August 31, 2014 and 2013 and are included in other assets in the accompanying consolidated balance sheets (in thousands):

	2014	2013
Land	$ 7,353	$ 4,085
Buildings and land improvements	43,969	24,998
Equipment	3,220	2,957
	54,542	32,040
Accumulated depreciation	(21,829)	(20,129)
	$ 32,713	$ 11,911

NOTE 8 – LONG-TERM DEBT

Long-term debt consists of the following as of August 31, 2014 and 2013 (in thousands):

	2014	2013
California Municipal Finance Authority		
Certificates of Participation (Community Hospitals of Central California Project) Series 2009, interest ranging from 3% to 5.5% payable semi-annually; principal payable in installments ranging from $3,880,000 in 2015 to $13,850,000 in 2039, collateralized by gross revenues.	$ 186,600	$ 190,290
Unamortized bond discount	(2,798)	(2,986)
Total certificates of participation	183,802	187,304
California Municipal Finance Authority		
Certificates of Participation (Community Hospitals of Central California Project) Series 2007, interest ranging from 5% to 5.25% payable semi-annually; principal payable in installments ranging from $3,755,000 in 2015 to $18,775,000 in 2046, collateralized by gross revenues.	296,480	300,055
Unamortized bond premium	7,395	7,758
Total certificates of participation	303,875	307,813
California Municipal Finance Authority		
Certificates of Participation (Community Hospitals of Central California Project) Series 2009, interest at 5.19%.	-	2,992
Building Loan Agreement (DKACC), interest at 0.90% to 1.97% payable quarterly, principal due December 2038, collateralized by a guarantee by the CMC Obligated Group.	25,589	25,589
Other long-term debt	5,770	2,680
	519,036	526,378
Current maturities	(8,301)	(10,695)
	$ 510,735	$ 515,683

NOTE 8 – LONG-TERM DEBT (CONTINUED)

Under the terms of the master trust indenture associated with the certificates of participation, certain members of CMC are designated as members of the Obligated Group. There are restrictive covenants requiring compliance by the Obligated Group. These include, among other things, limitations on the issuance of additional debt and the maintenance of certain financial ratios.

In 2009, DKACC borrowed $25,589,000 to finance the acquisition and construction of certain facilities and equipment under a financing structured to qualify for New Markets Tax Credits. The New Markets Tax Credits program is administered by the Federal government and provides tax incentives for the benefit of low-income communities. In order to comply with this program, affiliates of CMC's underwriter formed a group of entities (the Lenders), which were capitalized by $7,500,000 from an affiliate of the underwriter and by an $18,844,000 loan from CMC. This resulted in the Lenders accumulating funds totaling $25,589,000, which were then loaned to DKACC. The Obligated Group has guaranteed DKACC's repayment obligations under this borrowing, which has a final maturity of January 20, 2038, but such guaranty is not secured by an Obligation issued under the Master Indenture. Additionally, the Obligated Group has a limited guaranty, up to $10,000,000 over 7 years, related to the Lenders' realization of tax credits available under the New Markets Tax Credit program. The Obligated Group does not currently expect to make any payments under these guarantees.

Scheduled principal repayments on long-term debt and payments on capital lease obligations by fiscal year are as follows (in thousands):

	Long-term debt
2015	$ 8,437
2016	8,793
2017	9,118
2018	9,580
2019	9,997
Thereafter	468,514
	514,439
Add net unamortized bond premium	4,597
	$ 519,036

The aggregate estimated fair value of CMC's long-term obligations at August 31, 2014 and 2013 of $541,165,000 and $495,523,000, respectively, were estimated using discounted cash flow analyses based on CMC's current incremental borrowing rates for similar debt instruments. CMC's long-term obligations are classified as Level 2.

NOTE 9 – LINE OF CREDIT

CMC has a credit agreement with a bank that allows CMC to borrow up to $40,000,000. Under this agreement, credit card borrowings are interest-free and due monthly. All other borrowings bear interest on a LIBOR base. Amounts applied for letter of credit agreements totaled $2,707,000 and $2,857,000 on August 31, 2014 and 2013, respectively. The letter of credit agreements are effective through September 2014. Outstanding credit card borrowings were $200,000 and $714,000 on August 31, 2014 and 2013, respectively. There were no LIBOR-based borrowings as of these dates. A note securing the line of credit has been issued under the master trust indenture. The agreement expires on June 27, 2015.

NOTE 10 – PENSION PLAN

CMC maintains a contributory defined benefit cash balance pension plan that covers substantially all employees upon their retirement. Benefit payments for participants in the plan are determined by application of a benefit formula to the average base earnings of participants. In addition to normal retirement benefits, under certain circumstances, the plan also provides early retirement, disability, death, and spousal benefits. Employees of CMC become eligible to participate in the plan on January 1 or July 1 following the completion of 1,000 hours and one year of service. The vesting period is three years.

Mandatory contributions are made to the plan by the employees as specified in the plan documents. Total employee contributions to the plan for the years ending August 31, 2014 and 2013 were $5,094,000 and $4,875,000, respectively. Total employer contributions to the plan for the years ending August 31, 2014 and 2013 were $16,000,000 and $16,000,000, respectively. Total benefits paid for the years ending August 31, 2014 and 2013 were $13,085,000 and $11,678,000, respectively. The unfunded status is presented as a noncurrent liability in the accompanying consolidated balance sheets.

NOTE 10 – PENSION PLAN (CONTINUED)

The following tables set forth the plan's benefit obligation, fair value of plan assets, and funded status as of August 31, 2014 and 2013 (in thousands):

	2014	2013
Change in projected benefit obligation (PBO):		
PBO at beginning of year	$ 203,975	$ 231,208
Employer service cost	11,219	14,979
Interest cost	9,718	8,827
Actuarial (gain) loss	5,832	(44,164)
Plan participants' contributions	5,094	4,875
Benefits paid from plan assets	(13,085)	(11,678)
Administrative expenses paid	(65)	(72)
PBO at end of year	$ 222,688	$ 203,975

	2014	2013
Change in plan assets:		
Fair value of assets at beginning of year	$ 170,017	$ 152,946
Actual return on assets	21,524	7,946
Employer contributions	16,000	16,000
Plan participants' contributions	5,094	4,875
Benefits paid	(13,085)	(11,678)
Administrative expenses paid	(65)	(72)
Fair value of assets at end of year	$ 199,485	$ 170,017

NOTE 10 – PENSION PLAN (CONTINUED)

	2014	2013
Funded status at end of year	$ (23,203)	$ (33,957)
Unrecognized actuarial loss	25,927	28,928
Unrecognized prior service cost	240	295
Unfunded accumulated pension benefit obligation	(26,167)	(29,223)
Pension benefit obligation recognized in consolidated balance sheets	$ (23,203)	$ (33,957)
Accumulated benefit obligation at end of year	$ 198,236	$ 180,971

Weighted average assumptions as of August 31 are as follows:

	2014	2013
Discount rate	4.00%	4.90%
Expected long-term rate of return on assets	7.50%	7.50%
Rate of compensation increase	4.00%	4.00%

Net periodic pension cost for the plan for 2014 and 2013 is included in salaries, wages, and benefits in the accompanying consolidated statements of operations. Components of net periodic pension cost include the following (in thousands):

	2014	2013
Service cost	$ 11,219	$ 14,979
Interest cost	9,718	8,827
Expected return on plan assets	(13,266)	(14,017)
Amortization of prior service cost	55	55
Recognized net actuarial losses	576	3,175
Net periodic pension cost	$ 8,302	$ 13,019

	2014	2013
Amounts recognized in net assets:		
Net actuarial loss	$ 25,927	$ 28,928
Net prior service cost	240	295
	$ 26,167	$ 29,223

NOTE 10 – PENSION PLAN (CONTINUED)

	2014	2013
Amounts recognized as changes in net assets:		
Net gain	$ (2,425)	$ (38,092)
Amortization of prior service cost	(55)	(55)
Amortization of net loss	(576)	(3,175)
	$ (3,056)	$ (41,322)

The estimated net loss and prior service cost that will be amortized into net period pension cost during the 2015 fiscal year are $325,000 and $55,000, respectively.

CMC's pension plan asset allocations at August 31, 2014 and 2013 by asset category are as follows:

	2014	2013
Cash and equivalents	4%	6%
Debt securities	43%	41%
Equity securities	53%	53%
	100%	100%

The asset allocation policy for the pension plan is as follows: fixed income securities 30% to 60% (which may include U.S. government securities and U.S. government agency bonds, corporate notes and bonds, mortgage-backed bonds, preferred stock, and the fixed income securities of foreign governments and corporations); equity securities 30% to 60% (which may include domestic common stock, convertible notes and bonds, convertible preferred stocks, foreign equity securities); and mutual funds and limited liability companies or partnerships that invest in allowed securities as defined above.

CMC's investment strategy for pension plan assets is designed to emphasize long-term growth of principal while avoiding excessive risk. The investment performance of the total portfolio, as well as asset class components, is measured against commonly accepted performance benchmarks.

The expected long-term rate of return on plan assets is the expected average rate of return on the funds invested currently and on funds to be invested in the future in order to provide for the benefits included in the projected benefit obligation. The CMC pension plan used 7.5% in calculating the 2014 and 2013 expense amounts. This assumption is based on capital market assumptions and the plan's target asset allocation. CMC continues to monitor the expected long-term rate of return if changes in those parameters cause 7.5% to be outside of a reasonable range of expected returns, or if actual plan returns over an extended period of time suggest general market assumptions are not representative of expected plan results.

NOTE 10 – PENSION PLAN (CONTINUED)

The following table presents the plan assets measured at fair value at August 31, 2014 (in thousands):

Investments	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Fair value total
Cash and equivalents	$ 8,486	$ -	$ -	$ 8,486
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	18,013	-	-	18,013
U.S. government agency debt	-	12,367	-	12,367
	18,013	12,367	-	30,380
Corporate fixed income:				
Asset-backed securities	-	7,173	-	7,173
Financials	-	17,554	-	17,554
Other corporate bonds	-	30,290	-	30,290
	-	55,017	-	55,017
Common stocks:				
Health care	9,372	-	-	9,372
Utilities	840	-	-	840
Financials	8,157	-	-	8,157
Consumer staples	3,180	-	-	3,180
Consumer discretionary	6,075	-	-	6,075
Materials	3,228	-	-	3,228
Energy	5,363	-	-	5,363
Information technology	11,509	-	-	11,509
Industrials	6,794	-	-	6,794
American depository receipts	7,750	-	-	7,750
Other	436	-	-	436
	62,704	-	-	62,704
Mutual funds:				
Mid cap	6,231	-	-	6,231
Small cap	9,252	-	-	9,252
International core	18,149	-	-	18,149
Emerging markets	4,455	-	-	4,455
Specialty-real estate	1,803	-	-	1,803
Other	3,008	-	-	3,008
	42,898	-	-	42,898
	$ 132,101	$ 67,384	$ -	$ 199,485

NOTE 10 – PENSION PLAN (CONTINUED)

The following table presents the plan assets measured at fair value at August 31, 2013 (in thousands):

Investments	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Fair value total
Cash and equivalents	$ 10,417	$ -	$ -	$ 10,417
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	16,641	-	-	16,641
U.S. government agency debt	-	9,579	-	9,579
	16,641	9,579	-	26,220
Corporate fixed income:				
Asset-backed securities	-	7,251	-	7,251
Financials	-	10,994	-	10,994
Industrials	-	20,945	-	20,945
Other global corporate bonds	-	5,041	-	5,041
	-	44,231	-	44,231
Common stocks:				
Health care	6,107	-	-	6,107
Utilities	564	-	-	564
Financials	5,851	-	-	5,851
Consumer staples	3,982	-	-	3,982
Consumer discretionary	6,133	-	-	6,133
Materials	3,854	-	-	3,854
Energy	3,813	-	-	3,813
Information technology	10,448	-	-	10,448
Industrials	8,614	-	-	8,614
American depository receipts	4,872	-	-	4,872
	54,238	-	-	54,238
Mutual funds:				
Mid cap core	7,215	-	-	7,215
Small cap core	10,268	-	-	10,268
International core	6,976	-	-	6,976
Emerging markets	4,553	-	-	4,553
Specialty-real estate	5,899	-	-	5,899
	34,911	-	-	34,911
	$ 116,207	$ 53,810	$ -	$ 170,017

NOTE 10 – PENSION PLAN (CONTINUED)

For information about the valuation techniques and inputs to measure fair value of the plan assets, see discussion included in the fair value measurement discussion at Note 5.

The following pension benefit payments reflect expected future service. Payments expected to be paid over the next ten years are as follows (in thousands):

2015	$	13,227
2016		10,505
2017		14,071
2018		15,902
2019		16,977
2020-2024		129,915

CMC expects to contribute approximately $16,000,000 to the pension plan during the 2015 fiscal year.

CMC provides various supplemental executive retirement plans (SERPs). During 2013, it entered into a collateral assignment split dollar agreement with an executive. CMC has invested $4,739,000 into this plan and is entitled to receive a return of these funds, plus interest at a rate of 2.55%, upon the death of the executive. Other SERPs adopted during 2013 were designed to provide 25% to 47% of base salaries, depending on the participant, upon retirement at age 65. CMC contributed approximately $388,000 to this plan during fiscal year 2014.

CMC provides benefits to certain executives that are specifically linked to its longer-term retention goals for these employees. The terms vary by participant. During fiscal years 2014 and 2013, CMC contributed approximately $419,000 and $419,000, respectively, to these plans.

At August 31, 2014, the aggregate SERPs liability of $5,240,000 was recorded for all plans in other long-term liabilities.

NOTE 11 – RESTRICTED NET ASSETS

Temporarily and permanently restricted net assets are available for the following purposes as of August 31, 2014 and 2013 (in thousands):

	2014	2013
Temporarily restricted net assets:		
Patient care	$ 4,014	$ 5,090
Purchase of equipment	1,614	610
Scholarships and other education	5,235	5,492
Other	6,890	6,118
	17,753	17,310
Permanently restricted net assets	384	384
Total temporary and permanently restricted net assets	$ 18,137	$ 17,694

NOTE 12 – FUNCTIONAL CLASSIFICATION OF OPERATING EXPENSES

The following is a summary of management's estimated functional classification of operating expenses as of August 31, 2014 and 2013 (in thousands):

	2014	2013
Program services	$ 1,061,731	$ 1,078,211
Management and general	126,494	95,285
Fundraising	2,017	1,769
	$ 1,190,242	$ 1,175,265

NOTE 13 – OPERATING LEASES

CMC leases certain property and equipment under noncancelable operating leases that expire in various years through 2017. Future minimum payments at August 31, 2014 by fiscal year and in the aggregate, under noncancelable operating leases with initial terms of one year or more consist of the following (in thousands):

Fiscal year		
2015	$	4,310
2016		2,005
2017		1,480
2018		1,342
2019		1,342
Thereafter		6,820
	$	17,299

Total operating lease expense in 2014 and 2013 was $10,508,000 and $11,057,000, respectively.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Claims and regulatory environment – CMC is involved in various claims and litigation, as both plaintiff and defendant, arising in the ordinary course of business. The healthcare industry is subjected to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Government activity remains at a high level with respect to investigations and allegations across the nation concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

NOTE 14 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

Claims and regulatory environment (continued) – As disclosed in Notes 2 and 4, the County, Medicare, and Medi-Cal government reimbursement programs account for a substantial amount of CMC's net patient service revenue. Expenditure reduction efforts and budget concerns within the United States and California legislature continue to create uncertainty over the volume of future health care funding. It is at least reasonably possible that future reimbursements for patient services under these programs could be negatively impacted.

In 2010, Senate Bill 853 was enacted into law, directing the Department of Health Care Services (DHCS) to develop a new method of paying for hospital inpatient services in the fee-for-service Medi-Cal program utilizing a diagnosis related group (DRG) methodology. The DRG rate payment methodology for inpatient services began on July 1, 2013. The ultimate impact of the methodology is not yet known; however, any rate reductions as a result of the methodology change will be phased in over four years: the first year impact will be 2.5 percent for 2013-14; 7.5 percent in 2014-15; and 15 percent in 2015-16. In fiscal year 2016-17, the DRG base price will be fully implemented.

California Assembly Bill 97 (AB97) – AB97 requires DHCS to implement payment reductions of 10% to most categories of services in Medi-Cal fee for service. Reductions are effective for services provided on or after June 1, 2011. CMC has accrued approximately $9,850,000 at August 31, 2014 as a result of AB97. DHCS is expected to begin retrospective rate cuts in the fourth quarter of 2014 and the first quarter of 2015.

Pledges to Medical Foundation – CMC has made significant pledges to the Santé Medical Foundation (the Medical Foundation) to support its efforts to recruit needed specialists and primary care physicians to the Fresno area as well as its efforts to install electronic health record systems in local physician offices. Pledges of $14,077,000 and $13,050,000 and pledge payments of $9,131,000 and $12,472,000 were made in 2014 and 2013, respectively. Two of the board members of the Medical Foundation are also members of the board of CMC or executive management of CMC.

SINGLE AUDIT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED AUGUST 31, 2014

Federal Grantor Program Title	Federal CFDA/ Contract Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. Department of Health and Human Services			
Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White Program Part D)	93.153		$ 397,496
HIV Care Formula Grants	93.917		528,211
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease (Ryan White HIV/AIDS Program Part C)	93.918		481,697
Total Expenditure of Federal Awards			$ 1,407,404

See accompanying notes

1. GENERAL

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers (CMC) under programs of the federal government for the year ended August 31, 2014. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of CMC, it is not intended to and does not present the financial position, changes in net assets, or cash flows of CMC.

2. BASIS OF ACCOUNTING

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

3. RELATIONSHIP TO FINANCIAL STATEMENTS

Federal awards are reported as other revenue in CMC's consolidated statements of operations when qualifying expenses are incurred for the stated purpose of the grants.

4. SUBRECIPIENTS

CMC did not provide federal awards to subrecipients during the year ended August 31, 2014.

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

To the Board of Trustees
Community Hospitals of Central California and Affiliated Corporations
dba Community Medical Centers

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers (CMC), which comprise the consolidated balance sheet as of August 31, 2014, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated November 24, 2014.

Internal Control Over Financial Reporting
In planning and performing our audit of the consolidated financial statements, we considered CMC'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 CMC's internal control. Accordingly, we do not express an opinion on the effectiveness of CMC's internal control.

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

Our consideration of the 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 CMC'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 consolidated 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 the entity's internal control or on compliance. This report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Stockton, California
November 24, 2014

REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Board of Trustees
Community Hospitals of Central California and Affiliated Corporations
dba Community Medical Centers

Report on Compliance for Each Major Federal Program

We have audited Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers' (CMC) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of CMC's major federal programs for the year ended August 31, 2014. CMC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

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

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

Opinion on the Major Federal Program

In our opinion, CMC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended August 31, 2014.

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 2014-001 and 2014-002. Our opinion on each major federal program is not modified with respect to this matter.

CMC's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. CMC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of CMC 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 CMC'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 each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CMC's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies 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 questions costs as items 2014-001 and 2014-002 that we consider to be significant deficiencies.

CMC's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and question costs. CMC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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.

Moss Adams LLP

Stockton, California
November 24, 2014

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported

Non-compliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☒ Yes ☐ None reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? ☒ Yes ☐ No

Identification of Major Federal Programs

CFDA Numbers	*Name of Federal Program or Cluster*	*Type of Auditor's Report Issued*
93.153	U.S. Department of Health and Human Services – Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White Program)	*Unmodified*
93.918	U.S. Department of Health and Human Services – Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease (Ryan White HIV/AIDS Program Part C)	*Unmodified*

Dollar threshold used to distinguish between Type A and Type B programs $300,000

Auditee qualified as low-risk auditee? ☒ yes ☐ no

SECTION II – FINANCIAL STATEMENT FINDINGS

None noted

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 2014-001 – Level of Effort (Instance of noncompliance and significant deficiency)

CFDA Number	*Federal Agency/Pass-through Entity – Program Name*	*Award Number*	*Award year*	*Questioned Costs*
93.918	U.S. Department of Health and Human Services –Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White HIV/AIDS Program Part D)	H76HA00765-12-01	8/31/14	None

Criteria:
42 U.S. Code § 300ff–64 and the grant agreement state that the grantee must maintain its expenditures for early intervention services at a level not less than the level of expenditures for such services for the fiscal year preceding the fiscal year for which the applicant is applying to receive the grant.

Condition:
CMC did not maintain non-Federal funding for early intervention services for the period ending August 31, 2014 at a level greater than the amount expended for such services for the prior fiscal year.

Context:
The finding applies to Finance Department oversight and controls with respect to maintaining and tracking expenditures to ensure the expenditures for early intervention services in the current fiscal year exceed the expenditures for the prior fiscal year.

Effect:
Noncompliance with grant level of effort requirements.

Cause:
The non-Federal funding for HIV early intervention services in the current year were below budgeted amounts due to vacant staff positions and; therefore, CMC did not maintain non-Federal funding for HIV early intervention services at a level that was not less than the expenditures for such activities during the prior fiscal year.

Recommendation:
We recommend that management develop policies/procedures to monitor non-Federal funding for HIV early intervention services throughout the year to ensure that they exceed the previous year expenditures for such activities.

Views of responsible officials and planned corrective actions:
During the 2013-2014 fiscal year Community Special Services (CSS) had several vacant staff positions. CSS was unable to hire replacements for these positions in a timely manner. CSS have since hired per diem social workers and have trained the social workers to also cover CSS.

FINDING 2014-002 – Reporting (Instance of noncompliance and significant deficiency)

CFDA Number	*Federal Agency/Pass-through Entity – Program Name*	*Award Number*	*Award year*	*Questioned Costs*
93.153	U.S. Department of Health and Human Services – Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White Program)	H12HA24778-02-01	8/31/14	None
93.918	U.S. Department of Health and Human Services – Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White HIV/AIDS Program Part D)	H76HA00765-12-01	8/31/14	None

Criteria:
OMB Circular A-133, Compliance Supplement Part 3-L requires recipients to report expenditures under Federal awards.

Condition:
As the organization is a recipient of federal funds from the U.S Department of Health and Human Services, OMB Circular A-133 Compliance Supplement Part 3-L is relevant; and therefore, quarterly Federal Financial Reports are required to be submitted within 30 days of the end of each calendar quarter.

Context:
The finding applies to Finance Department oversight and controls with respect to maintaining and tracking expenditures to ensure the expenditures for early intervention services in the current fiscal year exceed the expenditures for the prior fiscal year.

Effect:
Noncompliance with grant financial reporting requirements.

Cause:
The quarterly federal funding report due April 30, 2014 was submitted May 1, 2014 due to a staff member not being able to compile all the information necessary for the report until the day after the due date and; therefore, CMC did not submit the report within the given deadline.

Recommendation:
We recommend that management develop policies/procedures to monitor completion and submission of Quarterly Reports for both Ryan White Programs within the given deadlines.

Views of responsible officials and planned corrective actions:
CMC has put in place calendar due date reminders for the staff accountant in charge of the grants to ensure reporting deadlines are met.

SECTION IV – SUMMARY OF PRIOR AUDIT FINDINGS

FINDING 2013-001 – Level of Effort (Instance of noncompliance and significant deficiency)

Condition:
CMC did not maintain non-Federal funding for early intervention services for the period ending August 31, 2013 at a level greater than the amount expended for such services for the prior fiscal year.

Recommendation:
We recommend that management develop policies/procedures to monitor non-Federal funding for HIV early intervention services throughout the year to ensure that they exceed the previous year expenditures for such activities.

Current status:
Not implemented. See current year finding 2014-001.