Report of Independent Auditors and
Consolidated Financial Statements
(with Supplementary Information)

CareOregon, Inc. and Subsidiaries

December 31, 2012 and 2011

MOSS-ADAMS LLP

6/3/13

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MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
CareOregon, Inc. and Subsidiaries

Report on Financial Statements

We have audited the accompanying consolidated financial statements of CareOregon, Inc. and Subsidiaries (the Organization), which comprise the consolidated financial position as of December 31, 2012 and 2011 and the related consolidated statements of activities and changes in net worth and cash flows for the years then ended, and the related notes to the consolidated 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 control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

REPORT OF INDEPENDENT AUDITORS (continued)

Opinion

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

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Moss Adams LLP

Portland, Oregon
May 17, 2013

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CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	December 31, 2012	December 31, 2011
CURRENT ASSETS		
Cash and cash equivalents	$ 30,616,309	$ 19,143,330
Investments – unrestricted	177,952,442	169,292,777
Maternity case rate receivable, net of allowance for doubtful accounts of $828,339 in 2012 and $251,867 in 2011	10,650,370	5,999,203
Patient centered primary care home receivable	2,506,932	-
Reinsurance recoveries receivable	715,000	600,000
Interest receivable	1,204,595	959,009
Pharmacy rebates receivable	4,710,419	3,087,693
Premium receivable	1,084,141	3,866,758
Contract receivable	-	252,023
Other receivables	2,505,281	1,061,771
Prepaid expenses	2,498,649	1,966,809
Deferred tax asset	510,994	373,596
Total current assets	234,955,132	206,602,969
ASSETS LIMITED AS TO USE		
Investments – statutory reserves	310,570	322,194
Investments – contractual reserves	9,895,861	20,069,826
Total assets limited as to use	10,206,431	20,392,020
FIXED ASSETS, net of accumulated depreciation and amortization of $17,966,732 in 2012 and $14,918,709 in 2011	20,916,985	21,642,584
LEASE DEPOSIT	26,136	9,886
Total assets	$ 266,104,684	$ 248,647,459

See accompanying notes to consolidated financial statements.

LIABILITIES AND NET WORTH

	December 31, 2012	December 31, 2011
CURRENT LIABILITIES		
Accrued medical claims payable	$ 53,548,875	$ 50,118,063
Claims adjudicated pending payment	4,214,026	4,275,286
Premium deficiency reserve	8,000,000	7,000,000
Managed care contract payable	720,695	3,348,560
Patient centered primary care home payable	2,559,090	-
Accrued Gainshare	3,007,000	-
Accounts payable and accrued expenses	6,211,667	4,189,134
Medicare advances payable	2,193,083	1,017,589
Risk corridor payable	866,655	505,655
Accrued payroll and benefits	2,599,946	1,576,782
Premium recoupment payable	1,896,551	1,910,548
Total current liabilities	85,817,588	73,941,617
DEFERRED RENT	23,714	-
NON-CURRENT DEFERRED TAXES	730,251	500,936
NET WORTH	179,533,131	174,204,906
Total liabilities and net worth	$ 266,104,684	$ 248,647,459

See accompanying notes to consolidated financial statements.

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET WORTH

	Years Ended December 31, 2012	2011
REVENUE		
Premium revenue	$ 699,398,704	$ 674,000,793
Management fee revenue	3,007,934	-
Other revenue	1,078,092	846,169
Total operating revenues	703,484,730	674,846,962
OPERATING EXPENSES		
Purchased healthcare	625,182,182	584,567,034
Managed care taxes	4,610,661	5,565,820
Salaries and benefits	28,105,896	22,849,545
Other administrative expenses	48,351,065	26,909,956
Total operating expenses	706,249,804	639,892,355
REVENUES OVER (UNDER) OPERATING EXPENSES	(2,765,074)	34,954,607
OTHER INCOME (EXPENSE)		
Investment income, net of transaction, custodial and advisory fees of $392,171 in 2012 and $376,653 in 2011	11,045,590	7,768,491
Gain (loss) on disposal of fixed assets	1,300	(8,375)
	11,046,890	7,760,116
INCOME FROM CONTINUING OPERATIONS, before income taxes	8,281,816	42,714,723
INCOME TAX EXPENSE	2,953,591	4,754,433
INCOME FROM CONTINUING OPERATIONS	5,328,225	37,960,290
LOSS FROM DISCONTINUED OPERATIONS	-	3,108,072
CHANGE IN NET WORTH	5,328,225	34,852,218
NET WORTH, beginning of the year	174,204,906	139,352,688
NET WORTH, end of year	$ 179,533,131	$ 174,204,906

See accompanying notes to consolidated financial statements.

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net worth	$ 5,328,225	$ 34,852,218
Loss from discontinued operations	-	3,108,072
Increase in net assets from continuing operations	5,328,225	37,960,290
Adjustments to reconcile net worth to net cash from operating activities:		
Depreciation and amortization	3,048,023	2,741,131
Realized and unrealized gain on investments	(6,081,107)	(3,460,460)
Net fixed income investment discount and premium amortization	959,465	1,169,148
(Gain) loss on disposal of fixed assets	(1,300)	8,375
Deferred income tax expense	91,917	339,624
Changes in assets and liabilities:		
Maternity case rate receivable	(4,651,167)	(1,039,566)
Patient accounts receivable	-	205,960
Reinsurance recoveries receivable	(115,000)	2,625,000
Interest receivable	(245,586)	389,494
Pharmacy rebates receivable	(1,622,726)	(1,764,518)
Premium receivable	2,782,617	(2,367,242)
Other receivables	(1,191,487)	(1,040,420)
Prepaid expenses	(548,090)	79,817
Accrued medical claims payable	3,430,812	(12,574,376)
Claims adjudicated pending payment	(61,260)	583,592
Premium deficiency reserve	1,000,000	(9,000,000)
Managed care contract payable	(2,627,865)	(1,122,279)
Patient centered primary care home payable, net	52,158	-
Accrued Gainshare	3,007,000	-
Accounts payable and accrued expenses	2,046,247	2,393,375
Medicare advances payable	1,175,494	600,157
Risk corridor payable	361,000	194,000
Accrued payroll and benefits	1,023,164	192,797
Premium recoupment payable	(13,997)	728,205
Net cash flows from operating activities from continuing operations	7,146,537	$ 17,842,104
Net cash flows from operating activities from discontinued operations	$ -	$ (2,009,113)

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2012	2011
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from investment sales and maturities – unrestricted	$ 39,313,041	$ 60,952,638
Purchase of investments – unrestricted	(42,797,794)	(68,727,348)
Proceeds from investment sales and maturities – contractual reserves	33,338,154	24,751,491
Purchase of investments – contractual reserves	(23,203,235)	(28,497,448)
Proceeds from investment sales and maturities – statutory reserves	-	300,000
Purchase of investments – statutory reserves	-	(320,684)
Purchase of fixed assets	(2,323,724)	(1,592,998)
Net cash flows from investing activities from continuing operations	4,326,442	(13,134,349)
Net cash flows from investing activities from discontinued operations	-	(465,946)
NET CHANGE IN CASH AND CASH EQUIVALENTS	11,472,979	2,232,696
CASH AND CASH EQUIVALENTS, beginning of year	19,143,330	16,910,634
CASH AND CASH EQUIVALENTS, end of year	$ 30,616,309	$ 19,143,330
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for interest	$ (3,354)	$ (924)
Cash paid for taxes	$ (3,895,600)	$ (3,247,123)

See accompanying notes to consolidated financial statements.

Note 1 - Nature of Business and Organization

CareOregon, Inc. (the Parent or CareOregon) is contracted with the Oregon Health Authority (OHA) as a fully capitated health plan, and is contracted with several Coordinated Care Organizations (CCOs) to assist them in managing their OHA contracts. Under contract with the OHA, the Parent is a Medicaid managed health care plan that provides health care services to its enrollees by contracting with a network of community and private medical providers throughout the State of Oregon. The Parent pays negotiated fees for services to providers. The contracts with the OHA are renewed annually. The contracts with the CCOs are renewable after terms ranging from one to five years.

CareOregon is organized and operated exclusively for charitable, educational and scientific purposes, including, for such purposes, making distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986. The Parent's mission is to be a community benefit organization to assure Oregon's vulnerable populations receive access to high quality health care from a stable network by a well-managed, financially sound organization.

In April and May 2012, under the Oregon Legislature's plan to transform the Oregon Health Plan (OHP) system through CCOs, the Parent formed three wholly-owned LLC CCOs: Columbia Pacific CCO, LLC; Jackson County CCO, LLC; and PrimaryHealth of Josephine County CCO, LLC. The majority of the Parent's OHP members were transferred to these CCOs as well as two independently formed CCOs, Health Share of Oregon (Health Share), formed in April 2012 and Yamhill County Care Organization, Inc. (Yamhill CCO), formed in July 2012.

In August 2012, Multnomah County Health Department assigned its managed care dental contract with OHA to CareOregon. As a part of the arrangement, CareOregon agreed to improve dental access for OHP members in Multnomah County.

CareOregon has entered into Management Service Agreements with its subsidiaries, Health Share, Yamhill CCO, Oregon's Health Co-Op, and Neighborhood Health Center (Neighborhood Health). Under the terms of the Management Service Agreements, the entities utilize the Parent's personnel, office space, equipment, computer systems, software and operating methodologies to manage their business.

The consolidated financial statements also include the following entities:

Health Plan of CareOregon, Inc. - The Parent formed a for-profit, wholly-owned subsidiary, Health Plan of CareOregon, Inc. (Health Plan) in 2005. Health Plan is a Health Care Service Contractor (HCSC) domiciled in the State of Oregon and is regulated by the Department of Consumer and Business Services (DCBS).

Health Plan is a Medicare Advantage and Prescription Drug Plan (MA-PD) with the Center for Medicare and Medicaid Services (CMS). Health Plan is a Special Needs MA-PD Plan and primarily targets enrollment of Medicaid and Medicare dual eligible members, but also offers a regular Medicare Advantage plan to members.

Note 1 - Nature of Business and Organization (continued)

Care Access LLC - Formed in July 2009, Care Access LLC (Care Access) purchased a medical office building in July 2009, to improve access to primary care in the underserved Rockwood area of Gresham, Oregon. Care Access improved the building and receives rental income from its medical clinic tenant, Multnomah County Health Department.

CareOregon Community Health LLC - The Parent formed a wholly-owned, single-member subsidiary, CareOregon Community Health LLC (Community Health), in April 2010, to provide increased access to quality health care for CareOregon members and those in the clinic communities. Community Health operated three clinics in Washington and Clackamas counties in leased facilities. The Gladstone clinic operated under the direction of Clackamas County Health Department.

Columbia Pacific CCO, LLC - The Parent formed a wholly-owned, single-member subsidiary, Columbia Pacific CCO, LLC (Columbia Pacific), in April 2012, as part of the Oregon Legislature's plan to transform the OHP system through CCOs. Columbia Pacific serves OHP members in Clatsop, Columbia, western Douglas, and Tillamook counties.

Jackson County CCO, LLC - The Parent formed a wholly-owned, single-member subsidiary, Jackson County CCO, LLC (Jackson Care Connect), in May 2012, as part of the Oregon Legislature's plan to transform the OHP system through CCOs. Jackson Care Connect serves OHP members in Jackson County.

PrimaryHealth of Josephine County CCO, LLC - The Parent formed a wholly-owned, single-member subsidiary, PrimaryHealth of Josephine County, LLC (PrimaryHealth), in May 2012, as part of the Oregon Legislature's plan to transform the OHP system through CCOs. PrimaryHealth serves OHP members in Josephine County.

As of October 1, 2011, Community Health contributed assets to form a new independent 501(c)(3) corporate entity, Neighborhood Health, to independently run the existing clinic operations and additionally offer dental services in Oregon City. Support and administrative services are provided by CareOregon, under agreements with Neighborhood Health.

The 2011 consolidated financial statements are presented net of the discontinued operations of Community Health.

Note 2 – Summary of Significant Accounting Policies

Basis of accounting and presentation – The accompanying consolidated financial statements have been prepared in conformity with the accrual basis of accounting whereby revenues are recognized when earned and expenses are recognized when an obligation is incurred. CareOregon and Subsidiaries (the Organization) presents its financial statements in accordance with Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. Under ASC 958, the Organization is required to report information regarding its financial position and activities according to three classes of net worth: unrestricted net worth, temporarily restricted net worth, and permanently restricted net worth. At December 31, 2012 and 2011, all the net worth was unrestricted, subject to contractual and statutory limitations (See Notes 4 and 5).

Principles of consolidation – The consolidated financial statements include the accounts of the Parent and its wholly-owned subsidiaries. All material inter-organization transactions have been eliminated.

Use of estimates – In preparing the financial statements in conformity with Generally Accepted Accounting Principles of the United States of America (GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of financial position, and revenues and expenses for the period. Actual results could differ from those estimates.

Significant estimates in these consolidated financial statements include accrued medical claims payable, maternity case rate receivable and related allowance, premium receivable, reinsurance recoveries receivable, premium deficiency reserve, Medicare advances payable and depreciation and amortization.

Concentrations of risk – Financial instruments, which potentially subject the Organization to concentrations of credit risk, consist of cash and short-term investments. The Organization maintains its cash in accounts that, at times, may exceed federally insured limits. The Organization makes such deposits with high credit quality entities and has not incurred any losses in such accounts. Investments are primarily fixed income securities and by their nature are subject to market interest rate fluctuations. Potential concentrations of credit risk exist due to market concentrations of high quality fixed income investments which react similarly to changing economic conditions.

The Organization's revenues were generated by providing health care services in accordance with the terms of the OHA and CMS contracts, and by providing management services in accordance with the terms of the Management Service Agreements. Loss of the contract(s) and agreement(s) due to non-renewal, federal and state health policy changes, or legislative funding decisions could materially affect the financial position of the Organization. The current CCO OHA contracts are effective through December 31, 2013. The current Managed Care Organization (MCO) OHA contract is effective through September 30, 2013. The Dental Care Organization (DCO) OHA contract is effective through October 31, 2013. The CMS contract is effective through December 31, 2013 and is renewable on an annual basis.

Note 2 – Summary of Significant Accounting Policies (continued)

Segments of the member population are served by concentrations of clinics and hospitals in counties throughout Oregon. Non-renewal of provider contracts could result in limited member access to care. The Organization's personnel, members, patients and provider networks are geographically concentrated in the state of Oregon.

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 Organization'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.

Observable inputs are those assumptions which market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Organization.

Unobservable inputs are assumptions based on the Organization's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

ASC 820, *Fair Value Measurements and Disclosures*, establishes a three-level valuation hierarchy for determining fair value that is based on the transparency of the inputs used in the valuation process. The inputs used in determining fair value in each of the three levels of the hierarchy are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Either: (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data or other pricing sources with reasonable levels of transparency.

Level 3 – Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Note 2 – Summary of Significant Accounting Policies (continued)

The following methods and assumptions were used by the Organization in estimating fair values of each class of financial instruments for which it is practicable to estimate that value, in accordance with the provisions of ASC 825, *Financial Instruments:*

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

Accounts receivable, accounts payable and accrued expenses – The carrying amounts are at historical costs; their respective estimated fair values approximate carrying values due to their current nature.

Investments – The carrying amount approximates fair value, and amounts are based on quoted market prices or alternative pricing sources with reasonable levels of transparency. Fair values and pricing methodology of investments are disclosed in Notes 3 through 6.

Cash and cash equivalents – The Organization considers cash to be cash in the bank or on hand and available for current use. Cash equivalents are investments maturing three months or less from date of purchase. The investments are readily marketable securities and are classified as current assets. Net interest income earned from cash and cash equivalents was $90,139 and $50,775, during 2012 and 2011, respectively.

Investments – unrestricted – Investments are stated at fair market value based on quoted market prices as of the statement of financial position dates (See Notes 3 through 6). The Organization uses the specific identification method for determining the cost basis and gain or loss on its investments.

Investments – statutory reserves – The statutory reserves are required by DCBS for Health Plan, and include treasury bonds and cash, stated at fair market value (See Note 5).

Investments – contractual reserves – The contractual reserves are required by OHA for the Parent, and include cash and securities, stated at fair market value. OHA requires these funds to be held for the purpose of making payments to providers in the event of the Parent's insolvency (See Note 4).

Receivables – Receivables consist primarily of amounts owed to the Organization for capitated premiums, maternity case rate premiums, Patient Centered Primary Care Home (PCPCH) payments, reinsurance recoveries and pharmacy related receivables. The Organization does not require collateral or other security to support the recorded receivable amounts. Management has estimated an allowance against maternity case rate receivables based on an aging analysis and the likelihood of collection.

Note 2 – Summary of Significant Accounting Policies (continued)

Fixed assets – Fixed assets are stated at cost, and are depreciated or amortized using the straight-line method over the estimated useful life. Useful lives are determined by the asset type, and can range from three to thirty years. Land is not depreciated. Significant additions and improvements that increase the estimated useful life of an asset are capitalized. Expenditures for maintenance and repairs are expensed as incurred. Software development and implementation costs are capitalized and amortized over a five-year useful life. Fixed asset purchases totaling less than $2,000 are expensed when purchased.

Revenue recognition – Capitation and premium payments received or accrued are recognized in the period to which the health care services coverage relates. Maternity case rate premiums are recognized in the period that a birth occurs. Management fee revenue is recognized in the period in which the management services are provided.

Hospital Reimbursement Adjustments (HRA), Graduate Medical Education (GME) and PCPCH contractual payments from the OHA, received with capitation and maternity case rate premiums, are recorded in premium revenue and purchased healthcare expenses. The amounts recorded for the year ended December 31, 2012 for HRA, GME and PCPCH payments were $83,024,227, $4,241,918 and $2,909,836, respectively. HRA and GME payments recorded for the year ended December 31, 2011 were $58,027,985 and $6,788,495, respectively.

Federal reinsurance and low-income cost sharing subsidy payments received from CMS are accounted for as premium revenue as the Medicare Part D (pharmacy) expenses are incurred. Subsidy amounts received, but not yet included in premium revenue, are recorded as Medicare advances payable. Amounts included in premium revenue and purchased healthcare expenses for 2012 and 2011 were $20,801,733 and $21,102,109, respectively.

Net investment income – Investment income consists of interest earnings, dividends, and both realized and unrealized gains and losses. Premiums and discounts on fixed income securities are recognized as adjustments to investment income using the scientific interest method. Interest on fixed income securities is recognized in income on an accrual basis. Investment income is presented net of investment transaction, custodial and advisory fees, which are expensed as incurred. Interest and dividends represent amounts earned on investment holdings, and are accrued when earned. Realized investment gains and losses represent capital gains and losses. Unrealized gains or losses represent net changes in fair market value.

Accrued medical claims payable and claims adjudicated pending payment – Accrued medical claims payable represents an estimate of medical costs incurred, but not yet billed and processed, through the date of the statement of financial position. The claims adjudicated pending payment includes amounts billed, processed and pending payment.

Note 2 – Summary of Significant Accounting Policies (continued)

Management's evaluation of the adequacy of the accrued medical claims payable is based on a review of utilization data, an analysis of claims paid after the statement of financial position date, and an actuarial review of historical claims experience. It is at least reasonably possible that the estimated accrued medical claims payable will change in the near-term. Actual medical expenses were higher than estimated amounts in 2011 and lower in 2010, resulting in an increase in purchased healthcare expenses during 2012 and 2011 of $4,448,100.

Premium deficiency reserve – In accordance with ASC 450, *Contingencies*, the Organization records a premium deficiency reserve (PDR) to recognize anticipated losses on contracts. A deficiency is calculated based on the expected revenue less expected medical and administrative costs plus an adjustment for expected investment income. Assumptions are based on actual and anticipated membership levels, claims experience, administrative cost budgets and forecasted rates of return on investments. This reserve is subjected to an actuarial review and analysis (See Note 9).

Managed care contracts payable – Medicaid premiums earned during 2012 and 2011 were subject to hospital reimbursement adjustment (HRA), and graduate medical education (GME) payments, and a 1% managed care organization (MCO) tax rate. The Parent accrued MCO taxes, HRA and GME payables as the revenues were received.

Patient Centered Primary Care Home Payable – PCPCH was accrued as the revenues were received.

Accrued gainshare – When the Parent's medical costs for Health Share members are below target levels, the gain will be used in accordance with a policy agreed upon by the Parent and the contracted providers. The gainshare is recorded when the amount is determinable. For the year ended December 31, 2012, CareOregon accrued $3,000,000 under the gainshare agreement.

Medicare advances payable – Health Plan receives federal reinsurance and low-income cost sharing subsidy payments from CMS related to its Medicare Part D coverage. Amounts received are recorded as Medicare advances payable until the related expenses have been incurred. Once incurred, the amounts received are recognized as revenue and are wholly offset against the related expenses.

Care Support and System Innovation (CSSI) program – The Parent supports the goal of improving the health of its members and the community through the CSSI program. Using a project format, the CSSI program identifies and funds innovative provider-based projects. Primary care clinics, specialists, hospitals, and ancillary providers may qualify to receive project funds as part of their compensation. CSSI program expense is recognized over the project funding period. Total CSSI program expenses for the years ended December 31, 2012 and 2011 were $3,685,671 and $2,738,283, respectively. Program amounts are established annually by the Organization's Board of Directors, based on available funds.

Note 2 – Summary of Significant Accounting Policies (continued)

Reinsurance – Reinsurance premiums are reported as a cost of purchased healthcare services and reinsurance recoveries are reported as a reduction of related purchased healthcare services.

Risk corridor payable – The federal government and Health Plan share profit and losses on the Medicare Part D benefit around a target amount within defined risk corridors determined in the annual Medicare bid. At December 31, 2012 and 2011, Health Plan had an experience rating refund liability and revenue reduction of $866,655 and $505,655, respectively, related to the anticipated risk corridor adjustment.

Income taxes – The Internal Revenue Service has recognized CareOregon as exempt from federal income taxes under provisions of Section 501(c)(3) of the Internal Revenue Code.

Income taxes arise primarily from the tax effects of the for-profit Health Plan's transactions reported in the financial statements, and consist of taxes currently due plus deferred taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary timing differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, measured by enacted tax rates for years in which the taxes are expected to be paid or recovered.

Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The factors used to assess the likelihood of realization include the Organization's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Failure to achieve forecasted taxable income in applicable tax jurisdictions would not affect the ultimate realization of deferred tax assets in 2011, due to sufficient taxes paid in 2010 and 2009 available for net operating loss (NOL) carryback, though it could result in an increase in the Organization's effective tax rate on future earnings beyond the available carryback periods.

The wholly-owned subsidiaries, CareOregon Community Health, LLC; Care Access, LLC; Columbia Pacific CCO, LLC; Jackson County CCO, LLC; and PrimaryHealth of Josephine County CCO, LLC, are single-member limited liability corporations, working to further CareOregon's exempt purpose. Care Access and Community Health are treated as disregarded entities for federal tax purposes and are reported with the Parent's financial results on its Form 990.

Note 2 – Summary of Significant Accounting Policies (continued)

The Organization recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Organization recognizes interest and penalties related to income tax matters in interest expense and other administrative expenses, respectively. Management regularly assesses the likelihood that deferred tax assets will be recovered from future taxable income, and records a valuation allowance, if necessary, to reduce deferred tax assets to the amounts believed to be realizable. See Note 11 for additional details.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before consolidated financial statements are issued. The Organization recognizes in the consolidated financial statements the effect 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 consolidated financial statements.

The Organization'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 consolidated financial statements are issued. The Organization has evaluated subsequent events through May 17, 2013, which is the date the consolidated financial statements were issued.

Note 3 – Investments – Unrestricted

The amortized cost basis and estimated fair market value of the Organization's unrestricted investments are as follows:

	December 31, 2012		December 31, 2011	
	Cost	Fair Market Value	Cost	Fair Market Value
U.S. Treasury Notes	$ 29,107,170	$ 33,070,744	$ 29,605,204	$ 33,015,544
U.S. Government Agency Bonds	15,438,807	16,377,328	11,792,470	12,967,986
Municipal bonds	13,346,298	15,343,308	5,210,077	5,606,448
Corporate bonds	58,322,665	62,367,064	53,460,656	56,150,316
Mutual and commingled funds	23,894,256	29,808,875	28,932,614	32,144,402
Other asset backed securities	20,062,580	20,985,123	28,132,801	29,408,081
	$ 160,171,776	$ 177,952,442	$ 157,133,822	$ 169,292,777

Note 3 – Investments – Unrestricted (continued)

Investment income from unrestricted investments includes interest and dividend income of $6,131,216 and $5,618,280 in 2012 and 2011, respectively. Unrealized and realized gains/losses are as follows:

	2012	2011
Unrealized Losses	$ -	$ (739,417)
Realized Losses	(14,564)	-
Unrealized Gains	5,621,710	3,175,960
Realized Gains	481,540	1,039,127
	$ 6,088,686	$ 3,475,670

As of December 31, 2012 and 2011, there were no investments that were in a continuous loss position for 12 months or longer. In accordance with its impairment policy, there were no other-than-temporary impairment (OTTI) losses recorded in 2012 or 2011. See Notes 4 through 6 for additional fair value disclosure.

Note 4 – Investments – Contractual Reserves

Investments – Contractual Reserves, as of December 31, 2012 and 2011, consist of government and corporate bonds, U.S. Treasury notes and money market funds. These funds are restricted as to their use, and are held to satisfy required risk-based reserves established by the OHA for the Parent.

As of December 31, 2012, the amortized cost basis and the estimated fair market value of the contractual reserves are $9,895,616 and $9,895,861, respectively, as compared to $20,072,104 and $20,069,826 as of December 31, 2011, respectively.

Investment income includes interest and dividend income of $13,106 and $23,054 in 2012 and 2011, respectively. Investment earnings also include unrealized gain of $2,523 in 2012 and unrealized loss of $1,717 in 2011.

Note 5 – Investments – Statutory Reserves

Investments – Statutory Reserves, as of December 31, 2012 and 2011, consist of U.S. Treasury notes. These funds are required for Health Plan by the DCBS.

As of December 31, 2012, the amortized cost basis and quoted fair market value of the statutory reserves are $303,334 and $310,570, respectively, as compared to $320,684 and $322,194 as of December 31, 2011, respectively.

Investment income includes interest income of $13,320 in 2012 and $14,935 in 2011. Unrealized losses of $7,890 and $13,493 were recorded in 2012 and 2011, respectively.

Note 6 – Fair Value of Investments

The table below shows the Organization's investments as of December 31, 2012 and 2011 measured at fair value on a recurring basis, and indicates the fair value hierarchy of the valuation techniques utilized by the Organization to determine such fair value. Assets and liabilities are considered to be "fair value on a recurring basis" if fair value is regularly measured.

While estimates of fair value are based on management's judgment of the most appropriate factors, there can be no assurance that had the Organization disposed of such items at December 31, 2012 and 2011, the estimated fair values would necessarily have been achieved at that date. Since market values may differ depending on various circumstances, the estimated fair values as of December 31, 2012, should not necessarily be considered to apply at subsequent dates.

Investments measured at fair value are comprised of marketable securities and alternative investments. Marketable security fair values are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Alternative investments are valued at fair value using significant unobservable inputs. The Organization considers alternative investments to include only those investments whose underlying investments are not marketable securities. The values of these investments are determined by fund managers and valuation experts, using relevant market data.

Note 6 – Fair Value of Investments (continued)

	Fair Value Measurements at December 31, 2012				
	Total Fair Value	Level One	Level Two	Level Three	
Money market funds – restricted	$ 6,268,489	$ 6,268,489	$ -	$ -	
Government					
U.S. Treasury Notes	37,008,686	37,008,686	-	-	Note a
Ontario and Quebec Province	473,581	-	473,581	-	
U.S. Agency Bonds	15,903,747	-	15,903,747	-	Note b
Corporate bonds	62,367,064	-	62,367,064	-	Note c
U.S. stock market index equities	29,808,875	29,808,875	-	-	
Taxable state municipal bonds	15,343,308	-	15,343,308	-	
Alternative investments					
Asset backed securities	7,432,550		7,432,550		
Asset backed securities	13,552,573	-	13,552,573	-	

Note a – This class consists of US Treasuries and TIPS investments.
Note b – This class includes FHLB, FNMA, FHLMC, GNMA and similar bond investments.
Note c – This class consists primarily of investments in US Corporate Bonds of large cap companies and includes bonds in the energy, information technology, utilities, financial services, retail, consumer products, transportation and pharmaceutical sectors.

The transfer of Level Two U.S. stock market index equities to Level One within the hierarchy from 2011 to 2012 was due to market data being available for these investments in active markets for identical investments.

	Fair Value Measurements at December 31, 2011			
	Total Fair Value	Level One	Level Two	Level Three
Money market funds – restricted	$ 4,556	$ 4,556	$ -	$ -
Government				
U.S. Treasury Notes	53,403,008	53,403,008	-	-
Quebec Province	222,520	-	222,520	-
U.S. Agency Bonds	12,745,466	-	12,745,466	-
Corporate bonds	56,150,316	-	56,150,316	-
CMO	7,103,422	-	7,103,422	-
U.S. stock market index equities	25,243,126	25,243,126	-	-
Taxable state municipal bonds	5,606,448	-	5,606,448	-
Mortgage pass through	16,316,361	-	16,316,361	-
Alternative investments				
Asset backed securities	6,901,276	-	6,901,276	-
Asset backed securities	2,404,378	-	2,404,378	-
Commercial MBS	3,583,920	-	3,583,920	-
	$ 189,684,797	$ 78,650,690	$111,034,107	$ -

Note a – This class consists of US Treasuries and TIPS investments.
Note b – This class includes FHLB, FNMA, FHLMC and similar bond investments.
Note c – This class consists primarily of investments in US Corporate Bonds of large cap companies and includes bonds in the energy, information technology, utilities, financial services, retail, consumer products, transportation and pharmaceutical sectors.

Note 6 – Fair Value of Investments (continued)

Investments at December 31 consist of the following:

	2012	2011
Investments – unrestricted	$ 177,952,442	$ 169,292,777
Investments – statutory reserves	310,570	322,194
Investments – contractual reserves	9,895,861	20,069,826
	$ 188,158,873	$ 189,684,797

The Organization's interests in alternative investments represent 4.0% and 3.6% of the total investments as of December 31, 2012 and 2011, respectively. These instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition.

Note 7 – Reinsurance

In the normal course of business, the Organization seeks to limit its exposure to a loss on any single member, and to recover a portion of benefits paid by ceding reinsurance risks under excess coverage agreements. Reinsurance agreements do not relieve the Organization from its obligation to pay providers.

Amounts recoverable from reinsurance contracts are estimated in a manner consistent with the claim limits and conditions associated with the reinsurance policy. Reinsurance premiums and recoveries are reported as components of medical costs. In addition, the Organization is required to obtain certain reinsurance coverage as a contractor of OHA and CMS.

The reinsurer for CareOregon and Health Plan assumed 90% of the combined risk for hospital and physician services, in excess of $350,000 and $300,000, respectively, in 2012, and $300,000 for both entities in 2011. Aggregate coverage per single member was $2,000,000 for combined services in 2012 and 2011. In addition to the private reinsurance coverage, CMS provided reinsurance on the Medicare Part D benefit by assuming 80% of the risk on claims paid in excess of $6,658 during 2012 and $6,448 during 2011.

Total reinsurance premiums incurred in 2012 and 2011 were $2,791,442 and $3,751,938, respectively. Reinsurance recoveries earned in 2012 and 2011 were $1,382,746 and $1,455,504, respectively.

Note 8 – Fixed Assets

Fixed assets at December 31 consist of the following:

	2012	2011
Land	$ 2,704,520	$ 2,704,520
Building	17,995,061	17,878,581
Computer software costs	6,245,246	5,924,288
Computer equipment	7,375,629	6,351,870
Office furnishings	2,042,058	2,002,137
Office equipment	1,160,555	1,082,185
Leasehold improvements	248,680	-
Work-in-process	1,111,968	617,712
	38,883,717	36,561,293
Less accumulated depreciation and amortization	(17,966,732)	(14,918,709)
	$ 20,916,985	$ 21,642,584

Work-in-process assets are various fixed assets purchased and not yet placed in service. The majority of work-in-process assets include costs incurred to upgrade the elevator system and remodel and furnishing costs for the newly leased space at the Lincoln Building.

Total depreciation and amortization expense in 2012 and 2011 was $3,048,023 and $2,741,131, respectively.

Community Health contributed many of its assets to Neighborhood Health on October 1, 2011 with a net book value of $594,686, approximating the assets' fair market value. As a result, no gain or loss was recognized upon the transfer.

Note 9 – Premium Deficiency Reserve

The Organization recorded a premium deficiency reserve (PDR) as described in Note 2. PDR estimates require complex assumptions regarding membership growth, shifts in member mix, changes in medical costs, utilization, projections of administrative costs and investment income. Actual results can vary from estimates. The Organization recorded PDR estimates, which affected purchased healthcare expenses of $8,000,000 (1.7% of premium revenue) and $7,000,000 (1.4% of premium revenue) at the end of December 31, 2012 and 2011, respectively. No losses were incurred for 2012, due to better performance than anticipated. The net impact of recording the PDR's and the related amortization on purchased healthcare expenses was an increase of $1,000,000 in 2012 and a decrease of $9,000,000 in 2011.

Note 10 – Employee Benefit Plans

The Parent has established a 401(k) plan covering all employees who are at least 18 years of age. The Parent matches 100% of employee deferrals up to 2% of compensation for participants who have worked 500 hours or more during the plan year. The plan includes a 3% non-discretionary safe harbor employer contribution which immediately vests. Supplemental discretionary employer contributions are determined each year by the Organization's Board of Directors. Eligible compensation is defined by the plan document. The discretionary contribution rate was 4% of eligible compensation in both 2012 and 2011. Discretionary contributions become fully vested after three years of service. Employees who work 1,000 or more hours during the plan year are considered vested for that plan year.

The Organization made 401(k) contributions of approximately $1,742,880 and $1,682,356 for the years ended December 31, 2012 and 2011, respectively. The total 401(k) plan contribution payable was $836,027 at December 31, 2012 and $61,646 at December 31, 2011.

The Plan has two voluntary deferred compensation plans under Sections 457(b) and 457(f) of the Internal Revenue Code. Qualification for participation in the two plans is limited to directors, managers and supervisors. During 2012 and 2011, the 457(b) plan allowed for a per employee maximum elective deferral of $17,000 and $16,500 per year, respectively. The 457(f) plan allows for employee deferrals up to 100% of salary and bonuses, though significant plan restrictions apply to the timing and availability of future distributions. The 457 plans allow for voluntary employer contributions.

The 457 plans result in unsecured liabilities owed by the Parent to the participants for future payments. Should the Parent become insolvent, the employee deferrals would be considered "unsecured assets" and, as such, would be available to satisfy all creditor claims.

The Parent made no voluntary employer contributions to the 457 plans during 2012 and 2011. The total 457 plans' contribution payable was $15,419 and $7,233 as of December 31, 2012 and 2011, respectively.

Note 11 – Income Taxes

Income taxes relate primarily to the Organization's for-profit Health Plan. Start-up expenses are expensed when incurred in accordance with GAAP, but are amortized over 15 years for tax purposes. There were no PDR reserves for Health Plan in either 2012 or 2011.

The Organization files income tax returns in the U.S. federal, state, and local jurisdictions. Tax years 2009 – 2012 remain subject to examination by those tax jurisdictions. The Organization does not have any uncertain tax positions. As of December 31, 2012, there was no accrued interest or penalties recorded in the financial statements.

Note 11 – Income Taxes (continued)

The components of the deferred tax assets in the accompanying statements of financial position are as follows:

	2012	2011
Current deferred tax asset (liability):		
Accrued medical claims related	$ 454,286	$ 318,282
Start-up costs	50,567	50,567
Other	6,141	4,747
	$ 510,994	$ 373,596
Non-current deferred tax asset (liability):		
Start-up costs	$ 353,966	$ 404,533
Unrealized gains	(1,084,217)	(905,469)
	$ (730,251)	$ (500,936)

No valuation allowance was needed on deferred tax assets.

Total deferred tax assets at December 31, 2012 and 2011 were $864,960, and $778,129, respectively.

Total deferred tax liabilities at December 31, 2012 and 2011 were $1,084,217 and $905,469, respectively.

The components of income tax expense are as follows:

	2012	2011
Health Plan:		
Current federal	$ 2,141,691	$ 3,207,372
Current state and local	715,983	1,201,637
Current income tax expense	2,857,674	4,409,009
Deferred federal	73,100	307,506
Deferred state and local	18,817	32,118
Deferred income tax expense	91,917	339,624
Health Plan income tax provision	2,949,591	4,748,633
Parent income tax provision on unrelated business income	4,000	5,800
Total income tax expense	$ 2,953,591	$ 4,754,433

Note 11 – Income Taxes (continued)

The statutory rate at which Health Plan provides for income taxes differs from the effective tax rate under GAAP primarily due to the following:

	Year ended December 31,			
	2012		2011	
	Amount	Rate	Amount	Rate
Health Plan provision computed at the statutory rate	$ 2,453,479	34.0%	$ 3,918,553	34.0%
Reconciling items net of federal tax benefit:				
State and local income taxes	485,154	7.2%	825,198	7.2%
Other	10,958	0.0%	4,882	0.0%
Health Plan income tax provision	$ 2,949,591	41.2%	$ 4,748,633	41.2%
Parent income tax provision unrelated business income tax	$ 4,000		$ 5,800	
	$ 2,953,591		$ 4,754,433	

Note 12 – Related-Party Transactions

In 2012 and 2011, the Organization's Board of Directors included representatives from the following entities that maintain contractual agreements or other transactions with the Organization: Albertina Kerr, Legacy Health System, Multnomah County Health Department, The Oregon Health Care Quality Corporation, Pacific Medical Group, St. Charles Health System and Virginia Garcia Memorial Health Center.

The contractual agreements cover transactions in the normal course of business for medical services, network development, CSSI projects, rental agreements, operating agreements and charitable contributions. Payments to the related entities totaled $75,652,852 and $93,592,671 in 2012 and 2011, respectively. Rental payments by Multnomah County Health Department to the Organization were $284,568 and $221,218 in 2012 and 2011, respectively.

Neighborhood Health: CareOregon provides certain management services to Neighborhood Health under an informal agreement. Management services revenue earned under this agreement total $285,029 for the year ended December 31, 2012.

CareOregon made several charitable contributions to Neighborhood Health to cover operating costs beyond revenues as it pursued Federally Qualified Health Center (FQHC) status, totaling $2,743,416 and $4,112,500 in 2012 and 2011, respectively. Community Health made monthly charitable contributions to fund operating losses of the Neighborhood Health Pain and Specialty Clinic in Washington County totaling $884,515 and $691,935 in 2012 and 2011, respectively.

Note 12 – Related-Party Transactions (continued)

Under a Provider Agreement with Neighborhood Health in the normal course of business, CareOregon incurred $2,859,696 and $543,950 of medical services costs during 2012 and 2011, respectively.

Total amounts receivable from Neighborhood Health as of December 31, 2012 were $109,862. Total amounts payable to Neighborhood Health as of December 31 2012 were $145,926,

Yamhill CCO: CareOregon and Yamhill CCO have entered into a Management Services Agreement effective November 1, 2012 through December 31, 2014. The contract calls for automatic one-year renewals through December 31, 2017, unless and until either party provides written notice of non-renewal at least 120 days prior to the end of the then-current term. Under the terms of the Management Services Agreement, the Parent is to administer the delivery of Physical Health Services on behalf of Yamhill CCO. In addition, under the Management Services Agreement, Yamhill CCO will utilize the Parent's personnel, office space, equipment, computer systems, software and operating methodologies to manage its business. Management services revenue earned under this agreement totaled $473,183 for the year ended December 31, 2012.

In October 2012, CareOregon and Yamhill CCO entered into a Grant Agreement. Under the terms of the Grant Agreement, CareOregon contributed the following to Yamhill CCO: $2,400,000 to be used solely as their primary and secondary restricted reserve requirements in accordance with Yamhill CCO's OHA Contract; $600,000 to be used to fund Yamhill CCO's start-up and operating costs; and $500,000 to fund Yamhill CCO's Transformation Fund.

Total amounts receivable from Yamhill CCO as of December 31, 2012 were $474,183. Total amounts payable to Yamhill CCO as of December 31 2012 were $41,389.

Health Share: In April 2012, CareOregon and Health Share entered into a Management Services Agreement. The Management Services Agreement is effective for an initial term of five years and shall be automatically renewed for additional one-year terms following the initial term unless either party notifies the other of its intentions not to renew at least 180 days prior to the end of the then-current term. Under the terms of the Management Services Agreement, the Parent shall provide certain management services to Health Share including staff, human resources, space, furnishings, supplies, financial services, IT services, and customer services. Management services revenue earned under this agreement totaled $1,382,665 for the year ended December 31, 2012.

Note 12 – Related-Party Transactions (continued)

In August 2012, CareOregon and Health Share entered into a Grant Agreement. Under the agreement, CareOregon contributed $16,500,000 to Health Share to establish their restricted reserve account required under the OHA contract. This contribution is reflected in the other administrative expenses line. The contribution is required to be returned to CareOregon upon the occurrence of certain events defined in the Grant Agreement. Health Share is required to return all or a portion of the contribution to CareOregon in the event of dissolution or winding up on or before September 1, 2022 or if the OHA terminates its agreement with Health Share on or before September 1, 2022. The amount of contribution to be returned to CareOregon would be the amount remaining after discharge of all liabilities and obligations of Health Share. Further, if Health Share is in existence on September 1, 2022 and under the terms of the OHA contract, the amount of the primary and secondary reserve requirements for Health Share on September 1, 2022 is less than the amount of the grant, then Health Share shall return to CareOregon any portion of the grant that is in excess of the minimum reserves amount required to be maintained. The grant agreement releases restrictions on donated reserves after ten years if reserves are still needed and Health Share is still operating under a similar Medicaid agreement with OHA.

CareOregon and Health Share have entered into a Risk Accepting Entity Participation Agreement (RAE Agreement) effective September 1, 2012 through December 31, 2013, which is automatically renewed for successive one-year terms until the agreement is terminated. Under the RAE Agreement, the Parent will arrange for services to Members on a fully-capitated basis, where the Parent retains the risk.

Capitated revenue received from Health Share under the agreement during 2012 equaled $99,259,679. Total amounts receivable from Health Share as of December 31, 2012 were $569,891. Total amounts payable to Health Share as of December 31 2012 were $100.

Multnomah County Health Department: Rental payments by Multnomah County Health Department to the Organization were $284,568 and $221,218 in 2012 and 2011, respectively. The rental agreement which was effective October 1, 2011, is for seven years with two five-year renewal options. The lease is cancellable by either party with six months written notice.

Oregon's Health CO-OP: In March 2012, CareOregon and Oregon's Health CO-OP entered into a Management Services Agreement. The Management Services Agreement is effective through December 31, 2016 with the option to negotiate a renewal or extension to be exercised prior to April 29, 2016. Under the terms of the Management Services Agreement, the Parent shall provide certain management services to Oregon's Health CO-OP including staff, human resources, space, furnishings, supplies, financial services, IT services, and customer services. Management services revenue earned under this agreement totaled $541,227 for the year ended December 31, 2012.

During 2012, CareOregon's board committed to pay $1,000,000 to Oregon's Health CO-OP to fund marketing for their company. This amount was paid in January 2013.

During 2012, CareOregon contributed in-kind legal fees to Oregon's Health CO-OP totaling $280,371. Total amounts receivable from Oregon's Health CO-OP as of December 31, 2012 were $212,079.

Note 13 - Commitments and Contingencies

Rental Agreements - Lessee

During 2012, the Parent entered into a new sublease for one floor of the Lincoln Building. The lease term is 36 months, expiring August 31, 2015. Total rental expense was $107,258 for the year ended December 31, 2012.

Effective October 1, 2011, Neighborhood Health Center accepted the responsibility for the following lease payments and rental expense for the last three months of 2011 and all of 2012. Community Health remains the legal lessee in the lease contracts.

Community Health leases the Milwaukie clinic facility under a cancelable operating lease. The lease expired June 30, 2011 and has been on a month-to-month lease since June 30, 2011. The amount paid under the agreement by Community Health prior to October 1, 2011 was $87,413.

Community Health leases the Beaverton clinic facilities under two non-cancelable operating leases. The leases expire December 15, 2015 and contain fixed payment increases at predetermined intervals over the life of the leases. Lease expense is recognized on a straight-line basis over the life of the lease. Total 2011 rental expense prior to October 1, 2011 for the non-cancelable operating leases was $46,125.

During 2011, Community Health entered a new lease for the dental operation in Oregon City. The lease term is 120 months, expiring September 14, 2021.

Future minimum lease payments under the non-cancelable operating leases are as follows:

Year ending December 31:	2013	$ 453,617
	2014	458,229
	2015	361,082
	2016	30,164
	2017	31,070
	thereafter	114,666
		$ 1,448,828

Note 13 – Commitments and Contingencies (continued)

Rental Agreements – Lessor

The Organization occupied approximately 100% of its office building space during the second half of 2012 and 95% of its office building space during the first half of 2012 and all of 2011. Rental income earned in 2012 and 2011 was $36,018 and $72,036, respectively. Through June 2012, the Parent had one tenant in the building.

Care Access purchased a medical office building in July 2009 and completed its renovation in August 2010. Care Access entered a seven-year lease agreement with Multnomah County in August 2010 and signed the first amendment in October 2011 when it was fully occupied. Rental income earned in 2012 and 2011 was $284,568 and $221,218, respectively.

Future minimum lease income from the medical building under operating leases is as follow:

Year ending December 31:	2013	$ 284,568
	2014	284,568
	2015	284,568
	2016	284,568
	2017	165,998
		$ 1,304,270

Note 14 – Retrospectively Rated Policies

Premium revenue includes revenue subject to retrospective rating features. CMS and Health Plan share profit and losses on the Part D (pharmacy) benefit within defined risk corridors around a target amount determined in the annual Medicare bid. At December 31, 2012 and 2011, Health Plan had an experience rating refund liability of $866,655 and $505,655, respectively, and a reduction of premium revenue of $695,478 and $333,403, respectively, related to the anticipated risk corridor adjustment. The amount of net premiums written by Health Plan in the years ended December 31, 2012 and 2011 subject to retrospective rating features were $12.2 million and $10.8 million, respectively.

Note 15 – Subsequent Events

On March 13, 2013, CareOregon, created LHW, LLC for the sole purpose of purchasing certain assets of Lean Healthcare West and continuing to operate its business activities. Lean Healthcare West provides training to individuals and organizations in implementing lean business practices in the health care industry, and sells and licenses training and other materials on implementing lean business practices in the health care industry. The Asset Purchase Agreement between CareOregon and Lean Healthcare West was effective March 29, 2013, and was for the amount of $2,000,000.

In February 2013, the Board of CareOregon approved $4,200,000 of additional contributions to Neighborhood Health payable in quarterly installments upon the completion of certain established goals. The contribution is being provided to support Neighborhood Health's anticipated operating losses through December 31, 2013.

Since December 31, 2012, OHA has notified the Organization that it will recoup PCPCH payments due to an error in enrollment data. These payments were originally received by the Parent during 2012 and were paid out to providers. The total expected recoupment is not known at this time, as OHA has yet to calculate the total net recoupment.

As Oregon's government agencies continue to manage the State's budget and resources, cuts in capitation rates paid to managed care plans, such as the Parent, along with reductions in benefits offered to members under the Oregon Health Plan may occur.

Note 16 – Information Concerning Subsidiaries and Affiliates

During the twelve months ended December 31, 2012 and 2011, the subsidiaries incurred management fees (See Note 1). These monthly management fees were settled within 30 days, and did not incur any related interest expense. The management fees are as follows:

	2012	2011
Health Plan	$ 8,805,675	$ 8,852,151
Community Health	24,000	129,857
Columbia Pacific	151,088	-
Jackson Care Connect	175,713	-
Primary Health	89,064	-
	$ 9,245,540	$ 8,982,008

Amounts due from subsidiaries represent unpaid charges by the Parent for management services provided and claims paid by the Parent on behalf of the subsidiary. The amounts due to the Parent at December 31, 2012 and December 31, 2011 were as follows:

Note 16 – Information Concerning Subsidiaries and Affiliates (continued)

	2012	2011
Health Plan	$ 792,862	$ 1,536,135
Care Access	294	588
Community Health	4,244	87,305
Columbia Pacific	91,449	-
Jackson Care Connect	89,999	-
Primary Health	43,763	-
	$ 1,022,611	$ 1,624,028

Amounts due from the Parent to Health Plan represent expenses paid by Health Plan on behalf of the Parent. The amounts due from the Parent at December 31, 2012 and 2011 were $8,798 and $9,732, respectively.

Amounts due from the Parent and Health Plan to Community Health, represent the cost of medical professionals performing services on behalf of the Parent and Health Plan. The amount due to Community Health from the Parent and Health Plan was $17,209 for the year ended December 31, 2011.

The Parent made equity transfers to its subsidiaries in 2012 in the following amounts:

Community Health	$ 500,000
Columbia Pacific	2,500,000
Jackson Care Connect	3,000,000
Primary Health	2,500,000
	$ 8,500,000

The Parent contributed Transformation Fund amounts to its subsidiaries in 2012 as follows:

Columbia Pacific	$ 250,000
Jackson Care Connect	1,000,000
Primary Health	250,000
	$ 1,500,000

Health Plan files required regulatory reports and financial statements with the DCBS in accordance with Statutory Accounting Principles (SAP). Prescribed SAP includes a variety of provisions outlined in publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations and general administrative rules.

Note 16 – Information Concerning Subsidiaries and Affiliates (continued)

Differences between statutory reserves/unassigned surplus and statutory net income and change in net worth, as determined on a GAAP basis, primarily relate to differences in accounting for investments and for non-admitted assets, which include pharmacy rebate receivables, prepaid expenses and deferred tax assets.

Health Plan is required by DCBS to maintain a minimum net capital of $2,500,000 and at least 300% of the authorized control level risk-based capital (RBC) as calculated in accordance with the NAIC. At December 31, 2012 and 2011 Health Plan's net capital and RBC exceeded the minimum requirements.

Note 17 – Health Care Reform

As a result of enacted federal health care reform legislation in 2010, and upheld by the Supreme Court in 2012, substantial changes are anticipated in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over approximately the next decade. This federal health care reform legislation did not affect the 2012 or 2011 financial statements.

SUPPLEMENTARY INFORMATION

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CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION – DECEMBER 31, 2012

	CareOregon	Medicare Health Plan	Rental Prop Care Access LLC	Community Health LLC	Columbia Pacific LLC	Jackson Care Connect LLC	PrimaryHealth Josephine County	Combined	Eliminations	Consolidated
CURRENT ASSETS										
Cash and cash equivalents	$ 14,988,765	$ 11,245,708	$ 460,981	$ 201,452	$ 584,206	$ 1,387,944	$ 1,747,253	$ 30,616,309	$ -	$ 30,616,309
Investments – unrestricted	130,730,648	47,221,794	-	-	-	-	-	177,952,442	-	177,952,442
Maternity case rate receivable, net of allowance for doubtful accounts of $828,339 in 2012	10,253,201	-	-	-	907,175	1,333,614	374,761	12,868,751	(2,218,381)	10,650,370
PCPCH receivable	2,506,932	-	-	-	-	-	-	2,506,932	-	2,506,932
Reinsurance recoveries receivable	675,000	40,000	-	-	-	-	-	715,000	-	715,000
Interest receivable	769,581	435,014	-	-	-	-	-	1,204,595	-	1,204,595
Pharmacy rebates receivable	3,902,121	808,298	-	-	-	-	-	4,710,419	-	4,710,419
Premium receivable	-	1,084,141	-	-	-	-	-	1,084,141	-	1,084,141
Contract receivable	-	-	-	-	-	-	-	-	-	-
Other receivables	2,386,440	56,844	-	36,498	-	13,214	12,285	2,505,281	-	2,505,281
Prepaid expenses	2,488,866	4,639	3,460	1,684	-	-	-	2,498,649	-	2,498,649
Deferred tax asset	-	510,994	-	-	-	-	-	510,994	-	510,994
Intercompany receivable	1,022,611	8,798	-	-	-	-	-	1,031,409	(1,031,409)	-
Total current assets	169,724,165	61,416,230	464,441	239,634	1,491,381	2,734,772	2,134,299	238,204,922	(3,249,790)	234,955,132
ASSETS LIMITED AS TO USE										
Investments – statutory reserves	-	310,570	-	-	-	-	-	310,570	-	310,570
Investments – contractual reserves	3,629,161	-	-	-	2,363,900	2,882,900	1,019,900	9,895,861	-	9,895,861
Total assets limited as to use	3,629,161	310,570	-	-	2,363,900	2,882,900	1,019,900	10,206,431	-	10,206,431
FIXED ASSETS, net of accumulated depreciation and amortization of $17,966,732	18,014,756	-	2,902,229	-	-	-	-	20,916,985	-	20,916,985
LEASE DEPOSIT	16,250	-	-	9,886	-	-	-	26,136		26,136
INVESTMENT IN SUBSIDIARY	11,400,000	-	-	-	-	-	-	11,400,000	(11,400,000)	-
Total assets	$202,784,332	$ 61,726,800	$ 3,366,670	$ 249,520	$ 3,855,281	$ 5,617,672	$ 3,154,199	$280,754,474	$ (14,649,790)	$266,104,684

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION – DECEMBER 31, 2012

	CareOregon	Health Plan	Care Access LLC	Community Health LLC	Columbia Pacific LLC	Jackson Care Connect LLC	PrimaryHealth Josephine County	Combined	Eliminations	Consolidated
CURRENT LIABILITIES										
Accrued medical claims payable	$ 39,904,177	$ 13,644,698	$ -	$ -	$ -	$ -	$ -	$ 53,548,875	$ -	$ 53,548,875
Claims adjudicated pending payment	2,848,125	1,365,901	-	-	-	-	-	4,214,026	-	4,214,026
Premium deficiency reserve	8,000,000	-	-	-	-	-	-	8,000,000	-	8,000,000
Managed care contracts payable	326,892	-	-	-	163,974	229,829	-	720,695	-	720,695
PCPCH payable	2,558,962	-	-	-	-	-	128	2,559,090	-	2,559,090
Accrued Gainshare	3,000,000	7,000	-	-	-	-	-	3,007,000	-	3,007,000
Accounts payable and accrued expenses	5,314,329	221,702	2,491	298,957	902,215	1,320,278	370,076	8,430,048	(2,218,381)	6,211,667
Medicare advances payable	-	2,193,083	-	-	-	-	-	2,193,083	-	2,193,083
Risk corridor payable	-	866,655	-	-	-	-	-	866,655	-	866,655
Accrued payroll and benefits	2,599,946	-	-	-	-	-	-	2,599,946	-	2,599,946
Premium recoupment payable	1,543,004	353,547	-	-	-	-	-	1,896,551	-	1,896,551
Intercompany payable	8,798	792,862	294	4,244	91,449	89,999	43,763	1,031,409	(1,031,409)	-
Total current liabilities	66,104,233	19,445,448	2,785	303,201	1,157,638	1,640,106	413,967	89,067,378	(3,249,790)	85,817,588
DEFERRED RENT	-	-	23,714	-	-	-	-	23,714	-	23,714
NON-CURRENT DEFERRED TAXES	-	730,251	-	-	-	-	-	730,251	-	730,251
NET WORTH										
Restricted Funds	-	-	-	-	250,000	1,000,000	250,000	1,500,000	-	1,500,000
Common stock	-	10	-	-	-	-	-	10	(10)	-
Equity Transfer	(16,800,000)	-	3,250,000	5,550,000	2,500,000	3,000,000	2,500,000	-	-	-
Additional paid-in capital	-	11,399,990	-	-	-	-	-	11,399,990	(11,399,990)	-
Net worth	153,480,099	30,151,101	90,171	(5,603,681)	(52,357)	(22,434)	(9,768)	178,033,131	-	178,033,131
Net worth	136,680,099	41,551,101	3,340,171	(53,681)	2,697,643	3,977,566	2,740,232	190,933,131	(11,400,000)	179,533,131
Total liabilities and net worth	$202,784,332	$ 61,726,800	$ 3,366,670	$ 249,520	$ 3,855,281	$ 5,617,672	$ 3,154,199	$280,754,474	$ (14,649,790)	$266,104,684

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET WORTH
FOR THE YEAR ENDED DECEMBER 31, 2012

	CareOregon	Health Plan	Care Access LLC	Community Health LLC	Columbia Pacific LLC	Jackson Care Connect LLC	PrimaryHealth Josephine County	Combined	Eliminations	Consolidated
REVENUE										
Premium revenue	$ 550,798,562	$ 126,732,674	$ -	$ -	$ 17,680,459	$ 25,830,299	$ 8,125,764	$ 729,167,758	$ (29,769,054)	$ 699,398,704
Other revenue	729,988	-	284,568	63,536	250,000	1,000,000	250,000	2,578,092	(1,500,000)	1,078,092
Management fee revenue	11,944,446	-	-	285,029	-	-	-	12,229,475	(9,221,541)	3,007,934
Total revenue	563,472,996	126,732,674	284,568	348,565	17,930,459	26,830,299	8,375,764	743,975,325	(40,490,595)	703,484,730
OPERATING EXPENSES										
Purchased healthcare	493,897,328	110,297,258	-	-	17,388,632	25,405,805	7,962,213	654,951,236	(29,769,054)	625,182,182
Managed care taxes	4,120,292	-	-	-	167,773	245,050	77,546	4,610,661	-	4,610,661
Salaries and benefits	27,828,260	6,339,872	-	277,636	138,679	163,303	78,037	34,825,787	(6,719,891)	28,105,896
Other administrative expenses	46,092,661	5,028,231	178,418	959,662	37,632	38,475	17,636	52,352,715	(4,001,650)	48,351,065
Total operating expenses	571,938,541	121,665,361	178,418	1,237,298	17,732,716	25,852,633	8,135,432	746,740,399	(40,490,595)	706,249,804
REVENUES OVER (UNDER) OPERATING EXPENSES	(8,465,545)	5,067,313	106,150	(888,733)	197,743	977,666	240,332	(2,765,074)	-	(2,765,074)
OTHER INCOME (EXPENSE)										
Investment income, net of transaction, custodial and advisory fees of $376,653 in 2012	8,895,906	2,148,803	740	441	(100)	(100)	(100)	11,045,590	-	11,045,590
Gain on disposal of fixed assets	1,300	-	-	-	-	-	-	1,300	-	1,300
	8,897,206	2,148,803	740	441	(100)	(100)	(100)	11,046,890	-	11,046,890
INCOME (LOSS) FROM CONTINUING OPERATIONS, BEFORE INCOME TAXES	431,661	7,216,116	106,890	(888,292)	197,643	977,566	240,232	8,281,816	-	8,281,816
INCOME TAX EXPENSE	4,000	2,949,591	-	-	-	-	-	2,953,591	-	2,953,591
INCOME FROM OPERATIONS	427,661	4,266,525	106,890	(888,292)	197,643	977,566	240,232	5,328,225	-	5,328,225
CHANGE IN NET WORTH	427,661	4,266,525	106,890	(888,292)	197,643	977,566	240,232	5,328,225	-	5,328,225
NET WORTH, beginning of year	144,752,438	37,284,576	3,233,281	334,611	-	-	-	185,604,906	(11,400,000)	174,204,906
Equity Transfer	(8,500,000)	-	-	500,000	2,500,000	3,000,000	2,500,000	-	-	-
NET WORTH, end of year	$ 136,680,099	$ 41,551,101	$ 3,340,171	$ (53,681)	$ 2,697,643	$ 3,977,566	$ 2,740,232	$ 190,933,131	$ (11,400,000)	$ 179,533,131

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION – DECEMBER 31, 2011

	CareOregon, Inc.	Health Plan	Care Access LLC	Community Health LLC	Combined	Eliminations	Consolidated
CURRENT ASSETS							
Cash and cash equivalents	$ 17,498,119	$ 915,101	$ 239,055	$ 491,055	$ 19,143,330	$ -	$ 19,143,330
Investments – unrestricted	123,044,053	46,248,724	-	-	169,292,777	-	169,292,777
Maternity case rate receivable, net of allowance for doubtful accounts of $251,867 in 2011	5,999,203	-	-	-	5,999,203	-	5,999,203
Reinsurance recoveries receivable	600,000	-	-	-	600,000	-	600,000
Interest receivable	853,957	105,052	-	-	959,009	-	959,009
Pharmacy rebates receivable	2,284,626	803,067	-	-	3,087,693	-	3,087,693
Premium receivable	-	3,866,758	-	-	3,866,758	-	3,866,758
Contract receivable	-	-	-	252,023	252,023	-	252,023
Other receivables	467,416	594,355	-	-	1,061,771	-	1,061,771
Prepaid expenses	2,157,032	802	5,888	32,087	2,195,809	(229,000)	1,966,809
Deferred tax asset	-	373,596	-	-	373,596	-	373,596
Intercompany receivable	1,612,765	9,732	-	28,625	1,651,122	(1,651,122)	-
Total current assets	154,517,171	52,917,187	244,943	803,790	208,483,091	(1,880,122)	206,602,969
ASSETS LIMITED AS TO USE							
Investment – statutory reserves	-	322,194	-	-	322,194	-	322,194
Investments – contractual reserves	20,069,826	-	-	-	20,069,826	-	20,069,826
Total assets limited as to use	20,069,826	322,194	-	-	20,392,020	-	20,392,020
FIXED ASSETS, net of accumulated depreciation and amortization of $14,918,708	18,628,139	-	3,014,445	-	21,642,584	-	21,642,584
LEASE DEPOSIT	-	-	-	9,886	9,886	-	9,886
INVESTMENT IN SUBSIDIARIES	11,400,000	-	-	-	11,400,000	(11,400,000)	-
TOTAL ASSETS	$204,615,136	$ 53,239,381	$ 3,259,388	$ 813,676	$261,927,581	$ (13,280,122)	$248,647,459

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF FINANCIAL POSITION – DECEMBER 31, 2011

	CareOregon, Inc.	Health Plan	Care Access LLC	Community Health LLC	Combined	Eliminations	Consolidated
CURRENT LIABILITIES							
Accrued medical claims payable	$ 40,852,039	$ 9,266,024	$ -	$ -	$ 50,118,063	$ -	$ 50,118,063
Claims adjudicated pending payment	2,842,797	1,432,489	-	-	4,275,286	-	4,275,286
Premium deficiency reserve	7,000,000	-	-	-	7,000,000	-	7,000,000
Managed care contracts payable	3,348,560	-	-	-	3,348,560	-	3,348,560
Accounts payable and accrued expenses	2,743,777	1,269,121	25,519	379,717	4,418,134	(229,000)	4,189,134
Medicare advances payable	-	1,017,589	-	-	1,017,589	-	1,017,589
Risk corridor payable	-	505,655	-	-	505,655	-	505,655
Accrued payroll and benefits	1,564,739	-	-	12,043	1,576,782	-	1,576,782
Premium recoupment payable	1,483,692	426,856	-	-	1,910,548	-	1,910,548
Intercompany payable	27,094	1,536,135	588	87,305	1,651,122	(1,651,122)	-
Total current liabilities	59,862,698	15,453,869	26,107	479,065	75,821,739	(1,880,122)	73,941,617
NON-CURRENT DEFERRED TAXES	-	500,936	-	-	500,936	-	500,936
NET WORTH							
Common stock	-	10	-	-	10	(10)	-
Additional paid-in capital	(8,300,000)	11,399,990	3,250,000	5,050,000	11,399,990	(11,399,990)	-
Net worth	153,052,438	25,884,576	(16,719)	(4,715,389)	174,204,906	-	174,204,906
Net worth	144,752,438	37,284,576	3,233,281	334,611	185,604,906	(11,400,000)	174,204,906
TOTAL LIABILITIES AND NET WORTH	$204,615,136	$ 53,239,381	$ 3,259,388	$ 813,676	$261,927,581	$ (13,280,122)	$248,647,459

CAREOREGON, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET WORTH
FOR THE YEAR ENDED DECEMBER 31, 2011

	CareOregon, Inc.	Health Plan	Care Access LLC	Community Health	Combined	Eliminations	Consolidated
REVENUE							
Premium revenue	$ 557,310,948	$ 116,689,845	$ -	$ -	$ 674,000,793	$ -	$ 674,000,793
Other revenue	624,953	-	221,216	-	846,169	-	846,169
Management fee revenue	8,852,151	-	-	-	8,852,151	(8,852,151)	-
Total revenue	566,788,052	116,689,845	221,216	-	683,699,113	(8,852,151)	674,846,962
OPERATING EXPENSES							
Purchased healthcare	488,981,504	95,585,530	-	-	584,567,034	-	584,567,034
Managed care taxes	5,565,820	-	-	-	5,565,820	-	5,565,820
Salaries and benefits	22,849,545	5,706,400	-	-	28,555,945	(5,706,400)	22,849,545
Other administrative expenses	24,033,265	5,830,882	191,560	-	30,055,707	(3,145,751)	26,909,956
Total operating expenses	541,430,134	107,122,812	191,560	-	648,744,506	(8,852,151)	639,892,355
REVENUES OVER OPERATING EXPENSES	25,357,918	9,567,033	29,656	-	34,954,607	-	34,954,607
OTHER INCOME (EXPENSE)							
Investment income, net of transaction, custodial and advisory fees of $376,653 in 2011	5,810,094	1,958,123	274	-	7,768,491	-	7,768,491
Loss on disposal of fixed assets	(8,375)	-	-	-	(8,375)	-	(8,375)
	5,801,719	1,958,123	274	-	7,760,116	-	7,760,116
INCOME FROM CONTINUING OPERATIONS, BEFORE INCOME TAXES	31,159,637	11,525,156	29,930	-	42,714,723	-	42,714,723
INCOME TAX EXPENSE	5,800	4,748,633	-	-	4,754,433	-	4,754,433
INCOME FROM CONTINUING OPERATIONS	31,153,837	6,776,523	29,930	-	37,960,290	-	37,960,290
LOSS FROM DISCONTINUED OPERATIONS	-	-	-	3,108,072	3,108,072	-	3,108,072
CHANGE IN NET WORTH	31,153,837	6,776,523	29,930	(3,108,072)	34,852,218	-	34,852,218
NET WORTH, beginning of year	121,898,601	30,508,053	3,203,351	492,683	156,102,688	(16,750,000)	139,352,688
Paid-in capital	(8,300,000)	-	-	2,950,000	(5,350,000)	5,350,000	-
NET WORTH, end of year	$ 144,752,438	$ 37,284,576	$ 3,233,281	$ 334,611	$ 185,604,906	$ (11,400,000)	$ 174,204,906