Report of Independent Auditors and
Consolidated Financial Statements with
Supplementary Information for

Sky Lakes Medical Center and Affiliates

September 30, 2014 and 2013

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Sky Lakes Medical Center and Affiliates

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls 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. 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 controls 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.

REPORT OF INDEPENDENT AUDITORS (continued)

Opinion

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

Other Matter – Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating balance sheet, consolidating statement of operations, consolidating changes in nets assets, combining balance sheet – obligated group, combining statement of operations – obligated group, and combining statement of changes in net assets – obligated group included on pages 34 through 41 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and, accordingly, we express no opinion on it.

Moss Adams LLP

Portland, Oregon
January 14, 2015

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SKY LAKES MEDICAL CENTER AND AFFILIATES
CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2014	September 30, 2013
CURRENT ASSETS		
Cash and cash equivalents	$ 23,293,743	$ 17,594,996
Certificates of deposit	20,875,105	19,721,494
Patient accounts receivable, net	24,351,008	22,169,501
Other receivables	4,536,055	4,668,717
Risk pool withhold receivable	2,744,067	1,883,658
Supplies inventories	2,181,720	1,814,623
Prepaid expenses	2,696,455	2,416,059
Promises to give, current portion	839,149	1,357,374
Total current assets	81,517,302	71,626,422
ASSETS LIMITED AS TO USE	5,006,061	9,485,540
PROPERTY AND EQUIPMENT, net	93,002,617	94,284,542
OTHER ASSETS		
Deferred financing costs, net of amortization	1,693,174	1,776,101
Promises to give, net of current portion	599,196	571,327
Investments	73,202,920	55,763,515
Other	1,460,358	1,516,526
Total other assets	76,955,648	59,627,469
Total assets	$ 256,481,628	$ 235,023,973

See accompanying notes.

LIABILITIES AND NET ASSETS

	September 30, 2014	September 30, 2013
CURRENT LIABILITIES		
Accounts payable	$ 6,129,087	$ 5,515,742
Accrued payroll	5,195,800	4,725,054
Accrued compensated absences	3,910,081	3,637,586
Accrued interest payable	239,134	245,508
Other accrued expenses	9,681,011	7,795,589
Estimated third-party payor settlements	2,723,969	3,717,310
Current portion of capital lease obligations	1,271,369	864,087
Current portion of long-term debt	1,605,000	2,174,735
Total current liabilities	30,755,451	28,675,611
LONG-TERM LIABILITIES		
Capital lease obligations, net of current portion	5,975,738	5,909,150
Long-term debt, net of current portion	52,982,427	54,674,010
Other long-term liabilities	5,641,824	5,400,654
Total long-term liabilities	64,599,989	65,983,814
Total liabilities	95,355,440	94,659,425
NET ASSETS		
Unrestricted net assets		
Sky Lakes Medical Center	156,037,574	135,655,751
Non-Controlling Interest	542,425	519,937
Total unrestricted net assets	156,579,999	136,175,688
Temporarily restricted	4,546,189	4,188,860
Total net assets	161,126,188	140,364,548
Total liabilities and net assets	$ 256,481,628	$ 235,023,973

See accompanying notes.

SKY LAKES MEDICAL CENTER AND AFFILIATES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended September 30,	
	2014	2013
REVENUES		
Patient service revenue, net of contractual adjustments	$ 204,242,411	$ 184,477,133
Provision for bad debts	(15,963,751)	(14,128,143)
Net patient service revenue	188,278,660	170,348,990
Contributions	2,694	1,493
Other revenue	10,094,029	4,569,519
Net assets released from restrictions	632,161	1,975,448
Total revenues	199,007,544	176,895,450
EXPENSES		
Salaries and benefits	91,349,474	82,901,610
Supplies	16,366,814	15,310,200
Drugs	10,638,744	9,830,969
Depreciation and amortization	10,137,814	9,183,830
Physician fees	6,857,110	6,997,393
Professional fees	1,105,163	1,371,635
Purchased services	17,078,125	14,430,650
Building and maintenance	8,670,641	8,235,464
Provider tax	9,001,120	7,522,652
Interest expense	2,985,681	2,938,493
Insurance	2,452,649	2,119,654
Rentals and lease expense	1,215,202	1,109,610
Minor equipment	607,371	522,427
Other	4,023,099	5,489,071
Total expenses	182,489,007	167,963,658
OPERATING INCOME	16,518,537	8,931,792
OTHER INCOME		
Investment income	3,622,529	4,473,467
Other non-operating income (expense)	(82,996)	1,582,031
Total other income	3,539,533	6,055,498
EXCESS OF REVENUES OVER EXPENSES	$ 20,058,070	$ 14,987,290

 See accompanying notes.

	Years Ended September 30, 2014	2013
UNRESTRICTED NET ASSETS		
Excess of revenues over expenses	$ 20,058,070	$ 14,987,290
Distributions and other	(54,229)	(103,977)
Net change in unrealized gains and losses on other-than-trading securities	376,718	844,329
Increase in unrestricted net assets before discontinued operations	20,380,559	15,727,642
Loss from discontinued operations	-	(96,270)
Increase in unrestricted net assets	20,380,559	15,631,372
TEMPORARILY RESTRICTED NET ASSETS		
Contributions	780,770	511,283
Investment income	217,897	387,548
Other revenue	14,575	26,945
Net assets released from restrictions	(632,161)	(1,975,448)
Increase (decrease) in temporarily restricted net assets	381,081	(1,049,672)
CHANGE IN NET ASSETS	20,761,640	14,581,700
NET ASSETS, beginning of year	140,364,548	125,782,848
NET ASSETS, end of year	$ 161,126,188	$ 140,364,548

See accompanying notes.

	Years Ended September 30, 2014	2013
CASH FLOWS FROM CONTINUING OPERATING ACTIVITIES		
Changes in net assets from continuing operations	$ 20,761,640	$ 14,677,970
Adjustments to reconcile change in net assets to net cash from operating activities:		
Depreciation and amortization	10,137,814	9,183,830
Net amortization of premiums and accretion of discounts on bonds	(86,583)	61,928
Net change in unrealized gains and losses on other-than-trading securities	(376,718)	(844,329)
Gain on sale of investments	(1,590,069)	(1,629,469)
Loss on sale of fixed assets	230,459	115,396
(Increase) decrease in:		
Patient accounts receivable, net	(2,181,507)	2,443,304
Other receivables	132,662	(496,968)
Risk pool withhold receivable	(860,409)	390,705
Supplies inventories	(367,097)	420,160
Prepaid expenses	(280,396)	376,952
Promises to give	490,356	703
Deferred financing costs, net	82,927	(181,464)
Other assets	56,168	56,168
Increase (decrease) in:		
Accounts payable	613,345	(2,045,753)
Accrued payroll	470,746	(39,942)
Accrued compensated absences	272,495	337,999
Accrued interest payable	(6,374)	4,777
Other accrued expenses	1,885,422	993,483
Estimated third-party payor settlements	(993,341)	396,591
Other long-term liabilities	241,170	342,896
Net cash from continuing operations	28,632,710	24,564,937

See accompanying notes.

	Years Ended September 30,	
	2014	2013
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investments	$ 25,520,201	$ 17,532,669
Purchase of investments	(36,513,340)	(27,917,753)
Purchase of certificates of deposit	(1,153,611)	(5,721,494)
Purchase of property and equipment	(7,686,850)	(12,017,048)
Net cash flows from investing activities	(19,833,600)	(28,123,626)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of bonds	-	18,400,000
Payments on long-term debt	(2,174,735)	(12,808,710)
Payment on capital lease obligations	(925,628)	(684,439)
Net cash flows from financing activities	(3,100,363)	4,906,851
CASH FLOWS FROM DISCONTINUED OPERATIONS	-	(96,270)
NET CHANGE IN CASH AND CASH EQUIVALENTS	5,698,747	1,251,892
CASH AND CASH EQUIVALENTS, beginning of year	17,594,996	16,343,104
CASH AND CASH EQUIVALENTS, end of year	$ 23,293,743	$ 17,594,996

The Medical Center entered into capital lease obligations in the amount $1,399,498 and $1,902,546 for new property and equipment for the years ended September 30, 2014 and 2013.

Cash paid for interest as of September 30, 2014 and 2013 was $2,992,048 and $2,933,716, respectively.

Note 1 – Description of Organization and Summary of Significant Accounting Policies

Organization – Sky Lakes Medical Center (the Medical Center) is a not-for-profit hospital located in south-central Oregon. The Medical Center provides inpatient, outpatient, and emergency care services to the residents of Southern Oregon and Northern California. The Medical Center was incorporated in Oregon in 1963.

Principles of consolidation – The consolidated financial statements include the accounts of the Medical Center and all of its wholly-owned and majority-owned subsidiaries. There are four other entities included in these consolidated financial statements:

West Physician Services, LLC (WPS)
West Physician Services, LLC was established by the Medical Center in 2003 to provide specialty care to patients. The Medical Center is the sole member of WPS.

Sky Lakes Medical Center Foundation, Inc. (the Foundation)
Sky Lakes Medical Center Foundation is a not-for-profit corporation formed to advance the work of the Medical Center through philanthropy. The Foundation is led by a board of directors who serve voluntarily and are elected by the Medical Center.

Klamath Medical Business Center, LLC (KMBC)
In 2004, the Medical Center, together with Cascade Comprehensive Care, Inc. (CCC), formed Klamath Medical Business Center, LLC. The Medical Center directly owns 50% of KMBC. In addition, they indirectly own approximately 18.5% through their ownership in CCC (Note 5). In addition, the Medical Center performs management functions for KMBC. KMBC exists for the purpose of leasing building facilities to the Medical Center and CCC.

Preferred Health Plan, Inc. (PHP)
Preferred Health Plan, Inc. was a former Klamath Falls-based insurance company which offered several medical plans. PHP discontinued operations during 2009 and fully liquidated as of September 30, 2013 (Note 17).

All significant intercompany transactions have been eliminated.

Use of estimates – The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates are necessary in determining the fair value of investments, the recorded value of the contractual and bad debt allowance, amount due to or from third parties, withhold risk pool withhold receivable and useful lives of fixed assets. Management believes the assumptions used in arriving at these estimates are reasonable.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

Fair value measurements – Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Market participants are buyers and sellers, who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured.

Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Medical Center's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities, and credit spreads. The valuation techniques used are based on observable and unobservable inputs.

The following methods and assumptions were used by the Medical Center in estimating fair values of each class of financial instruments for which it is practicable to estimate that value*:*

Cash and cash equivalents and certificates of deposit – The carrying amount approximates the fair value because of the short maturity of those instruments.

Long-term debt – Long-term debt is estimated by discounting future cash flows at rates currently available for debt with similar terms and remaining maturities. The carrying amount approximates the fair value.

Cash and cash equivalents – Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less. Financial instruments potentially subjecting the Medical Center to concentrations of credit risk consist primarily of bank demand deposits in excess of FDIC insured limits. The Medical Center has not experienced any losses in such accounts.

Certificates of deposit – Certificates of deposit are held at various financial institutions and range in maturity thru August 2018 and have interest rates ranging from .25% to 1.05%. Certificates of deposit are not subject to withdrawal limitations and are classified as current assets. Early withdrawal may result in a forfeiture of interest earned.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

Patient accounts receivable – In the normal course of business, the Medical Center provides credit terms to its patients, including billing to third-party insurance carriers, most of whom are local residents and are insured under third-party payor agreements. Patient accounts receivables are reduced by an allowance for doubtful accounts. In evaluating the collectability of receivables, the Medical Center 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, the Medical Center 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, the Medical Center 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. The Medical Center's allowance for contractual adjustments was $39,564,000 and $33,616,000 at September 30, 2014 and 2013, respectively. The Medical Center's bad debt provision was $15,163,000 and $12,892,000 at September 30, 2014 and 2013, respectively. There was no change in the methodology used by the Medical Center to estimate the allowance for contractual adjustments and bad debt provision in the current year.

The mix of gross receivables from patients and third-party payors was as follows at September 30:

	2014	2013
Medicare	34%	37%
Medicaid	25%	13%
Other third-party payors	24%	26%
Self-pay	14%	20%
Other governmental	3%	4%
Total	100%	100%

Other receivable – Other receivables consist mainly of employee loan receivables, physician loan receivables, and other miscellaneous receivables. These receivables are reduced by an allowance for doubtful accounts determined on a specific reserve basis.

Risk pool withhold receivable – The risk pool withhold receivable represents funds withheld from claims paid to the providers. The Medical Center contracts with physicians to provide health services. Under the terms of the contracts with participating providers, a percentage of their fees are retained by the Medical Center in an incentive pool reserve. Based upon the Medical Center's performance, the funds are either retained by the Medical Center or paid to the providers.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

Supplies inventories – Supplies inventories consist mainly of patient supplies and pharmaceuticals and are carried at the lower of cost (primarily average cost) or market.

Promises to give – Unconditional promises to give are recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promise becomes unconditional.

Assets limited as to use – Assets limited as to use include assets held by trustees under indenture agreements (Note 10).

Property and equipment – Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Deferred financing costs – Deferred financing costs incurred and bond premium received in connection with the issuance of the refunding gross revenue bonds are being amortized over the term of the bond issue by the straight line method, which approximates the effective interest rate method.

Investments – Investments in equity securities with readily determinable fair values and all investments that are available-for-sale are measured at fair value on the balance sheet. Investment securities that management has the positive intent and ability to hold until maturity are classified as held-to-maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the period remaining until maturity. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

The Medical Center also has various investments in health-related organizations. Generally, when the ownership interest in health-related activities is more than 50%, the activities are consolidated, and a minority interest is recorded if appropriate. When the ownership interest is at least 20%, but not more than 50%, it is typically accounted for on the equity method, and the income or loss is reflected in net revenue. Activities with less than 20% ownership or lacking significant influence over the operations of the related entity are carried at the lower of cost or estimated net realizable value.

Health insurance – The Medical Center offers health insurance (the Employee Benefit Plan) to its active employees and families. The Medical Center pays approximately 80% of the premium and employees contribute the remaining 20% through bi-weekly payroll deductions. The Employee Benefit Plan provides medical, dental, vision, and prescription coverage. The Employee Benefit Plan is self-funded, but is reinsured through HM Life Insurance Company with a specific attachment point of $250,000 per covered individual annually plus a $60,000 aggregating specific with an unlimited lifetime maximum. The Medical Center has established reserve amounts based upon information as to the status of claims plus development factors for incurred but not yet reported claims and anticipated future changes in underlying case reserves. Such reserve amounts are only estimates and there can be no assurance that the Medical Center's future Employee Benefit Plan obligations will not exceed the amount of its reserves. The Medical Center's reserve for health insurance was $1,811,000 and $1,949,000 at September 30, 2014 and 2013, respectively, and is included in accrued payroll on the consolidated balance sheet.

Worker's compensation – The Medical Center is self-funded for worker's compensation insurance, but is reinsured through Safety National Casualty Corporation with a specific attachment point of $500,000 per claim. The Medical Center has contracted with Empire Pacific Risk Management to act as the third party administrator to process and pay claims. The Medical Center has established reserve amounts based upon information as to the status of claims plus development factors for incurred but not yet reported claims and anticipated future changes in underlying case reserves. Such reserve amounts are only estimates and there can be no assurance that the Medical Center's future workers' compensation obligations will not exceed the amount of its reserves. The Medical Center's reserve for workers' compensation was $904,000 and $745,000 at September 30, 2014 and 2013, respectively, and is included in accrued payroll on the consolidated balance sheet.

Estimated malpractice costs – The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. Estimated malpractice costs are included in other accrued expenses and were approximately $468,000 and $807,000 as of September 30, 2014 and 2013, respectively. The estimated receivable, approximately $251,000 and $557,000 as of September 30, 2014 and 2013, respectively, is included in other receivables on the consolidated balance sheet.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

Net patient service revenue – The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. For uninsured patients that do not qualify for charity care, the Medical Center recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Medical Center's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Medical Center records a significant provision for bad debts related to uninsured patients in the period the services are provided. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Other operating revenues – During the 2014 fiscal year, the Medical Center received approximately $2,450,000 from Centers for Medicare & Medicaid (CMS), pursuant to the Health Information Technology for Economic and Clinical Health Act (HITECH Act), for reimbursement of Electronic Health Records (EHR) capital expenditures made by the Medical Center through June 30, 2014, also known as Meaningful Use funds. The Medical Center recognizes income associated with these funds when its requirements for reimbursement have been met and application for reimbursement has been submitted to CMS.

In July of 2014, the Medical Center contracted with Safeway Pharmacies to provide contract pharmacy services for the Medical Center and eligible patients of the Medical Center. Revenue from this pharmacy contract is included in other revenue.

Charity care – The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The policy of the Medical Center for charity care includes providing non-elective services to patients whose household income falls at or below 200% of the Federal Poverty Level at no cost. For those patients who fall between 200% and 400% of the Federal Poverty Level and who are unable to pay their bills, patients are eligible for either a partial write-off of their account, annual maximum out of pocket, or both. The policy applies to both insured patients as well as uninsured patients provided the patient meets the eligibility criteria. Total cost of charity care provided by the Medical Center was $4,278,000 and $5,884,000 as of September 30, 2014 and 2013, respectively.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

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

Temporarily and permanently restricted net assets – Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity. The Medical Center does not have any permanently restricted net assets at September 30, 2014 and 2013.

Excess of revenues over expenses – The statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include the net change in unrealized gains and losses on investments other-than-trading securities, distributions, and losses from discontinued operations.

Volunteers – A significant portion of the Medical Center's gift shop operations and patient relations functions are conducted by unpaid volunteers. The value of this contributed time is not reflected in the accompanying consolidated financial statements since the volunteers' time does not meet the criteria for recognition.

Income taxes – The Medical Center and Foundation are tax-exempt organizations and are not subject to state or federal income taxes, except on unrelated business income, in accordance with Section 501(c)(3) of the Internal Revenue Code.

The Medical Center and Foundation had no unrecognized tax benefits at September 30, 2014 or 2013. The Medical Center and Foundation recognize interest accrued and penalties related to unrecognized tax benefits as an administrative expense. During the years ended September 30, 2014 and 2013, the Medical Center and Foundation recognized no interest and penalties.

The Medical Center files an exempt organization information return and an unrelated business income tax return in the U.S. federal jurisdiction and an unrelated business income tax return with the Oregon Department of Revenue.

The Foundation files an exempt organization information return in the U.S. federal jurisdiction.

Note 1 – Description of Organization and Summary of Significant Accounting Policies (continued)

WPS, the Medical Center's for-profit corporate subsidiary, accounts for income taxes in accordance with Accounting Standards Codification (ASC) 740-10, whereby, income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are recognized for differences between the basis of assets and liabilities for financial statement and income tax purposes. The deferred tax assets and liabilities represent future tax return consequences of those differences, which will either be deductible or taxable when those assets and liabilities are recovered or settled. Deferred taxes are also recognized for operating losses that are available to offset future taxable income.

KMBC has elected to be taxed under the provisions of the Oregon Limited Liability Company Act. Under those provisions, the LLC does not pay federal income tax on its taxable income. Instead, the members are liable for income taxes on the LLC's taxable income.

The Klamath Falls Intercommunity Hospital Authority (the Authority) is a municipal corporation under Oregon state law and is not subject to federal income tax.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Medical Center recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Medical Center's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are issued.

The Medical Center has evaluated subsequent events through January 14, 2015, which is the date the financial statements were issued.

Reclassifications – Certain reclassifications have been made to the 2013 consolidated financial statements to conform to current-year presentations. These reclassifications did not affect previously reported excess of revenues over expenses or net assets.

Note 2 – Net Patient Service Revenue

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

- *Medicare* – Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Medical education costs and uncollected bad debts on patient accounts related to Medicare beneficiaries are paid based on a modified cost reimbursement methodology. Additional payments for the Medicare disproportionate share are made to the Medical Center based on the ratio of Title XIX inpatient recipients to total inpatients. The Medical Center is reimbursed for outpatient cost reimbursable items at a tentative rate with final settlement determined after submission of the annual cost report by the Medical Center and audit thereof by the Medicare fiscal intermediary.

- Atrio Health Plans, Inc. is a for-profit Oregon health care service, of which CCC owns a one-third interest. Atrio Health Plans, Inc. provides Medicare Advantage Plans to residents primarily of Douglas, Klamath, Marion, and Polk counties. The Medical Center received $10,912,230 and $9,643,265 in Medicare reimbursement from Atrio Health Plans, Inc. in fiscal years 2014 and 2013, respectively.

- *Medicaid* – Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Medical Center is reimbursed at a tentative rate with final settlement determined after submission of the annual cost report by the Medical Center and finalization of the cost report by the Oregon Division of Medical Assistance Programs (DMAP).

- CCC is a local Medicaid claims administrator of which the Medical Center owns 36% (Note 5). The Medical Center is paid on an interim basis based upon prospectively determined rates. The Medical Center also participates in a risk pool arrangement that encourages cost containment. The Medical Center received $11,204,816 and $11,424,406 in Medicaid reimbursements from CCC in fiscal years 2014 and 2013, respectively.

Entities doing business with governmental payors, including Medicare and Medicaid, are subject to risks unique to the government-contracting environment that are difficult to anticipate and quantify. Revenues are subject to adjustment as a result of examination by government agencies as well as auditors, contractors, and intermediaries retained by the federal, state, or local governments (collectively "Government Agents"). Resolution of such audits or reviews often extends (and in some cases does not even commence until) several years beyond the year in which services were rendered and/or fees received.

Note 2 – Net Patient Service Revenue (continued)

Moreover, different Government Agents frequently interpret government regulations or other requirements differently. For example, Government Agents might disagree on a patient's principal medical diagnosis, the appropriate code for a clinical procedure, or many other matters. Such disagreements might have a significant effect on the ultimate payout due from the government to fully recoup sums already paid. Governmental agencies may make changes in program interpretations, requirements, or "conditions of participation," some of which may have implications for amounts previously estimated. In addition to varying interpretation and evolving codification of the regulations, standards of supporting documentation and required data are subject to wide variation.

In accordance with generally accepted accounting principles, to account for the uncertainty around Medicare and Medicaid revenues, the client estimates the amount of revenue that will ultimately be received under the Medicare and Medicaid programs. Amounts ultimately received or paid may vary significantly from these estimates.

The Medical Center has also entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts and established charges, and prospectively determined daily rates.

Patient service revenue, net of contractual allowances of $283,510,831 and $246,361,262 for the years ending September 30, 2014 and 2013, respectively, recognized in the period from major payor sources, is as follows.

	2014	2013
Medicare	$ 79,582,307	$ 73,858,446
Other third-party payors	79,026,397	72,897,785
Medicaid	36,834,930	27,958,373
Other governmental	5,403,281	5,243,229
Self-pay	3,395,496	4,519,300
Provision for bad debts	(15,963,751)	(14,128,143)
Total net patient service revenue	$ 188,278,660	$ 170,348,990

Note 3 – Promises to Give

Unconditional promises to give at September 30 are as follows:

	2014	2013
Receivable in less than one year, net	$ 839,149	$ 1,357,374
Receivable in one to five years, net	599,196	571,327
	$ 1,438,345	$ 1,928,701

At September 30, 2014 and 2013, substantially all unconditional promises to give were from two donors.

Note 4 – Assets Limited as to Use

Assets held by trustees under indenture agreements for the bonds outstanding at September 30 include:

	2014	2013
Guaranteed investment contracts	$ 4,793,464	$ 4,793,464
Money market	101,959	4,491,404
Mutual funds	94,866	184,896
Interest receivable	15,772	15,776
	$ 5,006,061	$ 9,485,540

Note 5 – Investments

Investments, including investments held as assets limited as to use (Note 4), at September 30 include:

	2014	2013
Corporate bonds	$ 39,354,727	$ 29,263,795
Certificates of deposit	21,096,775	23,309,681
Common stocks	16,757,740	14,380,109
Life insurance	6,999,776	-
Mutual funds	5,667,186	5,338,022
Guaranteed investment contracts	4,793,464	4,793,464
Cascade Comprehensive Care, Inc.	3,103,034	2,465,249
Southern Oregon Linen Services, Inc.	364,730	345,669
Population Health Alliance, LLC	333,000	-
U.S. government securities	312,823	384,280
Mt. States Healthcare RRG	183,100	183,100
	$ 98,966,355	$ 80,463,369

Included on the consolidated balance sheet within assets limited as to use is approximately $118,000 and $4,507,000 as of September 30, 2014 and 2013, respectively of cash and accrued interest which is not reflected in the above investment totals.

Southern Oregon Linen Service, Inc.

The Medical Center owns 15.3% of the common stock in Southern Oregon Linen Service (SOLS). SOLS was established in 1996 as a central cooperative laundry to service several regional hospitals. The Medical Center concluded that it could not exert influence over SOLS' operations and financial activities; therefore, the Medical Center is accounting for the investment on the cost method.

Population Health Alliance of Oregon, LLC

The Medical Center has 7% ownership in Population Health Alliance of Oregon, LLC (PHA), which is accounted for using the cost method. PHA was created with other public benefit non-profit organizations to promote coordinated health care interventions and communication for populations with conditions in which self-care efforts are significant. The Medical Center concluded that it could not exert influence over PHA's operations and financial activities; therefore, the Medical Center is accounting for the investment on the cost method.

Mountain States Healthcare Reciprocal Risk Retention Group

The Medical Center owns 5% of the common stock in Mountain States Healthcare Reciprocal Risk Retention Group (Mt. States). Mt. States was formed in 2003 and provides hospital professional liability and general liability insurance to its subscribers. The Medical Center concluded that it could not exert influence over Mt. States' operations and financial activities; therefore, the Medical Center is accounting for the investment on the cost method.

Note 5 – Investments (continued)

Cascade Comprehensive Care, Inc.
The Medical Center owns 36% of the common stock in CCC, which is accounted for using the equity method. CCC is a managed health care company that currently manages a Medicaid contract under the Oregon Health Plan. CCC handles quality assurance, utilization management, claims adjudication, pharmacy management, encounter reporting, financial and solvency reporting, physician and provider contracting, reinsurance/stoploss issues, risk model management etc. for the local community.

The following represents the unaudited summary financial information for CCC for the years ended September 30:

	2014 (unaudited)	2013 (unaudited)
Current assets	$ 14,429,250	$ 6,044,796
Noncurrent assets	9,861,052	9,328,026
Total assets	$ 24,290,302	$ 15,372,822
Current liabilities	$ 15,682,000	$ 8,343,277
Noncurrent liabilities	60,000	26,000
Equity	8,548,302	7,003,545
Total liabilities and equity	$ 24,290,302	$ 15,372,822
Operating revenue	$ 47,837,160	$ 33,604,213
Operating expenses	46,035,146	31,963,118
Operating income	$ 1,802,014	$ 1,641,095

Note 6 – Fair Value Measurements

Financial Accounting Standards Board (FASB) ASC 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. That framework provides 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 measurement) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

Note 6 – Fair Value Measurements (continued)

Basis of fair value measurement –

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Medical Center has the ability to access.

Level 2 – Inputs to the valuation methodology are quoted prices in markets that are not considered to be active or financial instruments without quoted market prices, but for which all significant inputs are observable, either directly or indirectly.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2014 and 2013.

Common stocks – Valued at the closing price reported on the active market on which the individual securities are traded.

Life insurance – Life insurance is recorded at the estimated cash-surrender value of the policies.

Guaranteed investment contracts – The guaranteed investment contracts are valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the credit-worthiness of the issuer.

Mutual funds – Valued at the net asset value of shares held by the Medical Center at year end using prices quoted by the relevant pricing agent.

Certificates of deposit – Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the credit-worthiness of the issuer.

Corporate bonds and U.S. government securities, available-for-sale – Valued at the closing price reported on the major market on which the individual securities are traded or have reported broker trades which may be considered indicative of an active market. Where quoted prices are available in an active market, the investments are classified within level 1 of the valuation hierarchy. If quoted market prices are not available for the specific security, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, discounted cash flows, and other observable inputs. Such securities are classified within level 2 of the valuation hierarchy.

Note 6 – Fair Value Measurements (continued)

The following tables disclose by level, the fair value hierarchy, of the Medical Center's assets at fair value at September 30, 2014:

	Fair Value Measurements			
	Total Fair Value	Level One	Level Two	Level Three
Common stock				
Consumer goods	$ 4,286,362	2,289,411	$ 1,996,951	$ -
Financial	4,267,587	4,267,587	-	-
Technology	2,526,484	2,526,484	-	-
Healthcare	1,760,012	1,760,012	-	-
Basic materials	1,615,973	1,615,973	-	-
Services	1,159,504	1,159,504	-	-
Other	473,206	473,206	-	-
Industrial goods	338,101	338,101	-	-
Utilities	330,511	330,511	-	-
Life insurance	6,999,776	-	6,999,776	-
Guaranteed investment contracts				
Wachovia GIC	3,035,000	-	3,035,000	-
Morgan Stanley GIC	1,758,464	-	1,758,464	-
Mutual funds				
Equity funds	3,046,245	3,046,245	-	-
Blend funds	1,378,731	1,378,731	-	-
Bond funds	456,448	456,448	-	-
Value funds	321,840	321,840	-	-
Money market funds	85,597	85,597	-	-
Other funds	378,325	378,325	-	-
Certificates of deposit	21,096,775	-	21,096,775	-
Corporate bonds				
Consumer goods	267,732		267,732	-
Financial	222,552		222,552	-
Services	116,251		116,251	-
Healthcare	51,661		51,661	-
Industrial goods	50,867		50,867	-
Basic materials	32,710		32,710	-
U.S. government securities	312,823		312,823	-
	$ 56,369,537	$ 20,427,975	$ 35,941,562	$ -

Total investments held-to-maturity, valued at cost or equity as of September 30, 2014 is $42,596,818.

Investment securities that management has the positive intent and ability to hold until maturity are classified as held-to-maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts and therefore excluded from the above fair value table.

Note 6 – Fair Value Measurements (continued)

The following tables disclose by level, the fair value hierarchy, of the Medical Center's assets at fair value at September 30, 2013:

	Fair Value Measurements			
	Total Fair Value	Level One	Level Two	Level Three
Common stock				
Consumer goods	$ 3,978,946	$ 2,490,012	$ 1,488,934	$ -
Financial	3,741,647	3,741,647	-	-
Technology	1,880,372	1,880,372	-	-
Basic materials	1,743,718	1,743,718	-	-
Healthcare	1,199,215	1,199,215	-	-
Services	974,587	974,587	-	-
Industrial goods	459,815	459,815	-	-
Utilities	248,663	248,663	-	-
Other	153,146	153,146	-	-
Guaranteed investment contracts				
Wachovia GIC	3,035,000	-	3,035,000	-
Morgan Stanley GIC	1,758,464	-	1,758,464	-
Mutual funds				
Equity funds	2,672,928	2,672,928	-	-
Blend funds	973,524	973,524	-	-
Money market funds	491,755	491,755	-	-
Bond funds	466,745	466,745	-	-
Value funds	217,373	217,373	-	-
Other funds	515,697	515,697	-	-
Certificates of deposit	23,309,681	-	23,309,681	-
Corporate bonds				
Financial	229,666	-	229,666	-
Consumer goods	132,071	-	132,071	-
Services	93,637	-	93,637	-
Industrial goods	80,532	-	80,532	-
Technology	61,854	-	61,854	-
Healthcare	52,653	-	52,653	-
U.S. government securities	384,280	-	384,280	-
	$ 48,855,969	$ 18,229,197	$ 30,626,772	$ -

Total investments held-to-maturity, valued at cost or equity as of September 30, 2013 is $31,607,400.

Note 7 – Property and Equipment

A summary of property and equipment at September 30 follows:

	2014	2013
Buildings and fixed equipment	$ 121,566,850	$ 118,745,236
Moveable equipment	55,017,474	48,102,006
Equipment under capital lease obligations	16,144,798	14,438,750
Land improvements	4,114,570	4,114,570
Land	2,376,255	2,191,727
Leasehold improvements	184,149	184,149
	199,404,096	187,776,438
Less: Accumulated depreciation and amortization	(107,853,179)	(97,994,620)
	91,550,917	89,781,818
Construction in progress	1,451,700	4,502,724
	$ 93,002,617	$ 94,284,542

Depreciation expense from operations for the years ended September 30, 2014 and 2013 was $9,177,816 and $8,431,103, respectively. Amortization expense for the years ended September 30, 2014 and 2013 was $959,998 and $752,727, respectively. Accumulated amortization for equipment under capital lease obligations was $9,041,790 and $8,081,792 at September 30, 2014 and 2013, respectively.

Note 8 – Plum Ridge Care Center

Lease value of Plum Ridge Care Center – In 2001, Klamath County, Oregon deeded the Plum Ridge Care Center to the Authority. The Medical Center entered into a long-term lease agreement for a period of 89 years for the sum of $1 per year. In addition, the Medical Center has the option of purchasing the property at any time for the sum of $1. The Medical Center recognized the fair value of the lease at the time the agreement with the Authority was entered into. The Medical Center is amortizing the lease value over the life of the lease. The lease value of Plum Ridge Care Center at September 30, 2014 and 2013 was $1,460,358 and $1,516,526, respectively, and is included in other assets in the consolidated balance sheet.

Deferred rental revenue – In 2001, the Medical Center subleased the Plum Ridge Care Center to Plum Ridge Care Community, LLC, an unrelated third party, on equivalent lease terms as to the Medical Center's lease with the Authority, except the Medical Center did not grant the right to purchase the property to Plum Ridge Care Community, LLC. The Medical Center recognized a liability to Plum Ridge Care Community, LLC, for the lease value of the remaining term of the lease. The revenue is being amortized over the lease term. The deferred rental revenue of Plum Ridge Care Center was $2,507,868 and $2,541,306 at September 30, 2014 and 2013, respectively, and is included in other long-term liabilities in the consolidated balance sheet.

Note 9 – Capital Leases

Capital leases as of September 30 are as follows:

	2014	2013
Facility lease with a private party with monthly payments of $36,274 through September 2037 at 8.90%.	$ 4,253,496	$ 4,307,447
Equipment lease-purchase agreement with Toshiba America Medical Credit with monthly payments of $34,809 at 1.18% through September 2017.	1,196,805	-
Equipment lease-purchase agreement with Phillips Medical Capital, LLC with monthly payments of $17,153 at 2.11% through April 2018.	694,767	883,743
Equipment lease-purchase agreement with CareFusion Solutions, LLC with monthly payments of $6,857 at 2.64% through May 2017.	352,780	287,245
Equipment lease-purchase agreement with Phillips Medical Capital, LLC with monthly payments of $9,347 at 2.52% through October 2017.	338,427	440,655
Equipment lease-purchase agreement with Phillips Medical Capital, LLC with monthly payments of $17,668 at 4.79% through August 2015.	189,768	387,516
Equipment lease-purchase agreement with GE Healthcare Financial Services with monthly payments of $10,067 at 10.79% through December 2015.	140,674	240,375
Equipment lease-purchase agreement with Provident Equipment Leasing with monthly payments of $12,729 at 4.30% through April 2015.	80,390	226,256
Total capital lease obligations	7,247,107	6,773,237
Less current portion	(1,271,369)	(864,087)
Capital lease obligations, net of current portion	$ 5,975,738	$ 5,909,150

Note 9 – Capital Leases (continued)

Scheduled payments on capital lease obligations for the years ending September 30 are as follows:

2014	$ 1,703,000
2015	1,336,600
2016	1,231,100
2017	555,100
2018	435,300
Thereafter	7,835,200
Total minimum lease payments	13,096,300
Less: Amount representing interest	(5,849,193)
Present value of net minimum lease payments	$ 7,247,107

Note 10 – Long-Term Debt

Long term debt consisted of the following as of September 30:

	2014	2013
Series 2006 Bonds with interest rates from 4% to 5% and mature in varying amounts through 2036, net of premiums of $269,763 and $282,072 at September 30, 2014 and 2013, respectively.	$ 37,164,763	$ 37,982,072
Series 2012 Bonds with interest rates from 3.5% to 5% and mature in varying amounts through 2031, net of premiums of $1,262,644 and $1,336,938 at at September 30, 2014 and 2013, respectively.	17,422,664	17,851,938
Note payable with Washington Federal matured April 2014.	-	1,014,735
Total long-term debt	54,587,427	56,848,745
Less current portion	(1,605,000)	(2,174,735)
Long-term debt, net of current portion	$ 52,982,427	$ 54,674,010

Note 10 – Long-Term Debt (continued)

2012 Bonds
During the year ended September 30, 2013, the Authority issued $17,000,000 in Series 2012 Bonds to defease the remaining 2002 Bonds, to pay or to reimburse the Medical Center for the payment of costs of acquiring, installing, and testing new equipment, to fund a Reserve Fund for the 2012 Bonds, and to pay costs of issuing the 2012 Bonds. The issuance was structured as a legal defeasance. Adequate amounts of the 2012 Bond issuance were used to purchase U.S. Treasury Securities to fully pay the debt service requirements of the 2002 Bonds. The securities have been placed in an escrow account and the Escrow Agent for the account will pay the debt service requirements as they become due. As the debt for the 2002 Series has been legally defeased, the Medical Center is no longer required to report the liability in the consolidated balance sheet.

The 2012 Bonds are secured by a Deed of Trust on a portion of the Medical Center campus, including the main hospital facility. They are further secured by a Reserve Fund, created by the terms of the Bond Indenture to be held by the Bond Trustee to prevent a payment default on the Bonds. The Reserve Fund is required to maintain a balance equal to the lesser of the maximum annual debt service, 125% of the average annual debt service, or 10% of the bond proceeds. They are also secured by a pledge of the gross revenues.

2006 Bonds
In 2006, the Authority issued Series 2006 Bonds to defease $19,265,000 of the 2002 Bonds, to finance costs of improving, expanding, and equipping the existing hospital and related facilities, and to fund a Reserve Fund on behalf of the Medical Center. The issuance was structured as a legal defeasance. Adequate amounts of the 2006 Bond issuance were used to purchase U.S. Treasury Securities to fully pay the debt service requirements of $19,265,000 of the 2002 Bonds. The securities have been placed in an escrow account and the Escrow Agent for the account will pay the debt service requirements as they become due. Because it is legally defeased, the Medical Center is no longer required to report the $19,265,000 in the consolidated balance sheet.

The 2006 Bonds are secured by a Deed of Trust on a portion of the Medical Center campus, including the main hospital facility. They are further secured by a Reserve Fund, created by the terms of the Bond Indenture to be held by the Bond Trustee (Note 4) to prevent a payment default on the Bonds. The Reserve Fund is required to maintain a balance equal to the lesser of the maximum annual debt service, 125% of the average annual debt service, or 10% of the bond proceeds. They are also secured by a pledge of the gross revenues.

The Medical Center must satisfy certain covenants as long as the 2006 Bonds are outstanding. At September 30, 2014, management is not aware of any violation of the covenants.

Note 10 – Long-Term Debt (continued)

Scheduled future principal repayments for all long-term debt for the years ending September 30 are as follows:

2014	$ 1,605,000
2015	2,031,588
2016	2,146,588
2017	2,236,588
2018	2,426,588
Thereafter	44,141,075
	$ 54,587,427

Note 11 – Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	2014	2013
Capital Campaign	$ 1,402,324	$ 1,359,102
Cancer Endowment Fund	1,663,490	1,504,699
Cancer Discretionary Fund	510,032	441,493
Other Funds	970,343	883,566
Total temporarily restricted net assets	$ 4,546,189	$ 4,188,860

Note 12 – Income Taxes

WPS has $19,600,000 available of unused operating loss carry forwards available at September 30, 2014, that may be applied against future taxable income, which expire in years 2024 through 2034.

Utilization of any deferred tax assets for the operating loss carry forwards disclosed above is dependent on future taxable profits. Because WPS has no history of sustained profitability and the asset will not be realized within one year of the balance sheet date, deferred tax assets of $7,500,000, including the unused operating loss carry forwards, have been fully reserved for at September 30, 2014 and 2013. The deferred tax asset, net of reserve, is $0 at September 30, 2014 and 2013.

Note 13 – Commitments and Contingencies

Operating Leases

Lessee Leases
The Medical Center leases equipment and facilities under operating leases which expire through May of 2018. Total rental expense in 2014 and 2013 for all operating leases was approximately $870,000 and $715,000, respectively.

Minimum future payments on non-cancelable leases as of September 30 are:

2015	$ 1,670,400
2016	599,000
2017	557,900
2018	165,800
	$ 2,993,100

Lessor Leases
The Medical Center is the lessor of the office space to various physicians under operating leases expiring in various years through 2057.

Following is a summary of property on or held for lease at September 30:

	2014	2013
Buildings and improvements	$ 7,376,144	$ 7,234,745
Less accumulated depreciation	(4,396,200)	(4,088,454)
	$ 2,979,944	$ 3,146,291

Minimum future rentals to be received on non-cancelable leases as of September 30 are:

2015	$ 481,000
2016	414,000
2017	388,000
2018	388,000
2019	317,000
Thereafter	579,000
	$ 2,567,000

Litigation
The Medical Center is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Medical Center's future financial position or results from operations.

Note 14 – Related-Party Transactions

The following is a summary of transactions between the Medical Center and related parties:

Atrio Health Plans
CCC owns a one-third interest in Atrio Health Plans, Inc. Atrio Health Plans, Inc. is a for-profit Oregon health care service contractor providing Medicare Advantage Plans to residents primarily of Douglas, Klamath, Marion, and Polk counties. The Medical Center received $10,912,230 and $9,643,265 in Medicare reimbursement from Atrio Health Plans, Inc. in fiscal year 2014 and 2013, respectively.

Southern Oregon Linen Services
The Medical Center purchased laundry services of $440,552 and $443,750 from Southern Oregon Linen Services in fiscal years 2014 and 2013, respectively.

Note 15 – Functional Expenses

The Medical Center provides general health care services to residents within its geographic location. Expenses related to providing these services for the Medical Center as of September 30 are as follows:

	2014	2013
Health care services	$ 155,143,586	$ 141,141,447
General and administrative	27,345,421	26,822,211
Total	$ 182,489,007	$ 167,963,658

Note 16 – Retirement Plans

401(a) – Money Purchase Pension Plan
The Medical Center has established a defined contribution retirement plan for all employees who have at least one year of service, are age twenty-one or older, and have completed 1,000 hours of service in the plan year. The Medical Center is required to contribute 5% of an employee's eligible compensation to the plan each plan year. The Medical Center accrued $2,802,485 and $2,607,007 to the plan on behalf of employees for fiscal years ended September 30, 2014 and 2013, respectively.

403(b) – Elective Deferral Plan
The Medical Center has established a 403(b) retirement plan covering substantially all employees under the guidelines of Internal Revenue Code 403(b) Tax Deferred Annuity Plan. The employees may elect to contribute, according to a salary reduction agreement, a percentage of their annual compensation and are eligible for the plan on the first day of employment with the Medical Center. The Plan is a 'Custodial Account Plan' invested in mutual funds.

Note 16 – Retirement Plans (continued)

401(k) Plan
WPS established the West Physician Services 401(k) Retirement Plan, which is a qualified retirement plan under Section 401(k) of the Internal Revenue Code. All employees over 21 years of age are eligible to participate in the plan. There are no employer contributions made to the plan.

409(a) – Retirement Plan
WPS established the West Physician Services Nonqualified Retirement Plan, for the purposes of providing nonqualified retirement benefits to a select group of its employees. The Medical Center is required to contribute 15% of an employee's compensation to the plan each plan year. In addition, the plan permits eligible employees to defer a portion of their compensation. The participant balances are distributable in cash after retirement or termination of employment. The Medical Center contributed $442,081 and $337,657 to the plan on behalf of employees for fiscal years ended September 30, 2014 and 2013, respectively.

457(b) – Deferred Compensation Plan
The Medical Center established the Sky Lakes Medical Center 457(b) Plan. The Plan is a 457(b) qualified deferred compensation plan that permits eligible employees to defer a portion of their compensation. The participant balances are distributable in cash after retirement, unforeseeable emergencies, or termination of employment. Employer contributions to the plan totaled $49,384 and $56,544 for the years ended September 30, 2014 and 2013, respectively. The Medical Center may hold the participant balances in cash or invest it in assets selected by the Plan Administrator. The Plan Administrator has elected to invest the participant balances in mutual funds.

Note 17– Discontinued Operations

On March 31, 2009, the Board of Directors of PHP announced the Company was withdrawing from the Oregon insurance market. This is consistent with the Medical Center's long-term strategy to focus its activities on providing inpatient, outpatient, and emergency care services to the residents of Southern Oregon and Northern California, and to divest unrelated activities.

As of September 30, 2013, PHP was fully liquidated and had no remaining assets or liabilities.

Note 18 – Health Care Reform

In March 2010, President Obama signed the Health Care Reform Legislation (the "Affordable Care Act") into law. The new law resulted in sweeping changes across the health care industry. The primary goal of this comprehensive legislation is to extend health care 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. The Medical Center saw a significant increase in its Medicaid population during the current year. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system.

Some provisions of the healthcare reform legislation have impacted the Medical Center as of 2014, such as the expansion of the Medicaid program. Further legislative policies are required for several provisions that will be effective in future years. The effect of the changes that will be required in future years are not determinable at this time.

SKY LAKES MEDICAL CENTER AND AFFILIATES
CONSOLIDATING BALANCE SHEET
SEPTEMBER 30, 2014

ASSETS

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Klamath Medical Business Center	Total	Eliminating Entries	Consolidated
CURRENT ASSETS						
Cash and cash equivalents	$ 22,974,684	$ 133,350	$ 185,709	$ 23,293,743	$ -	$ 23,293,743
Certificates of deposit	20,875,105	-	-	20,875,105	-	20,875,105
Patient accounts receivable, net	24,347,970	-	-	24,347,970	3,038	24,351,008
Other receivables	7,865,441	-	-	7,865,441	(3,329,386)	4,536,055
Risk pool withhold receivable	2,744,067	-	-	2,744,067	-	2,744,067
Supplies inventories	2,181,720	-	-	2,181,720	-	2,181,720
Prepaid expenses	2,696,455	-	-	2,696,455	-	2,696,455
Promises to give, current portion	-	839,149	-	839,149	-	839,149
Total current assets	83,685,442	972,499	185,709	84,843,650	(3,326,348)	81,517,302
ASSETS LIMITED AS TO USE	5,006,061	-	-	5,006,061	-	5,006,061
PROPERTY AND EQUIPMENT, net	92,084,541	-	899,141	92,983,682	18,935	93,002,617
OTHER ASSETS						
Deferred financing costs, net of amortization	1,693,174	-	-	1,693,174	-	1,693,174
Promises to give, net of current portion	-	599,196	-	599,196	-	599,196
Investments	55,842,088	17,892,014	-	73,734,102	(531,182)	73,202,920
Other	1,460,358	-	-	1,460,358	-	1,460,358
Total other assets	58,995,620	18,491,210	-	77,486,830	(531,182)	76,955,648
Total assets	$ 239,771,664	$ 19,463,709	$ 1,084,850	$ 260,320,223	$ (3,838,595)	$ 256,481,628

LIABILITIES AND NET ASSETS

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Klamath Medical Business Center	Total	Eliminating Entries	Consolidated
CURRENT LIABILITIES						
Accounts payable	$ 6,129,087	$ -	$ -	$ 6,129,087	$ -	$ 6,129,087
Accrued payroll	5,195,800	-	-	5,195,800	-	5,195,800
Accrued compensated absences	3,910,081	-	-	3,910,081	-	3,910,081
Accrued interest payable	239,134	-	-	239,134	-	239,134
Other accrued expenses	11,587,608	1,427,789	-	13,015,397	(3,334,386)	9,681,011
Estimated third-party payor settlements	2,723,969	-	-	2,723,969	-	2,723,969
Current portion of capital lease obligations	1,271,369	-	-	1,271,369	-	1,271,369
Current portion of long-term debt	1,605,000	-	-	1,605,000	-	1,605,000
Total current liabilities	32,662,048	1,427,789	-	34,089,837	(3,334,386)	30,755,451
LONG-TERM LIABILITIES						
Capital lease obligations, net of current portion	5,975,738	-	-	5,975,738	-	5,975,738
Long-term debt, net of current portion	52,982,427	-	-	52,982,427	-	52,982,427
Other long-term liabilities	5,641,824	-	-	5,641,824	-	5,641,824
Total long-term liabilities	64,599,989	-	-	64,599,989	-	64,599,989
Total liabilities	97,262,037	1,427,789	-	98,689,826	(3,334,386)	95,355,440
NET ASSETS						
Unrestricted - Sky Lakes Medical Center	142,509,627	13,489,731	1,084,850	157,084,208	(1,046,634)	156,037,574
Unrestricted - Non-Controlling Interest	-	-	-	-	542,425	542,425
Temporarily restricted	-	4,546,189	-	4,546,189	-	4,546,189
Total net assets	142,509,627	18,035,920	1,084,850	161,630,397	(504,209)	161,126,188
Total liabilities and net assets	$ 239,771,664	$ 19,463,709	$ 1,084,850	$ 260,320,223	$ (3,838,595)	$ 256,481,628

SKY LAKES MEDICAL CENTER AND AFFILIATES
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2014

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Klamath Medical Business Center	Total	Eliminating Entries	Consolidated
REVENUES						
Patient service revenue, net contractual adjustments	$ 204,242,411	$ -	$ -	$ 204,242,411	$ -	$ 204,242,411
Provision for bad debts	(15,963,751)	-	-	(15,963,751)	-	(15,963,751)
Net patient service revenue	188,278,660	-	-	188,278,660	-	188,278,660
Contributions	-	2,694	-	2,694	-	2,694
Other revenue	12,264,424	-	285,708	12,550,132	(2,456,103)	10,094,029
Net assets released from restrictions	-	632,161	-	632,161	-	632,161
Total revenues	200,543,084	634,855	285,708	201,463,647	(2,456,103)	199,007,544
EXPENSES						
Salaries and benefits	91,352,444	145,542	-	91,497,986	(148,512)	91,349,474
Supplies	16,368,204	-	-	16,368,204	(1,390)	16,366,814
Drugs	10,638,744	-	-	10,638,744	-	10,638,744
Depreciation and amortization	10,098,707	-	39,107	10,137,814	-	10,137,814
Physician fees	6,872,998	-	-	6,872,998	(15,888)	6,857,110
Professional fees	1,104,278	-	9,032	1,113,310	(8,147)	1,105,163
Purchased services	17,348,980	-	3,796	17,352,776	(274,651)	17,078,125
Building and maintenance	8,593,163	-	77,478	8,670,641	-	8,670,641
Provider tax	9,001,120	-	-	9,001,120	-	9,001,120
Interest expense	2,985,681	-	-	2,985,681	-	2,985,681
Insurance	2,449,788	-	2,861	2,452,649	-	2,452,649
Rentals and lease expense	1,816,082	-	-	1,816,082	(600,880)	1,215,202
Minor equipment	607,371	-	-	607,371	-	607,371
Other	3,966,591	1,436,308	-	5,402,899	(1,379,800)	4,023,099
Total expenses	183,204,151	1,581,850	132,274	184,918,275	(2,429,268)	182,489,007
OPERATING INCOME (LOSS)	17,338,933	(946,995)	153,434	16,545,372	(26,835)	16,518,537
OTHER INCOME (EXPENSE)						
Investment income	2,339,681	1,366,820	-	3,706,501	(83,972)	3,622,529
Other non-operating income (expense)	(77,629)	1,000	-	(76,629)	(6,367)	(82,996)
Total other income	2,262,052	1,367,820	-	3,629,872	(90,339)	3,539,533
EXCESS OF REVENUES OVER EXPENSES	$ 19,600,985	$ 420,825	$ 153,434	$ 20,175,244	$ (117,174)	$ 20,058,070

SKY LAKES MEDICAL CENTER AND AFFILIATES
CONSOLIDATING STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2014

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Klamath Medical Business Center	Total	Eliminating Entries	Consolidated
UNRESTRICTED NET ASSETS						
Excess of revenues over expenses	$ 19,600,985	$ 420,825	$ 153,434	$ 20,175,244	$ (117,174)	$ 20,058,070
Distributions and other	-	-	(108,458)	(108,458)	54,229	(54,229)
Net change in unrealized gains and losses on other-than-trading securities	19,713	357,005	-	376,718	-	376,718
Increase (decrease) in unrestricted net assets	19,620,698	777,830	44,976	20,443,504	(62,945)	20,380,559
TEMPORARILY RESTRICTED NET ASSETS						
Contributions	-	780,770	-	780,770	-	780,770
Investment income	-	217,897	-	217,897	-	217,897
Other revenue	-	14,575	-	14,575	-	14,575
Net assets released from restrictions	-	(632,161)	-	(632,161)	-	(632,161)
Decrease in temporarily restricted net assets	-	381,081	-	381,081	-	381,081
CHANGE IN NET ASSETS	19,620,698	1,158,911	44,976	20,824,585	(62,945)	20,761,640
NET ASSETS, beginning of year	122,888,929	16,877,009	1,039,874	140,805,812	(441,264)	140,364,548
NET ASSETS, end of year	$ 142,509,627	$ 18,035,920	$ 1,084,850	$ 161,630,397	$ (504,209)	$ 161,126,188

SKY LAKES MEDICAL CENTER AND AFFILIATES – OBLIGATED GROUP
COMBINING BALANCE SHEET
SEPTEMBER 30, 2014

ASSETS

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Total	Eliminating Entries	Total Obligated Group
CURRENT ASSETS					
Cash and cash equivalents	$ 22,974,684	$ 133,350	$ 23,108,034	$ -	$ 23,108,034
Certificates of deposit	20,875,105	-	20,875,105	-	20,875,105
Patient accounts receivable, net	24,347,970	-	24,347,970	3,038	24,351,008
Other receivables	7,865,441	-	7,865,441	(3,329,386)	4,536,055
Risk pool withhold receivable	2,744,067	-	2,744,067	-	2,744,067
Supplies inventories	2,181,720	-	2,181,720	-	2,181,720
Prepaid expenses	2,696,455	-	2,696,455	-	2,696,455
Promises to give, current portion	-	839,149	839,149	-	839,149
Total current assets	83,685,442	972,499	84,657,941	(3,326,348)	81,331,593
ASSETS LIMITED AS TO USE	5,006,061	-	5,006,061	-	5,006,061
PROPERTY AND EQUIPMENT, net	92,084,541	-	92,084,541	18,935	92,103,476
OTHER ASSETS					
Deferred financing costs, net of amortization	1,693,174	-	1,693,174	-	1,693,174
Promises to give, net of current portion	-	599,196	599,196	-	599,196
Investments	55,842,088	17,892,014	73,734,102	(86,952)	73,647,150
Other	1,460,358	-	1,460,358	-	1,460,358
Total other assets	58,995,620	18,491,210	77,486,830	(86,952)	77,399,878
Total assets	$ 239,771,664	$ 19,463,709	$ 259,235,373	$ (3,394,365)	$ 255,841,008

LIABILITIES AND NET ASSETS

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Total	Eliminating Entries	Total Obligated Group
CURRENT LIABILITIES					
Accounts payable	$ 6,129,087	$ -	$ 6,129,087	$ -	$ 6,129,087
Accrued payroll	5,195,800	-	5,195,800	-	5,195,800
Accrued compensated absences	3,910,081	-	3,910,081	-	3,910,081
Accrued interest payable	239,134	-	239,134	-	239,134
Other accrued expenses	11,587,608	1,427,789	13,015,397	(3,334,386)	9,681,011
Estimated third-party payor settlements	2,723,969	-	2,723,969	-	2,723,969
Current portion of capital lease obligations	1,271,369	-	1,271,369	-	1,271,369
Current portion of long-term debt	1,605,000	-	1,605,000	-	1,605,000
Total current liabilities	32,662,048	1,427,789	34,089,837	(3,334,386)	30,755,451
LONG-TERM LIABILITIES					
Capital lease obligations, net of current portion	5,975,738	-	5,975,738	-	5,975,738
Long-term debt, net of current portion	52,982,427	-	52,982,427	-	52,982,427
Other long-term liabilities	5,641,824	-	5,641,824	-	5,641,824
Total long-term liabilities	64,599,989	-	64,599,989	-	64,599,989
Total liabilities	97,262,037	1,427,789	98,689,826	(3,334,386)	95,355,440
NET ASSETS					
Unrestricted	142,509,627	13,489,731	155,999,358	(59,979)	155,939,379
Temporarily restricted	-	4,546,189	4,546,189	-	4,546,189
Total net assets	142,509,627	18,035,920	160,545,547	(59,979)	160,485,568
Total liabilities and net assets	$ 239,771,664	$ 19,463,709	$ 259,235,373	$ (3,394,365)	$ 255,841,008

SKY LAKES MEDICAL CENTER AND AFFILIATES – OBLIGATED GROUP
COMBINING STATEMENT OF OPERATIONS
SEPTEMBER 30, 2014

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Total	Eliminating Entries	Total Obligated Group
REVENUES					
Patient service revenue, net contractual adjustments	$ 204,242,411	$ -	$ 204,242,411	$ -	$ 204,242,411
Provision for bad debts	(15,963,751)	-	(15,963,751)	-	(15,963,751)
Net patient service revenue	188,278,660	-	188,278,660	-	188,278,660
Contributions	-	2,694	2,694	-	2,694
Other revenue	12,264,424	-	12,264,424	(2,456,103)	9,808,321
Net assets released from restrictions	-	632,161	632,161	-	632,161
Total revenues	200,543,084	634,855	201,177,939	(2,456,103)	198,721,836
EXPENSES					
Salaries and benefits	91,352,444	145,542	91,497,986	-	91,497,986
Supplies	16,368,204	-	16,368,204	(1,390)	16,366,814
Drugs	10,638,744	-	10,638,744	-	10,638,744
Depreciation and amortization	10,098,707	-	10,098,707	-	10,098,707
Physician fees	6,872,998	-	6,872,998	-	6,872,998
Professional fees	1,104,278	-	1,104,278	(8,147)	1,096,131
Purchased services	17,348,980	-	17,348,980	(274,651)	17,074,329
Building and maintenance	8,593,163	-	8,593,163	-	8,593,163
Provider tax	9,001,120	-	9,001,120	-	9,001,120
Interest expense	2,985,681	-	2,985,681	-	2,985,681
Insurance	2,449,788	-	2,449,788	-	2,449,788
Rentals and lease expense	1,816,082	-	1,816,082	(600,880)	1,215,202
Minor equipment	607,371	-	607,371	-	607,371
Other	3,966,591	1,436,308	5,402,899	(1,379,800)	4,023,099
Total expenses	183,204,151	1,581,850	184,786,001	(2,264,868)	182,521,133
OPERATING INCOME (LOSS)	17,338,933	(946,995)	16,391,938	(191,235)	16,200,703
OTHER INCOME (EXPENSE)					
Investment income	2,339,681	1,366,820	3,706,501	(8,885)	3,697,616
Other non-operating income (expense)	(77,629)	1,000	(76,629)	-	(76,629)
Total other income	2,262,052	1,367,820	3,629,872	(8,885)	3,620,987
EXCESS OF REVENUE OVER EXPENSES	$ 19,600,985	$ 420,825	$ 20,021,810	$ (200,120)	$ 19,821,690

SKY LAKES MEDICAL CENTER AND AFFILIATES – OBLIGATED GROUP
COMBINING STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2014

	Sky Lakes Medical Center	Sky Lakes Medical Center Foundation	Total	Eliminating Entries	Total Obligated Group
UNRESTRICTED NET ASSETS					
Excess of revenues over expenses	$ 19,600,985	$ 420,825	$ 20,021,810	$ (200,120)	$ 19,821,690
Net change in unrealized gains and losses on other-than-trading securities	19,713	357,005	376,718	-	376,718
Increase in unrestricted net assets	19,620,698	777,830	20,398,528	(200,120)	20,198,408
TEMPORARILY RESTRICTED NET ASSETS					
Contributions	-	780,770	780,770	-	780,770
Investment income	-	217,897	217,897	-	217,897
Other revenue	-	14,575	14,575	-	14,575
Net assets released from restrictions	-	(632,161)	(632,161)	-	(632,161)
Decrease in temporarily restricted net assets net assets	-	381,081	381,081	-	381,081
CHANGE IN NET ASSETS	19,620,698	1,158,911	20,779,609	(200,120)	20,579,489
NET ASSETS, beginning of year	122,888,929	16,877,009	139,765,938	(24,259)	139,741,679
NET ASSETS, end of year	$ 142,509,627	$ 18,035,920	$ 160,545,547	$ (224,379)	$ 160,321,168