Report of Independent Auditors
and Consolidated Financial Statements

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

August 31, 2012 and 2011

MOSS-ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying consolidated balance sheets of Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers (CMC) as of August 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of CMC's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CMC's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CMC as of August 31, 2012 and 2011, and the results of its consolidated operations, changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 21, 2012, on our consideration of CMC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Moss Adams LLP

Stockton, California
November 21, 2012
(except for the schedule of expenditures of federal awards which is dated May 30, 2013)

CONSOLIDATED BALANCE SHEETS

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

ASSETS

	AUGUST 31, 2012	AUGUST 31, 2011
Current assets:		
Cash and equivalents	$ 70,300	$ 96,528
Short-term investments	14,283	39,816
Patient accounts receivable (less allowance for doubtful accounts of $102,547 in 2012 and $108,440 in 2011)	149,831	135,668
Due from State of California for supplemental funding	13,722	9,947
Other receivables	79,948	3,157
Inventories	11,636	11,236
Prepaid expenses and other	14,496	31,492
	354,216	327,844
Assets limited as to use:		
Board-designated assets	267,343	219,886
Assets held by trustee for:		
Debt service	35,571	40,846
Self-insurance in captive insurance company	12,764	13,427
Project funds	-	23,413
Donor-restricted assets	13,110	12,443
	328,788	310,015
Property, plant, and equipment, net	496,967	457,859
Construction in progress	254,182	208,781
Other assets	61,303	61,004
	$ 1,495,456	$ 1,365,503

LIABILITIES AND NET ASSETS

	2012	2011
Current liabilities:		
Accounts payable	$ 64,289	$ 52,192
Accrued compensation and employee benefits	61,872	67,851
Estimated third-party settlements	16,005	23,985
Other accrued liabilities and deferred revenue	50,233	52,070
Current maturities of long-term debt	11,542	10,951
	203,941	207,049
Long-term debt, less current maturities	525,944	537,668
Pension benefit obligation	78,261	63,607
Other long-term obligations	52,168	43,490
	860,314	851,814
Net assets:		
Unrestricted	622,032	501,246
Temporarily and permanently restricted	13,110	12,443
	635,142	513,689
	$ 1,495,456	$ 1,365,503

CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands)

	YEARS ENDED AUGUST 31,	
	2012	2011
Unrestricted revenues, gains, and other support:		
Net patient service revenues	$ 1,246,644	$ 1,175,931
Less: Provision for bad debts	(113,946)	(105,782)
	1,132,698	1,070,149
Premium revenue	1,345	1,327
Investment income	15,970	8,659
Other revenue	34,696	32,541
	1,184,709	1,112,676
Expenses:		
Salaries, wages, and benefits	527,255	503,502
Supplies	183,283	177,256
Outside services	166,868	151,893
Insurance	5,187	5,472
Depreciation and amortization	46,350	41,358
Rental and lease	10,257	11,537
Interest	15,738	15,961
Utilities	10,592	10,183
Other	86,713	77,791
Gain on early extinguishment of debt	-	(1,683)
	1,052,243	993,270
Excess of revenues, gains and other support over expenses	132,466	119,406
Net change in unrealized gains and losses on investments	1,013	562
Net assets released from restrictions for equipment acquisition	2,538	4,484
Change in unfunded accumulated pension benefit obligation	(15,230)	14,682
Other	(1)	-
Change in unrestricted net assets	$ 120,786	$ 139,134

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, 2010	$ 362,112	$ 14,318	$ 376,430
Excess of revenues, gains, and other support over expenses	119,406	-	119,406
Net change in unrealized gains and losses on investments	562	-	562
Donor-restricted contributions	-	4,458	4,458
Net assets released from restrictions and used for operations	-	(1,849)	(1,849)
Net assets released from restrictions for equipment acquisition	4,484	(4,484)	-
Change in unfunded accumulated pension benefit obligation	14,682	-	14,682
	139,134	(1,875)	137,259
Balance at August 31, 2011	501,246	12,443	513,689
Excess of revenues, gains, and other support over expenses	132,466	-	132,466
Net change in unrealized gains and losses on investments	1,013	-	1,013
Donor-restricted contributions	-	5,114	5,114
Net assets released from restrictions and used for operations	-	(1,909)	(1,909)
Net assets released from restrictions for equipment acquisition	2,538	(2,538)	-
Change in unfunded accumulated pension benefit obligation	(15,230)	-	(15,230)
Other	(1)	-	(1)
	120,786	667	121,453
Balance at August 31, 2012	$ 622,032	$ 13,110	$ 635,142

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

	YEARS ENDED AUGUST 31, 2012	2011
Cash flows from operating activities:		
Change in net assets	$ 121,453	$ 137,259
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net unrealized gains on investments	(1,013)	(562)
Donor-restricted contributions	(4,986)	(4,211)
Provision for bad debts	113,946	105,782
Depreciation and amortization	46,350	41,358
Amortization of bond discount/premium	(178)	120
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	(204,900)	(121,245)
Due from State of California for supplemental funding	(3,775)	(220)
Inventories, prepaid expenses, and other	14,732	(32,682)
Accounts payable and other accrued liabilities	22,595	44,150
Accrued compensation and employee benefits	(5,979)	4
Pension benefit obligation	14,654	(11,183)
Estimated third-party settlements	(7,980)	25,728
	104,919	184,298
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(132,952)	(155,739)
Purchase of investments	(191,365)	(219,417)
Proceeds from sales of investments	175,498	129,239
Cash and cash equivalents movements in assets limited as to use	(4,476)	81,609
Change in assets under bond indenture agreements	28,116	11,003
Proceeds from sale of interest in subsidiary	-	2,480
Other	1	-
	(125,178)	(150,825)
Cash flows from financing activities:		
Repayments of long-term debt	(11,260)	(33,752)
Proceeds from long-term debt	305	-
Proceeds from restricted contributions	4,986	4,211
	(5,969)	(29,541)
	(26,228)	3,932
Cash and equivalents, beginning of year	96,528	92,596
Cash and equivalents, end of year	$ 70,300	$ 96,528
Supplemental disclosure of cash flow information:		
Interest paid	$ 27,153	$ 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)

Effective October 1, 2009, Fresno Community Hospital and Medical Center exchanged its 80.9% interest in Advanced Medical Imaging (AMI) and its 19.1% interest in California Imaging Institute (CII) for a 50% interest in a new medical imaging company formed from the merger of AMI and CII. The newly formed company, CII LLC, operates two freestanding outpatient imaging centers that provide comprehensive imaging services. It is owned in partnership with certain radiology physicians. 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 nonprofit single member LLC, whose sole member is Fresno Community Hospital and Medical Center. DKACC completed construction of an ambulatory care clinic building on the CRMC campus during 2010, which is leased to CRMC.

Community Insurance Services Company – Effective September 1, 2009, CMC formed Community Insurance Services Company (CISC), which is a wholly owned captive insurance company that maintains professional and general liability coverage.

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. In October 2010, CHCC sold 50% of its interest in Santé to two physician groups for $2,480,000. Prior to the sale, Santé distributed $10,000,000 to CHCC. The distribution decreased Santé's net assets from $15,167,000 to $5,167,000. CMC recognized a $103,000 loss in the consolidated financial statements from this transaction in 2011. 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 fund-raising 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 provisions 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 $20,724,000 and $20,143,000 for the years ended August 31, 2012 and 2011, respectively.

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.

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.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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, 2012 and 2011, is as follows:

	2012	2011
Medicare	17%	15%
Medi-Cal and managed Medi-Cal	29%	28%
Contracted rate payors	44%	49%
Commercial insurance and other payors	10%	8%
Total	100%	100%

Allowance for doubtful accounts – Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility 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.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for doubtful accounts (continued) – CMC's allowance for doubtful accounts for self-pay patients decreased from 83.7 percent of self-pay accounts receivable at August 31, 2011, to 82.7 percent of self-pay accounts receivable at August 31, 2012. In addition, CMC's self-pay write-offs increased $8,100,000 from $105,800,000 for fiscal year 2011 to $113,900,000 for fiscal year 2012. Increased write-offs were the result of increased gross revenue of 6.2 percent in fiscal year 2012. CMC has not changed its charity care or uninsured discount policies during fiscal years 2011 or 2012. CMC maintained allowances for doubtful accounts from third-party payors of $8,300,000 in fiscal year 2011 and $9,200,000 in fiscal year 2012.

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.

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.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 2012 and 2011, $11,440,000 and $10,783,000, 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.

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, 2012, CMC has a claims liability of $55,033,000 and a corresponding insurance recovery receivable of $3,648,000 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.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Professional liability insurance – As of September 1, 2009, CMC formed a wholly owned captive insurance company called Community Insurance Services Company (CISC). CISC has issued claims-made policies to insure the medical and general liability risks of CMC's affiliates. CISC retains $2,000,000 for each and every loss and reinsures $118,000,000 with third-party reinsurers. As of August 31, 2012 and 2011, CMC had recorded estimated liabilities for claims incurred and reported of $7,041,000 and $6,596,000, respectively. These amounts are included within current liabilities in 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 $3,049,000 and $2,997,000 have been recorded for the actuarially estimated incurred but not reported liability that is not covered by third-party insurance at August 31, 2012 and 2011, 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.

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.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New accounting pronouncements – In April 2009, the FASB issued SFAS No. 164, *Not-for-Profit Entities: Mergers and Acquisitions*, including an amendment of FASB Statement No. 142, as codified by Accounting Standards Update (ASU) 2010-07. This statement provides guidance on accounting for a combination of not-for-profit entities and applies to a combination that meets the definition of either a merger of not-for-profit entities or an acquisition by a not-for-profit entity. The provision establishes principles and requirements for how a not-for-profit entity (a) determines whether a combination is a merger or an acquisition, (b) applies the carryover method in accounting for a merger, (c) applies the acquisition method in accounting for an acquisition, and (d) determines what information to disclose with respect to the nature and financial effects of a merger or acquisition.

This statement also amends both ASC 350, *Intangibles-Goodwill and Other*, and ASC 810, *Noncontrolling Interest.* The provisions of ASU 2010-07 are to be applied prospectively and are effective for CMC in the fiscal year ended August 31, 2011 for mergers and acquisitions. Pursuant to ASU 2010-07, CMC has discontinued the amortization of goodwill during the fiscal year ended August 31, 2011.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06), which amended ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), to require new disclosures related to transfers in and out of Level 1 and Level 2 fair value measurements, including the reasons for the transfers and to require new disclosures related to activity in Level 3 fair value measurements. In addition, ASU 2010-06 clarifies existing disclosure related to the level of disaggregation of classes of assets and liabilities and provides further detail about inputs and valuation techniques used for fair value measurement. CMC adopted ASU 2010-06 in the fiscal year ended August 31, 2011 (Note 5).

In August 2010, the FASB issued ASU 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure* (ASU 2010-23), which requires that cost be used as a measurement for charity care disclosure purposes and that cost be identified as the direct and indirect costs of providing charity care. It also requires disclosure of the method used to identify or determine such costs. CMC is required to adopt ASU 2010-23 in the fiscal year ended August 31, 2012. The adoption of ASU 2010-23 did not have a material impact on its consolidated financial statements.

In August 2010, the FASB issued ASU 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries (*ASU 2010-24), which clarifies that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. CMC has adopted ASU 2010-24 in the fiscal year ended August 31, 2012.

In July 2011, the FASB issued 2011-07, *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (*ASU 2011-07), which requires health care entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their statement of operations. CMC adopted ASU 2011-07 in the fiscal year ended August 31, 2012.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications – Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 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 21, 2012, 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 gross patient charges by major payor group as of the years ended August 31, 2012 and 2011, is as follows:

	2012	2011
Medicare	29%	26%
Medi-Cal and managed Medi-Cal	33%	33%
Contracted rate payors	26%	30%
Commercial insurance and other payors	5%	5%
Medically Indigent Services Program (MISP)	7%	6%
Total	100%	100%

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

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:

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.

Medi-Cal – Inpatient and outpatient services rendered to Medi-Cal program beneficiaries are reimbursed primarily under contracted rates. 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 $32,357,000 and $10,667,000, respectively, for the year ended August 31, 2012 and $37,085,000 and $9,333,000, respectively, for the year ended August 31, 2011. As of August 31, 2012 and 2011, CMC recorded receivables of $13,722,000 and $9,947,000, respectively, for amounts due from the State of California for SB855, SB1255, and other programs.

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 $3,365,000 and decreased $3,039,000 in 2012 and 2011, respectively, related to updates of prior years' cost report reserves and increased by $14,082,000 and $3,202,000, 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 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 $9,198,000 and $12,550,000 for the years ended August 31, 2012 and 2011, respectively, calculated by multiplying the ratio of cost to gross charges for CMC by the gross uncompensated charges associated with providing charity care to its 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. The Program was administered in two parts. The first part (Part One), created by Assembly Bill 1653 (signed into law in September 2010), covers the period beginning April 1, 2009 through December 31, 2010. The second part (Part Two), created by Senate Bill 90 (signed into law in March 2011), covers the period beginning January 1, 2011 through June 30, 2011. Part One became effective in fiscal year 2011 after approval from the Centers for Medicare and Medicaid Services (CMS). CMC recognized $117,598,000 in net patient service revenue and $62,286,000 in expense for the year ended August 31, 2011. Additionally, the California Hospital Association created a private program, the California Health Foundation and Trust (CHFT), established for several purposes, including aggregating and distributing financial resources to support charitable activities at various hospital and health systems in California. A pledge agreement was executed during the fiscal year ended August 31, 2010 between CMC and CHFT whereby CMC paid $4,263,000 prior to August 31, 2011 into a grant fund established by CHFT, pending approval of the legislation noted above.

Part Two of the Program had not received final approval from CMS as of August 31, 2011. CMC paid $22,178,000 in 2011 for Part Two of the Program, and recorded this as a prepaid expense at August 31, 2011. CMC received supplemental payments for Part Two of $38,394,000 in 2011. As the program was not yet legally effective in 2011, these revenues were deferred and recorded as a part of other current liabilities at August 31, 2011. Final approval by CMS occurred on December 29, 2011. CMC recognized $48,187,000 in net patient service revenue and $22,351,000 in expense for the year ended August 31, 2012 relating to Part Two of the Program.

California subsequently 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, 2012, estimated supplemental payments for the period July 1, 2011 through August 31, 2012 of $90,878,000 are included in net patient service revenue, and estimated fees and pledges for this same time period of $52,607,000 are included in other expenses. At August 31, 2012, CMC has a receivable of $72,747,000 and a liability of $36,364,000 relating to the 30 month Program. The managed care portion of this program has not received final approval from CMS and is not yet effective as of August 31, 2012. As the managed care portion of the 30 month Program has not been final approved, CMC has not recorded any activity relating to the managed care portion at August 31, 2012.

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, 2012 and 2011, is as follows (in thousands):

	2012		2011	
	Cost	Fair value and carrying value	Cost	Fair value and carrying value
Cash and equivalents	$ 48,906	$ 48,906	$ 112,597	$ 112,597
U.S. Treasury bills and notes	20,945	20,945	27,410	27,554
U.S. government agency debt	48,900	49,321	43,824	44,426
Corporate debt securities	119,244	119,536	92,340	93,198
Equity securities	46,229	51,035	26,828	29,334
Mutual funds	28,120	28,311	17,563	17,841
Repurchase agreements	19,394	19,394	19,393	19,393
Total cash and marketable securities	331,738	337,448	339,955	344,343
Less amounts classified as short-term investments	(14,283)	(14,283)	(39,816)	(39,816)
Pledges receivable, net	5,623	5,623	5,488	5,488
Total assets limited as to use	$ 323,078	$ 328,788	$ 305,627	$ 310,015

During 2012 and 2011, CMC incurred impairment charges of $63,000 and $400,000, respectively, to recognize unrealized losses that were deemed to be other-than-temporary.

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, 2012 (in thousands):

	2012			
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	$ 14,283	$ -	$ -	$ 14,283
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	20,945	-	-	20,945
U.S. government agency debt	-	49,321	-	49,321
	20,945	49,321	-	70,266
Corporate debt securities:				
Health care	-	7,087	-	7,087
Energy	-	14,019	-	14,019
Financials	-	56,130	-	56,130
Industrials	-	7,200	-	7,200
Information technology	-	5,877	-	5,877
Telecommunications	-	7,497	-	7,497
Consumer staples	-	1,553	-	1,553
Consumer discretionary	-	9,066	-	9,066
Other	-	11,107	-	11,107
	-	119,536	-	119,536
Equity securities:				
Health care	8,928	-	-	8,928
Utilities	1,981	-	-	1,981
Financials	4,676	-	-	4,676
Consumer staples	5,439	-	-	5,439
Consumer discretionary	3,968	-	-	3,968
Materials	2,282	-	-	2,282
Energy	5,581	-	-	5,581
Information technology	10,449	-	-	10,449
Industrials	5,793	-	-	5,793
Telecommunications	1,938	-	-	1,938
	51,035	-	-	51,035
Mutual funds:				
Mid cap core	8,078	-	-	8,078
Small cap core	7,797	-	-	7,797
International core	4,068	-	-	4,068
Emerging markets	4,174	-	-	4,174
Specialty-real estate	4,194	-	-	4,194
	28,311	-	-	28,311
	114,574	168,857	-	283,431
Funds held by trustees				
Repurchase agreements	-	19,394	-	19,394
Cash and equivalents	34,623	-	-	34,623
	34,623	19,394	-	54,017
Total	$ 149,197	$ 188,251	$ -	$ 337,448

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

The following table presents financial assets measured at fair value as of August 31, 2011 (in thousands):

	2011			
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	$ 39,817	$ -	$ -	$ 39,817
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	27,554	-	-	27,554
U.S. government agency debt	-	44,426	-	44,426
	27,554	44,426	-	71,980
Corporate debt securities:				
Health care	-	1,425	-	1,425
Energy	-	12,370	-	12,370
Financials	-	42,510	-	42,510
Industrials	-	4,825	-	4,825
Information technology	-	3,959	-	3,959
Telecommunications	-	7,024	-	7,024
Consumer staples	-	10,858	-	10,858
Consumer discretionary	-	6,015	-	6,015
Other	-	4,212	-	4,212
	-	93,198	-	93,198
Equity securities:				
Health care	3,830	-	-	3,830
Utilities	958	-	-	958
Financials	3,054	-	-	3,054
Consumer staples	4,380	-	-	4,380
Consumer discretionary	2,435	-	-	2,435
Materials	1,508	-	-	1,508
Energy	3,588	-	-	3,588
Information technology	5,426	-	-	5,426
Industrials	3,391	-	-	3,391
Telecommunications	764	-	-	764
	29,334	-	-	29,334
Mutual funds:				
Mid cap core	4,820	-	-	4,820
Small cap core	5,019	-	-	5,019
International core	4,031	-	-	4,031
Emerging markets	1,754	-	-	1,754
Specialty-real estate	2,217	-	-	2,217
	17,841	-	-	17,841
	114,546	137,624	-	252,170
Funds held by trustees				
Repurchase agreements	-	19,393	-	19,393
Cash and equivalents	72,780	-	-	72,780
	72,780	19,393	-	92,173
Total	$ 187,326	$ 157,017	$ -	$ 344,343

NOTE 5 – ASSETS LIMITED AS TO USE (CONTINUED)

The scheduled maturities of the debt securities as of August 31, 2012, are as follows:

	Amortized cost basis	Estimated fair value
Due within 1 year or less	$ 16,261	$ 16,369
Due after 1 year through 5 years	100,444	100,466
Due after 5 years	22,483	22,644
	139,188	139,479
Mortgage-backed securities accrued interest and other	34,635	35,056
	$ 173,823	$ 174,535

The scheduled maturities of the debt securities as of August 31, 2011, are as follows:

	Amortized cost basis	Estimated fair value
Due within 1 year or less	$ 14,940	$ 14,964
Due after 1 year through 5 years	85,447	85,979
Due after 5 years	21,699	22,090
	122,086	123,033
Mortgage-backed securities accrued interest and other	41,488	42,145
	$ 163,574	$ 165,178

Investment income is composed of the following for the years ended August 31, 2012 and 2011 (in thousands):

	2012	2011
Interest income	$ 4,392	$ 6,011
Net realized gains/losses on sales of securities and other-than-temporary impairment	10,398	2,157
Dividends	1,180	491
	$ 15,970	$ 8,659

NOTE 6 – PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following as of August 31, 2012 and 2011 (in thousands):

	2012	2011
Land and land improvements	$ 32,226	$ 29,995
Buildings and improvements	468,059	492,176
Equipment	440,247	336,805
	940,532	858,976
Accumulated depreciation	(443,565)	(401,117)
	$ 496,967	$ 457,859

NOTE 7 – OTHER ASSETS

Other assets consist of the following as of August 31, 2012 and 2011 (in thousands):

	2012	2011
Loan receivable from DKACC Lenders (Note 9)	$ 18,844	$ 18,844
Investment in rental properties	12,662	13,624
Real estate held for development	6,037	6,037
Intangible assets, net	3,543	3,119
Unamortized financing costs, net	8,009	8,325
Investment in joint ventures	10,453	8,487
Other	1,755	2,568
	$ 61,303	$ 61,004

CMC owns rental properties, recorded at cost, net of accumulated depreciation. Investments in rental properties consist of the following as of August 31, 2012 and 2011 and are included in other assets in the accompanying consolidated balance sheets (in thousands):

	2012	2011
Land	$ 4,085	$ 4,085
Buildings and land improvements	24,843	25,023
Equipment	2,957	2,883
	31,885	31,991
Accumulated depreciation	(19,223)	(18,367)
	$ 12,662	$ 13,624

NOTE 8 – LONG-TERM DEBT

Long-term debt consists of the following as of August 31, 2012 and 2011 (in thousands):

	2012	2011
California Municipal Finance Authority		
Certificates of Participation (Community Hospitals of Central California Project) Series 2009, interest ranging from 3% to 5.5% payable semiannually; principal payable in installments ranging from $3,510,000 in 2013 to $13,850,000 in 2039, collateralized by gross revenues. Interest payments were funded through February 1, 2012	$ 193,800	$ 197,146
Unamortized bond discount	(3,177)	(3,371)
Total certificates of participation	190,623	193,775
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 $3,400,000 in 2013 to $18,775,000 in 2046, collateralized by gross revenues	303,455	306,690
Unamortized bond premium	8,127	8,499
Total certificates of participation	311,582	315,189
California Municipal Finance Authority		
Certificates of Participation (Community Hospitals of Central California Project) Series 2009, interest at 5.19% payable monthly; principal payable in installments ranging from $4,299,000 in 2013 to $2,992,000 in 2014, collateralized by equipment.	7,291	11,372
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
Note payable to an LLC and its owners, payable in monthly installments through 2021, interest at 4.25%		
Other long-term debt	2,401	2,694
	537,486	548,619
Current maturities	(11,542)	(10,951)
	$ 525,944	$ 537,668

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
2013	$ 11,726
2014	10,759
2015	7,861
2016	8,253
2017	8,635
Thereafter	485,302
	532,536
Add net unamortized bond premium	4,950
	$ 537,486

The aggregate estimated fair value of CMC's long-term obligations at August 31, 2012 and 2011, of $485,473,000 and $458,551,000, respectively, were estimated using discounted cash flow analyses based on CMC's current incremental borrowing rates for similar debt instruments.

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 $4,800,000 on August 31, 2012 and 2011. Outstanding credit card borrowings were $3,489,000 and $2,806,000 on August 31, 2012 and 2011, 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 April 30, 2013.

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, 2012 and 2011, were $4,711,000 and $4,357,000, respectively. Total employer contributions to the plan for the years ending August 31, 2012 and 2011 were $14,000,000 and $13,000,000, respectively. Total benefits paid for the years ending August 31, 2012 and 2011, were $10,012,000 and $8,375,000, respectively. The unfunded status is presented as a noncurrent liability in the accompanying consolidated balance sheets.

NOTE 10 – PENSION PLAN (CONTINUED)

The following table sets forth the plan's benefit obligation, fair value of plan assets, and funded status as of August 31, 2012 and 2011 (in thousands):

	2012	2011
Change in projected benefit obligation (PBO):		
PBO at beginning of year	$ 193,426	$ 183,733
Employer service cost	12,177	13,401
Interest cost	8,886	8,019
Actuarial loss (gain)	22,076	(7,653)
Plan participants' contributions	4,711	4,357
Benefits paid from plan assets	(10,012)	(8,374)
Administrative expenses paid	(56)	(57)
PBO at end of year	$ 231,208	$ 193,426

	2012	2011
Change in plan assets:		
Fair value of assets at beginning of year	$ 129,818	$ 108,943
Actual return on assets	14,485	11,950
Employer contributions	14,000	13,000
Plan participants' contributions	4,711	4,357
Benefits paid	(10,012)	(8,375)
Administrative expenses paid	(56)	(57)
Fair value of assets at end of year	$ 152,946	$ 129,818

NOTE 10 – PENSION PLAN (CONTINUED)

	2012	2011
Funded status at end of year	$ (78,261)	$ (63,607)
Unrecognized actuarial loss	70,196	54,911
Unrecognized prior service cost	350	404
Unfunded accumulated pension benefit obligation	(70,546)	(55,315)
Pension benefit obligation recognized in consolidated balance sheets	$ (78,261)	$ (63,607)
Accumulated benefit obligation at end of year	$ 205,794	$ 173,995

Weighted average assumptions as of August 31 are as follows:

	2012	2011
Discount rate	3.90%	4.70%
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 2012 and 2011 is included in salaries, wages, and benefits in the accompanying consolidated financial statements of operations. Components of net periodic pension cost include the following (in thousands):

	2012	2011
Service cost	$ 12,177	$ 13,401
Interest cost	8,886	8,019
Expected return on plan assets	(10,151)	(8,628)
Amortization of prior service cost	55	55
Recognized net actuarial losses	2,457	3,652
Net periodic pension cost	$ 13,424	$ 16,499

	2012	2011
Amounts recognized in net assets:		
Net actuarial loss	$ 70,196	$ 54,911
Net prior service cost	350	404
	$ 70,546	$ 55,315

NOTE 10 – PENSION PLAN (CONTINUED)

	2012	2011
Amounts recognized as changes in net assets:		
Net loss (gain)	$ 17,742	$ (10,975)
Amortization of prior service cost	(55)	(55)
Amortization of net loss	(2,457)	(3,652)
	$ 15,230	$ (14,682)

The estimated net loss and prior service cost that will be amortized into net period pension cost during the 2013 fiscal year are $3,175,000 and $55,000, respectively.

CMC's pension plan asset allocations at August 31, 2012 and 2011, by asset category are as follows:

	2012	2011
Cash and equivalents	6%	9%
Debt securities	35%	32%
Equity securities	59%	59%
	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 2012 and 2011 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, 2012:

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	$ 9,776	$ -	$ -	$ 9,776
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	11,108	-	-	11,108
U.S. government agency debt	-	10,721	-	10,721
	11,108	10,721	-	21,829
Corporate fixed income:				
Strip and zero coupon	-	600	-	600
Asset-backed securities	-	6,575	-	6,575
Financials	-	7,887	-	7,887
Industrials	-	13,483	-	13,483
Other global corporate bonds	-	3,172	-	3,172
	-	31,717	-	31,717
Common stocks:				
Health care	2,558	-	-	2,558
Utilities	938	-	-	938
Financials	3,930	-	-	3,930
Consumer staples	3,887	-	-	3,887
Consumer discretionary	6,614	-	-	6,614
Materials	5,111	-	-	5,111
Energy	4,671	-	-	4,671
Information technology	10,209	-	-	10,209
Industrials	6,713	-	-	6,713
American depository receipts	5,355	-	-	5,355
	49,986	-	-	49,986
Mutual funds:				
Large cap core	4,281	-	-	4,281
Mid cap core	7,752	-	-	7,752
Small cap core	6,692	-	-	6,692
International core	6,912	-	-	6,912
Emerging markets	6,011	-	-	6,011
Specialty-real estate	7,990	-	-	7,990
	39,638	-	-	39,638
	$ 110,508	$ 42,438	$ -	$ 152,946

NOTE 10 – PENSION PLAN (CONTINUED)

The following table presents the plan assets measured at fair value at August 31, 2011:

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	$ 11,092	$ -	$ -	$ 11,092
U.S. Treasury and U.S. agency fixed income:				
U.S. Treasury bills and notes	5,660	-	-	5,660
U.S. government agency debt	-	11,525	-	11,525
	5,660	11,525	-	17,185
Corporate fixed income:				
Strip and zero coupon	-	588	-	588
Asset-backed securities	-	4,521	-	4,521
Financials	-	5,186	-	5,186
Industrials	-	9,785	-	9,785
Other global corporate bonds	-	4,865	-	4,865
	-	24,945	-	24,945
Common stocks:				
Health care	3,140	-	-	3,140
Utilities	625	-	-	625
Financials	2,469	-	-	2,469
Consumer staples	3,410	-	-	3,410
Consumer discretionary	4,048	-	-	4,048
Materials	3,732	-	-	3,732
Energy	3,670	-	-	3,670
Information technology	6,811	-	-	6,811
Industrials	6,624	-	-	6,624
American depository receipts	3,808	-	-	3,808
	38,337	-	-	38,337
Mutual funds:				
Large cap core	11,415	-	-	11,415
Mid cap core	6,471	-	-	6,471
Small cap core	1,734	-	-	1,734
International core	7,787	-	-	7,787
Emerging markets	4,721	-	-	4,721
Specialty-real estate	6,131	-	-	6,131
	38,259	-	-	38,259
	$ 93,348	$ 36,470	$ -	$ 129,818

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):

Fiscal year:		
2013	$	9,745
2014		9,041
2015		18,437
2016		15,750
2017		14,775
2018-2022		97,230

CMC expects to contribute approximately $79,000,000 to the pension plan during the 2013 fiscal year.

NOTE 11 – RESTRICTED NET ASSETS

Temporarily and permanently restricted net assets are available for the following purposes as of August 31, 2012 and 2011 (in thousands):

	2012	2011
Temporarily restricted net assets:		
Patient care	$ 4,146	$ 3,596
Purchase of equipment	758	2,549
Scholarships and other education	4,202	2,032
Other	3,620	3,882
	12,726	12,059
Permanently restricted net assets	384	384
Total temporary and permanently restricted net assets	$ 13,110	$ 12,443

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, 2012 and 2011 (in thousands):

	2012	2011
Program services	$ 950,183	$ 905,194
Management and general	100,606	86,869
Fund-raising	1,454	1,207
	$ 1,052,243	$ 993,270

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, 2012, 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:	
2013	$ 3,604
2014	4,430
2015	2,628
2016	1,622
2017	1,453
Thereafter	12,047
	$ 25,784

Total operating lease expense in 2012 and 2011 was $10,373,000 and $12,466,000, respectively.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Clovis Community Medical Center expansion – As of August 31, 2012, approximately $217,100,000 is recorded in construction in progress for the CCMC expansion project. In November 2012, CMC expects to place a large portion of the project in service. The Gross Maximum Price (GMP) for the construction portion of the project is $203,900,000. A total of $164,100,000 has been paid to the general contractor as of August 31, 2012, with the remaining $39,800,000 expected to be paid in full shortly after the completion date of the project in December 2013.

NOTE 14 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

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.

In July 2012, CRMC received a letter from the Department of Health and Human Services/ Office of Inspector General/ Office of Audit Services to begin a hospital compliance review. The review is going on at hospitals nationwide, and focuses on known areas of noncompliance identified in past Office of the Inspector General (OIG) reviews nationally.

The OIG conducted an onsite review in September/October of 2012, the final results of which have not been received by CMC. Based on preliminary findings, CMC estimates that approximately $1,100,000 in overpayments has occurred and has recorded a corresponding liability at August 2012 to reflect a repayment obligation. The individual repayments have been submitted to CMS through the re-bill process. This total repayment was recorded as a reduction of net patient service revenue. CMC management believes that the repayment estimate is reasonable and that any further adjustments based on the conclusion of the OIG review would not have a material effect on the financial position or results of operations of CMC.

CCMC has begun a self-audit to identify potential noncompliance in the areas identified in the CRMC review by OIG. Management estimates a payment return to CMS of approximately $242,000. These repayments are in the process of being submitted to CMS through the re-bill process. Items which are not in the timely filling periods will have a check issued to CMS with a letter and appropriate documentation.

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 32 million 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. CMC is unable to predict the full impact of the Health Care Reform Legislation at this time due to the law's complexity and current lack of implementing regulations or interpretive guidance. However, CMC expects that provisions of the Health Care Reform Legislation, should it remain in effect in substantially its current form, will have a material effect on its business.

Pledges to Medical Foundation – CMC has made significant pledges to the Santé 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 $8,815,000 and $1,900,000, and pledge payments of $1,909,000 and $0 were made in 2012 and 2011, respectively.

SINGLE AUDIT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED AUGUST 31, 2012

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)	93.153		$ 406,435
HIV Care Formula Grants	93.917		521,503
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease (Ryan White HIV/AIDS Program Part C)	93.918		612,316
Total Expenditure of Federal Awards			$ 1,540,254

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, 2012. 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. Pass-through entity identifying numbers are presented where available.

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. SUBRECIPIENT AWARDS

Of the federal expenditures presented in the Schedule, CMC provided federal awards to subrecipients as follows:

Program Name	Federal CFDA/ Contract Number	Amount Provided
Grants for Coordinated Services and Access to Research for Women, Infants, Children, and Youth (Ryan White Program)	93.153	$ 90,000

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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 the consolidated financial statements of Community Hospitals of Central California and Affiliated Corporations dba Community Medical Centers (CMC), for the year ended August 31, 2012, and have issued our report thereon dated November 21, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CMC's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance 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 non-compliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Audit Committee, Board of Trustees, management of CMC, and state and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Moss Adams LLP

Stockton, California
November 21, 2012

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REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

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

Compliance

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, 2012. CMC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CMC's management. Our responsibility is to express an opinion on CMC's compliance based on our audit.

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. Our audit does not provide a legal determination of CMC's compliance with those requirements.

In our opinion, CMC complied, in all material respects, with the 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, 2012.

Internal Control over Compliance

Management of CMC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered CMC's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance 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.

Internal Control Over Compliance (continued)

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, non-compliance 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 non-compliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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
May 30, 2013

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued:	Unqualified			
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 programs:				
• Material weakness(es) identified?	☐	yes	☒	no
• Significant deficiency(ies) identified?	☐	yes	☒	none reported
Type of auditor's report issued on compliance for major program:	Unqualified			
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 Programs

CFDA Number(s)	Name of Federal Program or Cluster
93.917	*Ryan White HIV/AIDS Treatment Extension Act of 2009*
93.918	*Ryan White Part C EIS Program*

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

None noted.

SECTION IV – SUMMARY OF PRIOR AUDIT FINDINGS

FINDING 2011-01 – Program income (Instance of non-compliance and significant deficiency)

Condition: CMC's charity policy does not specifically address the requirements above and does not reference a separate policy for HIV patients, the tracking of the cap is maintained by the Lab Tracker system, but the information for qualifying patients is not consistently maintained.

Recommendation: CMC update their charity policy to include the requirements above and train staff on this policy and ensure consistency is maintained to monitor the cap on the charges and sliding fee adjustments are made accordingly.

Current status: Implemented. In August 2011, CMC developed and implemented a new sliding fee policy for the HIV patient.