Fletcher Allen Health Care, Inc. and Subsidiaries

Consolidated Financial Statements and Additional Information as of and for the Years Ended September 30, 2006 and 2005, and Independent Auditors' Reports

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005:	
Balance Sheets	2
Statements of Operations	3
Statements of Changes in Net Assets	4
Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6–26
SUPPLEMENTAL SCHEDULES AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005:	27
Consolidating Balance Sheet Information	28–29
Consolidating Statement of Operations Information	30
Obligated Group Balance Sheets Information	31–32
Obligated Group Statements of Operations Information	33
Obligated Group Statements of Changes in Net Assets Information	34
Note to Supplemental Schedules	35

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Fletcher Allen Health Care, Inc.:

We have audited the accompanying consolidated balance sheets of Fletcher Allen Health Care, Inc. and subsidiaries (the "Company") as of September 30, 2006 and 2005, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at September 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic consolidated financial statements. The supplemental schedules are the responsibility of the management of the Company. Such information has been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.

Deloitte + Touche LLP

December 6, 2006

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 44,519	$ 32,096
Patient and other trade accounts receivable, net of allowance for doubtful accounts of $14,223 in 2006 and $13,900 in 2005	107,852	92,769
Short-term investments	177	3,515
Inventories	10,338	9,052
Current portion of restricted assets	7,000	4,000
Prepaid and other current assets	16,080	12,418
Total current assets	185,966	153,850
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:		
Board-designated assets	122,742	123,620
Assets held by trustee under bond indenture agreements	31,301	30,710
Restricted assets	22,192	24,551
Donor restricted assets for specific purposes	9,169	10,067
Donor restricted assets for permanent endowment	23,593	24,900
Total assets whose use is limited or restricted	208,997	213,848
PROPERTY AND EQUIPMENT—Net	437,313	445,690
OTHER ASSETS:		
Deferred financing costs—net	19,102	19,898
Notes receivable and other assets	1,803	1,651
Investment in affiliated companies	13,131	13,297
Pledges receivable	1,626	2,645
Total other assets	35,662	37,491
TOTAL	$867,938	$850,879

	2006	2005
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current installments of long-term debt	$ 7,450	$ 6,616
Accounts payable	31,828	20,312
Accrued expenses and other liabilities	46,699	61,480
Accrued payroll and related benefits	35,566	29,560
Estimated third-party payor settlements	9,069	13,798
Estimated amounts for incurred but unreported claims	19,611	15,345
Total current liabilities	150,223	147,111
LONG-TERM LIABILITIES:		
Long-term debt—excluding current installments	372,612	380,103
Reserve for outstanding losses on malpractice and workers' compensation claims	19,816	25,261
Pension and other postretirement benefit obligations	10,478	36,485
Other long-term liabilities	1,991	3,865
Total long-term liabilities	404,897	445,714
Total liabilities	555,120	592,825
COMMITMENTS AND CONTINGENT LIABILITIES		
NET ASSETS:		
Unrestricted	276,576	218,429
Temporarily restricted	12,649	14,725
Permanently restricted	23,593	24,900
Total net assets	312,818	258,054
TOTAL	$867,938	$850,879

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
UNRESTRICTED REVENUE AND OTHER SUPPORT:		
Net patient service revenue	$ 634,697	$ 583,112
Premium revenue	56,210	58,789
Other revenue	20,684	18,289
Total unrestricted revenue and other support	711,591	660,190
EXPENSES:		
Salaries, payroll taxes, and fringe benefits	409,660	374,933
Supplies and other	166,713	157,303
Purchased services	26,857	24,910
Depreciation and amortization	35,060	30,618
Interest expense	16,890	6,623
Provision for bad debts	14,872	12,759
Underwriting expenses	3,415	4,305
Medical claims	21,283	24,473
Total expenses	694,750	635,924
INCOME FROM OPERATIONS	16,841	24,266
NONOPERATING REVENUE (EXPENSE):		
Investment income and losses	14,933	7,745
Unrealized gain (loss) on interest rate swap contracts	3,963	(1,183)
Other	(394)	(381)
Total nonoperating revenue	18,502	6,181
EXCESS OF REVENUE OVER EXPENSES	35,343	30,447
NET UNREALIZED (LOSSES) GAINS ON INVESTMENTS	(2,524)	5,667
ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES	3,106	2,573
ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT	18,240	(17,175)
TRANSFER OF NET ASSETS	4,843	
INCREASE IN UNRESTRICTED NET ASSETS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	59,008	21,512
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(861)	
INCREASE IN UNRESTRICTED NET ASSETS	$ 58,147	$ 21,512

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
UNRESTRICTED NET ASSETS:		
Excess of revenue over expenses	$ 35,343	$ 30,447
Net unrealized (losses) gains on investments	(2,524)	5,667
Assets released from restrictions for capital purchases	3,106	2,573
Additional minimum pension liability adjustment	18,240	(17,175)
Transfer of net assets	4,843	
Cumulative effect of change in accounting principle	(861)	
Increase in unrestricted net assets	58,147	21,512
TEMPORARILY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	2,581	2,284
Investment income	1,794	531
Net unrealized (losses) gains on investments	(901)	1,050
Net realized gains on investments	1,486	
Net assets released from restrictions used in operations	(759)	(674)
Net assets released from restrictions used for nonoperating purposes	(232)	(153)
Net assets released from restrictions used for capital purchases	(3,106)	(2,573)
Transfer of net assets	(2,939)	
(Decrease) increase in temporarily restricted net assets	(2,076)	465
PERMANENTLY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	104	198
Change in beneficial interest in perpetual trusts	493	641
Transfer of net assets	(1,904)	
(Decrease) increase in permanently restricted net assets	(1,307)	839
INCREASE IN NET ASSETS	54,764	22,816
NET ASSETS—Beginning of year	258,054	235,238
NET ASSETS—End of year	$ 312,818	$ 258,054

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES AND GAINS:		
Increase in net assets	$ 54,764	$ 22,816
Adjustments to reconcile increase in net assets to net cash provided by operating activities and gains:		
Depreciation and amortization	35,060	31,037
Provision for bad debts	14,872	12,759
Restricted contributions and investment income received	(4,479)	(3,013)
Additional minimum pension liability adjustment	(18,240)	17,175
Loss on disposal of property and equipment	512	115
Unrealized (gain) loss on interest rate swap contracts	(3,963)	1,183
Realized and unrealized losses (gains) on investments	1,939	(8,851)
Undistributed earnings of affiliated companies	(640)	(1,880)
Cumulative effect of change in accounting principle	861	
Change in beneficial interest in perpetual trusts	(493)	(641)
(Decrease) increase in cash resulting from change in:		
Patient and other accounts receivable	(29,955)	(13,317)
Pledges receivable	1,019	1,465
Other current and noncurrent assets	(4,217)	2,741
Accounts payable and accrued expenses	(3,265)	(3,910)
Accrued payroll and related expenses	6,006	(356)
Current and other liabilities	(5,908)	3,698
Pension and postretirement benefit obligations	(7,767)	(3,603)
Net cash provided by operating activities and gains	36,106	57,418
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of property and equipment, net	(26,304)	(87,584)
Purchase of investments	(65,788)	(61,396)
Proceeds from sale of investments	69,837	103,344
Proceeds from distribution of equity investees	500	800
Net cash used in investing activities	(21,755)	(44,836)
CASH FLOWS OF FINANCING ACTIVITIES:		
Proceeds from restricted contributions and restricted investment income	4,479	2,512
Repayment of long-term debt	(6,657)	(3,998)
Change in long-term liabilities	250	(851)
Proceeds from issuance of long-term debt		150
Net cash used in financing activities	(1,928)	(2,187)
NET INCREASE IN CASH AND CASH EQUIVALENTS	12,423	10,395
CASH AND CASH EQUIVALENTS—Beginning of year	32,096	21,701
CASH AND CASH EQUIVALENTS—End of year	$ 44,519	$ 32,096
SUPPLEMENTAL CASH FLOW INFORMATION—Cash paid during the year for interest	$ 17,035	$ 15,200

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

1. ORGANIZATION

Fletcher Allen Health Care, Inc. ("FAHC") is an academic and teaching health care resource and regional referral center providing a full range of primary, secondary and tertiary-level inpatient and outpatient health care services. FAHC is closely integrated with the University of Vermont College of Medicine ("UVM") under an affiliation agreement for teaching and research.

FAHC has the following wholly owned subsidiaries: Fletcher Allen Health Ventures, Inc. ("FAHV"), Fletcher Allen Medical Group, PLLC ("FAMG"), Fletcher Allen Provider Corporation ("FAPC"), Fletcher Allen Coordinated Transport, LLC ("FACT"), Fletcher Allen Skilled Nursing Care, LLC ("FASNF"), Fletcher Allen Health Care Foundation, Inc. ("FAHCF") and VMC Indemnity Company Ltd. ("VMCIC"). Vermont Managed Care, Inc. ("VMC") is a wholly owned subsidiary of FAHV.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principals of Consolidation—The consolidated financial statements include the accounts of FAHC and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The assets of members of the consolidated group may not be available to meet the obligations of another member of the group.

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

Cash and Cash Equivalents—Cash and cash equivalents include all highly liquid investments with remaining maturities of three months or less when purchased, excluding amounts classified as assets whose use is limited or restricted.

Contributions—Unconditional promises to give that are expected to be collected within one year are recorded at their estimated net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts on those amounts are computed using a risk-free rate applicable to the year in which the promise is received. Amortization of the discount is included in contribution revenue. Conditional promises to give are not included as support until the conditions are substantially met.

Investments and Investment Income—Investments in equity securities with readily determinable fair market values and all investments in debt securities are recorded at fair value. Fair value is based on quoted market prices. Investments in limited partnerships and limited liability corporations for which FAHC's ownership is less than 5% are recorded at cost. The limited partnership investments generally have restrictions on withdrawals. Investment income or loss (including realized gains and losses on investments, interest and dividends), to the extent not capitalized, is included in nonoperating revenue (expense) unless the income or gain (loss) is restricted by donor or law. Realized gains or losses on the sale of investments are determined by use of average costs. Unrealized gains and losses on investments carried at fair value are excluded from the excess of revenue over expenses and reported as an increase or decrease in net assets, except that declines in fair value that are judged to be other-than-temporary are reported as realized losses.

Investments, in general, are exposed to various risks such as interest rate, credit and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the balance sheets and statements of operations and changes in net assets.

In prior years, purchases and sales of investments were reported net in the statement of cash flows. Commencing in 2006, the FAHC began reporting such purchases and sales gross. The 2005 statement of cash flows has been adjusted for comparability.

Investment in Affiliates—Investments in 20% to 50% owned affiliates are accounted for using the equity method of accounting. These include Vermont Clinical Resources, Inc., Copley Woodlands, Inc., The Vermont Health Plan, Starr Farm Partnership, OB Net Services, LLC and Southwestern Vermont-Fletcher Allen Dialysis Services, LLC.

Assets Whose Use Is Limited or Restricted—Assets whose use is limited or restricted primarily include board designated assets, assets held by trustees under indenture agreements, donor restricted assets, and restricted assets which are held for insurance related liabilities. Board designated assets may be used at the Board's discretion.

Property and Equipment—Property and equipment acquisitions are recorded at cost or, in the case of gifts, at fair market value at the date of the gift. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. Approximately $0 and $420,000 of depreciation expense in 2006 and 2005, respectively, is included in nonoperating expense. 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 consolidated financial statements.

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support and are excluded from the excess of revenue 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 these long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Impairment of Long-Lived Assets—Long-lived assets to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value, less cost to sell.

Costs of Borrowing—Interest cost incurred on borrowed funds during the period of construction of capital assets, net of investment income on borrowed assets held by trustees, is capitalized as a component of the cost of acquiring those assets. Approximately $627,000 and $8,482,000 of interest was capitalized during 2006 and 2005, respectively. Net deferred financing costs totaled $19,102,000 and $19,900,000 as of September 30, 2006 and 2005, respectively. Such amounts are reported with other assets and are being amortized over the period the related obligations are outstanding. Accumulated amortization of deferred financing costs totaled $3,069,000 and $2,273,000 at September 30, 2006 and 2005, respectively.

Temporarily and Permanently Restricted Net Assets—Temporarily restricted net assets are those whose use by FAHC 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 FAHC in perpetuity.

During 2006, FAHC completed a study of restricted net assets. As a result of that study, FAHC determined that temporarily and permanently restricted net assets of approximately $4,843,000 should be reported as unrestricted net assets. This amount has been recorded as a transfer of net assets in the accompanying consolidated statements of operations and changes in net assets.

Consolidated Statements of Operations—For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as nonoperating revenue and expense.

Excess of Revenue Over Expenses—The consolidated statements of operations include excess of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, primarily include unrealized gains and losses on investments (other than those on which other than temporary losses are recognized), permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions restricted by donors for acquiring such assets), the adjustment to record the cumulative effect of the change in accounting for asset retirement obligations, and the minimum pension liability adjustment.

Net Patient Service Revenue—Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Under the terms of various agreements, regulations and statutes, certain elements of third-party reimbursement are subject to negotiation, audit and/or final determination by the third-party payors. In addition, laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Differences between amounts previously estimated for retroactive adjustments and amounts subsequently determined to be recoverable or payable are included in net patient service revenue in the year that such amounts become known. Changes in prior year estimates increased net patient service revenue by approximately $5,800,000 in 2006 and $3,800,000 in 2005.

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

Medicare—Inpatient acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services are paid based on a cost reimbursement methodology. Outpatient services are based upon a prospective standard rate for procedures performed or services rendered. FAHC is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by FAHC and audits thereof by the Medicare fiscal intermediary. Medicare reimbursement for professional billings is determined by a standard fee schedule that is determined by the Centers for Medicare and Medicaid Services of the U.S. Department of Health and Human Services. The percentage of net patient service revenue and premium revenue earned from the Medicare program was approximately 36% in fiscal year 2006 and 31% in 2005, respectively.

Medicaid—Inpatient services rendered to Medicaid program beneficiaries are reimbursed under prospectively determined per diem rates. The prospectively determined per diem rates are not subject to retroactive adjustment. Outpatient services rendered to Medicaid beneficiaries are reimbursed under a prospectively determined rate per charge for laboratory and some radiology services and under a cost reimbursement methodology for all other outpatient services. FAHC is reimbursed for outpatient services at a tentative rate, with final settlement determined after submission of annual cost reports by FAHC and audits thereof by the fiscal intermediary. Medicaid reimbursement for professional billings is determined by a standard fee schedule that is determined by the State of Vermont. 13% of FAHC's net revenue in 2006 and less then 10% in fiscal year 2005 was earned from the Medicaid program.

Commercial Insurers—Services rendered to patients with commercial insurance are generally reimbursed at standard charges less a negotiated discount or according to DRG or negotiated fee schedules.

Vermont Managed Care, Inc. negotiates contracts with insurers and other payors for the provision of health care services through participating providers which are primarily its member organizations. As a result, VMC is currently managing and/or has entered into contracts with managed care plans primarily on behalf of FAHC. Under the terms of these agreements, VMC provides managed care services to subscribers of the managed care plans (the "Plans") who select VMC as their primary health plan provider. Payments to FAHC from VMC for services on behalf of respective Plan subscribers are based on a discounted fee for service or a predetermined fee schedule.

Premium Revenue—FAHC and VMC have agreements with various Health Maintenance Organizations ("HMOs") to provide medical services to subscribing participants. Under these agreements, FAHC or VMC receive monthly capitation payments based on the number of each HMO's participants regardless of services actually performed. In addition, the HMOs make fee-for-service payments to FAHC for certain covered services based upon discounted fee schedules.

Other Revenue—Other revenue consists primarily of research revenue, sales of pharmaceuticals and related products, net assets released from restrictions used for operations, and rental income.

Research Grants and Contracts—Revenue related to research grants and contracts is recognized as the related costs are incurred. Indirect costs relating to certain government grants and contracts are reimbursed at fixed rates negotiated with the government agencies. Research grants and contracts are accounted for as exchange transactions. Amounts received in advance of incurring the related expenditures are recorded as unexpended research grants and are included with accrued expenses.

Goodwill—At September 30, 2006 and 2005, the carrying value of goodwill totaled $260,000 and $356,000, respectively. Goodwill is stated at cost and is amortized using the straight-line method over its estimated useful life. Accumulated amortization of goodwill amounted to $524,000 and $428,000 at September 30, 2006 and 2005, respectively.

Reserves for Outstanding Losses and Loss-Related Expenses for Malpractice Claims—The liabilities for outstanding losses and loss-related expenses and the related provision for losses and loss-related expenses include estimates for malpractice losses incurred but not reported as well as losses pending settlement. Such liabilities are necessarily based on estimates and, while management believes the amounts provided are adequate, the ultimate liability may be in excess of or less than the amounts provided. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The methods for making such estimates and the resulting liability are actuarially reviewed on an annual basis, and any adjustments required are reflected in operations currently.

Income Taxes—FAHC, FAPC and FAMG (application pending) are incorporated and recognized by the Internal Revenue Service as tax-exempt under section 501(c)(3) of the Internal Revenue Code. Accordingly, the Internal Revenue Service has determined that FAHC and FAPC are exempt from federal income taxes on related income pursuant to section 501(a) of the Code. FACT, and FASNF are single member limited liability corporations. As such, for tax purposes, FACT and FASNF are treated as divisions of FAHC. No provision for federal income taxes has been recorded in the accompanying consolidated financial statements for these organizations.

FAHV is a for-profit subsidiary subject to federal and state taxation. A 50% interest in OB Net Services, LLC is maintained by FAHC. This LLC files federal partnership tax returns and FAHC recognizes its proportionate share of the income/loss as related function income. For this entity, FAHC applies the provisions of SFAS No. 109, *Accounting for Income Taxes*. The tax provisions, and related tax assets and liabilities, for this entity are not material.

VMCIC is currently not a taxable entity under the provisions of the territory of Bermuda and, accordingly, no provision for taxes has been recorded by VMCIC. In the event that such taxes are levied, VMCIC has received an undertaking from the Bermuda Government exempting it from all such taxes until 2016.

Other-Than-Temporarily Impairment of Investments—FAHC reviews its investments to identify those for which market value is below cost. FAHC then makes a determination as to whether the investment should be considered other-than-temporarily impaired based on guidelines established in the FASB Emerging Issues Task Force Issue No. 03-1, *The Meaning of Other-Than-Temporarily Impairment and its Application to Certain Investments*. No losses related to declines in value that were other than temporary in nature were recognized for the years ended September 30, 2006 and 2005.

Adoption of New Accounting Pronouncement—Effective September 30, 2006, FAHC adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 143, *Accounting for Asset Retirement Obligations*, as clarified by Financial Interpretation ("FIN") No. 47, *Accounting for Conditional Asset Retirement Obligations* issued in March 2005. FIN 47 clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. SFAS No. 143 requires the fair value of a liability for the legal obligation associated with an asset retirement be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized.

Upon adopting FIN 47, FAHC recorded a liability of approximately $861,000 which was recognized as the cumulative effect of a change in accounting principle. The estimated future undiscounted value of the asset retirement obligation is approximately $1,337,000. Because SFAS 143 requires retrospective application to the inception of the liability, the initial asset retirement obligation was calculated using a discount rate of 4.5%. The cumulative effect of the adoption of FIN 47 reflects the accretion of the liability and depreciation of the related asset component from the liability inception date through September 30, 2006.

Substantially all of the impact of adopting FIN 47 relates to estimated costs to remove asbestos that is contained within FAHC's facilities. If FAHC had adopted FIN 47 effective October 1, 2004, the liability would not have been materially different from the liability recorded at September 30, 2006 and the impact on operating results in 2005 and 2006 would have been immaterial.

Recently Issued Accounting Pronouncements—In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R*). This statement will require FAHC to recognize the overfunded or underfunded status of its defined benefit postretirement plans as an asset or liability in its consolidated balance sheet. The Statement will also require FAHC to recognize changes in the funded status of the plans in the year in which the changes occur as a change in unrestricted net assets presented below the excess of revenue over expenses in its consolidated statement of operations and changes in net assets. This statement will also require FAHC to measure the funded status of all its defined benefit postretirement plans as of the balance sheet date. FAHC is required to initially recognize the funded status of its defined benefit postretirement plans and to provide certain related disclosures as of September 30, 2007. FAHC is initially required to measure plan assets and benefit obligations as of its balance sheet date as of September 30, 2009. FAHC is currently evaluating the impact of this Statement on its consolidated financial statements.

3. CHARITY CARE AND COMMUNITY SERVICE

FAHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because FAHC does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The amount of charges foregone for services and supplies furnished under FAHC's charity care policy aggregated approximately $15,300,000 and $17,400,000 in 2006 and 2005, respectively.

4. ASSETS WHOSE USE IS LIMITED OR RESTRICTED

Assets whose use is limited or restricted are stated at fair value except as indicated, and at September 30, 2006 and 2005, consisted of the following (in thousands):

	2006	2005
Cash and cash equivalents	$ 4,794	$ 4,462
Money market funds	2,833	8,691
Bonds and notes	31,804	37,110
Mutual funds	145,342	142,049
Limited partnerships (at cost)	19,640	17,940
Other	11,584	10,596
	$ 215,997	$ 220,848

Assets held by trustee under bond indenture agreements included approximately $55,000 held in construction funds and $31,170,000 held in debt service reserve funds at September 30, 2006, none of which are reported as short-term investments. At September 30, 2005, $3,000,000 of these investments were reported as short-term investments.

Investment income and gains for the years ended September 30, 2006 and 2005, consisted of the following (in thousands):

	2006	2005
Nonoperating revenue and expenses:		
Investment income	$ 10,300	$ 5,611
Net realized gains on sales of securities	4,633	2,134
	14,933	7,745
Other changes in unrestricted net assets—net unrealized (loss) gains on investments	(2,524)	5,667
Changes in temporarily restricted net assets:		
Investment income	1,794	531
Net unrealized (losses) gains on investments	(901)	1,050
Net realized gains on investments	1,486	
	2,379	1,581
Changes in permanently restricted net assets—change in beneficial interest in perpetual trusts	493	641
Total	$ 15,281	$ 15,634

At September 30, 2006 and 2005, FAHC held investments that had a fair market value of approximately $1,351,000 and $761,000, respectively, less than their cost. Of this amount, approximately $1,300,000 relates to investments where the cost has exceeded the market value for in excess of one year at September 30, 2006.

The amortized cost and estimated fair value of securities classified as available for sale by FAHC's for-profit subsidiaries at September 30, 2006 and 2005, were as follows (in thousands):

2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 501	$ 2	$ -	$ 503
Mutual funds	25,131	2,749	(329)	27,551
	$ 25,632	$ 2,751	$ (329)	$ 28,054

2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 752	$ 14	$ -	$ 766
Corporate debt securities	500	1		501
Total debt securities	1,252	15	-	1,267
Corporate index funds	1,492	642		2,134
Mutual funds	21,658	2,959	(139)	24,478
	$ 24,402	$ 3,616	$ (139)	$ 27,879

Proceeds from sales of available-for-sale securities were $7,300,000 and $750,000 for the years ended September 30, 2006 and 2005, respectively.

The amortized cost and estimated fair value of marketable debt securities classified as available for sale at September 30, 2006 and 2005, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands).

	2006		2005	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 501	$ 503	$ 750	$ 752
Due within 1–5 years			502	515
	$ 501	$ 503	$ 1,252	$ 1,267

5. PROPERTY AND EQUIPMENT

A summary of property and equipment at September 30, 2006 and 2005, is as follows (in thousands):

	2006	2005
Land	$ 7,796	$ 6,582
Land improvements	13,941	13,920
Leasehold improvements	37,105	35,769
Buildings	465,565	445,130
Equipment, furniture, and fixtures	226,528	210,868
	750,935	712,269
Less accumulated depreciation and amortization	(324,050)	(293,006)
	426,885	419,263
Construction-in-progress	10,428	26,427
	$ 437,313	$ 445,690

Accounts payable and accrued expenses include approximately $3,000,000 and $22,486,000 at September 30, 2006 and 2005, respectively, related to a construction project. In addition, FAHC is committed to contracts approximating $2,100,000 at September 30, 2006, for the completion of the project.

6. INVESTMENT IN AFFILIATED COMPANIES

Investment in affiliated companies at September 30, 2006 and 2005, consisted of the following (in thousands):

	2006	2005
Starr Farm Partnership	$ 3,788	$ 3,760
The Vermont Health Plan	9,139	9,035
Other	204	502
	$ 13,131	$ 13,297

Distributions from these affiliated organizations totaled $500,000 and $800,000 for the years ended September 30, 2006 and 2005, respectively. FAHC's share of the earnings of these affiliates is reported as nonoperating revenue and totaled approximately $640,000 and $1,900,000 for the years ended September 30, 2006 and 2005, respectively. Summarized financial information from the unaudited financial statements of these organizations at September 30, 2006 and 2005, and for the years then ended is as follows (in thousands of dollars):

2006	Ownership Percentage	Total Assets	Net Assets	Change in Net Assets
Starr Farm Partnership	50 %	$ 10,066	$ 7,576	$ 202
The Vermont Health Plan	29	49,794	26,391	(369)
2005				
Starr Farm Partnership	50 %	$ 10,225	$ 7,374	$ (78)
The Vermont Health Plan	29	46,985	26,760	3,673

7. LONG-TERM DEBT

Long-term debt at September 30, 2006 and 2005, consisted of the following (in thousands):

	2006	2005
Vermont Educational & Health Buildings Financing Agency Hospital Revenue Bonds:		
Series 2004B Bonds, variable rate (3.6% to 3.755% at September 30, 2006) payable through 2035	$ 168,025	$ 170,000
Series 2000A Bonds, 4.3% to 6.25%, payable through 2028, net of unamortized bond discount of $730 and $763	96,878	97,260
Series 2004A Bonds, 2.0% to 5.0%, payable through 2025, net of unamortized bond premium of $1,781 and $1,878	46,713	48,486
Series 2000B Bonds, variable rate (3.55% at September 30, 2006), payable through 2031	50,000	50,000
Select Auction Variable Rate Securities (SAVRS) 1994 Bonds, variable rate (3.45% to 4.93% at September 30, 2006), payable through 2013, net of unamortized discount of $262 and $291	17,667	19,688
Capital leases and other notes payable	779	1,285
	380,062	386,719
Less current portion	(7,450)	(6,616)
Long-term debt	$ 372,612	$ 380,103

Revenue Bonds—On April 15, 2004, FAHC, in connection with the Vermont Educational and Health Building Financing Agency (the "Agency"), issued $170,000,000 of tax exempt revenue bonds ("2004B Bonds"), refunded its 1993 bonds with Series 2004A Bonds in the amount of $47,620,000 and converted the 2000B Bonds from weekly variable rate bonds to auction rate securities. The 2004B, 2000B, and 2004A bonds are all insured. The net proceeds from the 2004B Bonds were used to refinance a construction loan and to finance the construction of a new ambulatory care building and the renovation of existing space (collectively, the "Renaissance Project"). FAHC granted the Agency a mortgage on certain property and a security interest in its gross receipts, as defined.

Various trustee held funds are required under terms of the Series 2004A and 2004B Bonds. A project fund in the amount of $143,806,000 was established from which to pay for the cost of the Renaissance Project, and debt service reserve funds were established in the amount of $4,773,000 and $13,658,000 respectively, for the payment of principal and interest if FAHC fails to make required payments.

FAHC and certain of its subsidiaries are obligated under various other revenue bonds, capital leases, and notes payable. Under the terms of the loan agreements, the obligations are collateralized by liens on pledged assets and gross receipts, as defined. Various trustee-held funds are required under the terms of the loan agreements (see Note 4). Under one of the loan agreements, a reserve fund is required only upon the failure to meet certain financial ratios. Such ratios have been met and, as such, no funding has been required under this agreement.

Scheduled Maturities of Long-Term Debt—Scheduled maturities of long-term debt and payments on capital lease obligations for the next five years and thereafter are as follows (in thousands):

2007	$ 7,450
2008	7,070
2009	7,673
2010	7,930
2011	7,650
Thereafter	342,289
	$ 380,062

Loan Covenants—Under the terms of a master indenture, FAHC is required to meet certain covenant requirements. In addition, the indenture provides for restrictions on, among other things, additional indebtedness and dispositions of property. At September 30, 2006 and 2005, FAHC was in compliance with these requirements.

Interest Rate Swap Agreements—In connection with the issuance of the Series 2004B Bonds, FAHC entered into two interest rate swap contracts in the notional principal amount of $67,500,000 each, which effectively convert the variable auction rate of the bonds to a fixed rate of 3.76% over the life of the bonds. The termination date of these swaps contracts is December 1, 2034.

In August 1993, FAHC entered into an interest rate swap agreement in the notional principal amount of $37,600,000, covering three swaps with a combined fixed payment thereunder equal to a 4.93% interest rate on the 1994 SAVRS bond issue. The termination date of this swap agreement is September 1, 2013.

FAHC and the counterparties in the interest rate swap agreements are exposed to credit risk in the event of nonperformance or early termination of the agreements. FAHC and its counterparty under the 1993 swap agreement entered into a bilateral pledge agreement whereby, on a monthly basis, the counterparty calculates the aggregate exposure amount based on current market value of replacing the interest rate swap agreement with a like financial instrument should either party default. Depending upon the market price at the calculation date, FAHC or its counterparty is required to either collateralize or insure any aggregate exposure in excess of $1,000,000. The replacement of fair value of the interest rate swap agreement with a like instrument would cause FAHC to pay approximately $880,000 and $1,323,000 at September 30, 2006 and 2005, respectively, to the counterparty. FAHC has insured this amount in excess of $1,000,000.

FAHC’s only derivatives are the interest rate swaps described above. As of September 30, 2006 and 2005, the net fair value of the swap agreements of approximately $100,000 and ($3,865,000), respectively, were included in notes receivable and other assets and in other long-term liabilities, with the change in value recorded as nonoperating revenue (expense).

Letters of Credit—FAHC has letter-of-credit agreements with a bank which may be renewed each year, which provide for maximum borrowings of up to $1,300,000. The letters of credit remain unused at September 30, 2006 and 2005.

8. OPERATING LEASES

FAHC has entered into certain operating lease agreements for the rental of building space and equipment. Rental expense amounted to $9,954,000 and $10,004,000 for 2006 and 2005, respectively.

Minimum future lease payments required under noncancelable operating leases at September 30, 2006, were as follows (in thousands):

Years Ending September 30	
2007	$ 7,546
2008	5,863
2009	4,218
2010	3,147
2011	2,355
Thereafter	8,603
	$ 31,732

The above payments exclude anticipated payments under fair market purchase options. FAHC expects to exercise fair market purchase options totaling approximately $5,326,000 under leases in effect at September 30, 2006.

9. RESTRICTIONS ON NET ASSETS

At September 30, 2006 and 2005, temporarily restricted net assets are available for the following purposes (in thousands):

	2006	2005
Indigent care	$ 432	$ 1,530
Education and research	4,698	4,680
Children’s programs	1,799	1,361
Capital projects	2,247	3,487
Other health care services	3,473	3,667
	$ 12,649	$ 14,725

At September 30, 2006, temporarily restricted net assets includes approximately $2,483,000 of accumulated gains on permanently restricted net assets which are subject to board appropriation in accordance with state law. Permanently restricted net assets are restricted to (in thousands):

	2006	2005
Investments to be held in perpetuity, the income from which is expendable to support:		
Indigent care	$ 4,298	$ 4,517
Education and research	4,280	4,153
Other health care services	15,015	16,230
	$ 23,593	$ 24,900

10. MALPRACTICE AND OTHER CONTINGENCIES

Malpractice and Workers' Compensation—FAHC is insured against malpractice losses under a claims-made insurance policy with VMCIC. VMCIC has reinsurance with commercial carriers for coverage above a self-insured retainage amount of $5,000,000 per claim with a $20,000,000 aggregate, with limits on such reinsurance. VMCIC provides claims-made coverage to certain affiliates of FAHC for periods prior to the merger that created FAHC.

FAHC is also self-insured for workers' compensation claims, in part through VMCIC, and maintains an excess insurance policy to limit its exposure on claims to $500,000 per occurrence.

The reserve for outstanding losses has been discounted at a rate of 6% at September 30, 2006 and 5% at September 30, 2005, resulting in a reduction in the reserve of approximately $2,842,000 in 2006 and $1,800,000 in 2005.

Activity in the reserve for outstanding losses and loss-related expenses at VMCIC for malpractice and workers' compensation claims is summarized as follows (in thousands):

	2006	2005
Balance—beginning of year	$ 29,261	$ 27,238
Less reinsurance receivables	1,537	
Net balance at October 1	27,724	27,238
Losses incurred related to:		
Current period	7,355	7,251
Prior acts and tail coverage assumed	(3,940)	(2,946)
Total incurred	3,415	4,305
Paid losses related to:		
Current period	614	122
Prior period	7,052	3,697
Total paid	7,666	3,819
Net balance—end of year	23,473	27,724
Reinsurance recoverables	3,343	1,537
Balance—end of year	$ 26,816	$ 29,261

As a result of changes in estimates of incurred events in prior years, primarily professional liability, the estimate of incurred losses decreased by approximately $3,583,000 and $3,068,000 as of September 30, 2006 and 2005, respectively.

The reserve for losses, which was determined with the assistance of an actuarial consultant, includes estimates of claims incurred but not reported. Approximately $7,000,000 and $4,000,000 of the reserve at September 30, 2006 and 2005, respectively, is included in current liabilities and the balance of the reserve is included in the noncurrent reserve for outstanding losses on malpractice and workers' compensation claims in the accompanying balance sheets at September 30, 2006 and 2005, respectively.

Employee Health and Dental Insurance—FAHC maintains a self-insurance plan for employee health and dental insurance. Under the terms of the plan, employees and their dependents are eligible for participation and, as such, FAHC is responsible for the administration of the plan and any resultant liability incurred. FAHC maintained a stop-loss insurance policy to limit its exposure on claims to $175,000 per member per year, in 2006 and 2005, with a per year benefit maximum of $1,500,000. FAHC has recorded a reserve of approximately $5,324,000 and $4,180,000 at September 30, 2006 and 2005, respectively, to provide for claims made and claims incurred but not reported. The amount of the reserve was determined with the assistance of an actuarial consultant and is included in accrued expenses in the accompanying balance sheets.

Other Contingencies—FAHC and its subsidiaries are parties in various legal proceedings and potential claims arising in the ordinary course of its business. In addition, the health care industry as a whole is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to government review and interpretation as well as regulatory actions, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue from patient services. Management does not believe that these matters will have a material adverse effect on FAHC's consolidated financial position or results of operations.

Collective Bargaining Agreement—The organization is subject to a collective bargaining agreement with respect to its RN and LPN nursing staff. The current agreement runs through July 9, 2009, and covers approximately 1,500 staff.

11. STATUTORY CAPITAL AND SURPLUS

VMCIC is registered under the Bermuda Insurance Act of 1978 and related regulations (the "Act") and is obliged to comply with various provisions of the Act regarding minimum levels of solvency and liquidity. Statutory capital and surplus at September 30, 2006 and 2005 was $21,326,000 and $16,953,000, respectively, and the amount required to be maintained by VMCIC was $2,647,000 and $3,122,000, respectively. In addition, a minimum liquidity ratio must be maintained whereby liquid assets, as defined by the Act, must exceed 75% of defined liabilities. The minimum required level of liquid assets was $20,059,000 and $23,512,000 at September 30, 2006 and 2005, respectively. As of September 30, 2006 and 2005, the liquidity requirements were met. FAHC reports all of VMCIC's investments in marketable securities as restricted assets in the accompanying balance sheets.

The declaration of dividends from retained earnings and additional paid-in capital is limited to the extent that the above requirements are met. At September 30, 2006 and 2005, retained earnings and additional paid-in capital of VMCIC amounting to $2,647,000 and $3,122,000, respectively, was not available for distribution.

12. PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

Fletcher Allen Health Care Defined Benefit Plan—Employees of the former Medical Center Hospital of Vermont ("MCHV") are covered by a pension plan, formerly the Pension Plan for Employees of Vermont Health Foundation, Inc. The Plan is a defined benefit final average pay plan with benefit accruals based on an average of salary rates on each January 1. It is the policy to fund at least the required minimum contribution under Internal Revenue Code, section 412.

The Plan was amended effective January 1, 1995, to provide for the continued participation in the Plan of any eligible employee who was a member on December 31, 1994, and who was an employee on January 1, 1995. The amendment also provided that no person could become a member on and after January 1, 1995. Effective July 1, 1996, the Plan was further amended to account for a curtailment of benefits for certain other employees.

In addition to providing pension benefits, FAHC sponsors a defined benefit postretirement health care plan for retired employees. Substantially all of FAHC's employees who are at least age 55 with 15 years of pension eligibility service and all employees who are eligible for normal retirement may become eligible for such benefits. The postretirement health care plan is contributory with retiree contributions adjusted annually. The marginal cost method is used to provide for postretirement benefits.

A reconciliation of the changes in the FAHC Defined Benefit Plan and the FAHC Defined Benefit Postretirement Health Care Plan projected benefit obligations and the fair value of assets for the years ended September 30, 2006 and 2005, follows. FAHC uses a June 30 measurement date for measuring plan assets and obligations. The premiums paid by retirees participating in the FAHC Postretirement Health Care Plan exceed the cost covered by FAHC. Therefore the projected benefit obligation has been reduced to zero.

	FAHC Defined Benefit Plan		Postretirement Health Care Plan	
	2006	2005	2006	2005
	(In thousands)			
Changes in benefit obligations:				
Projected benefit obligations—beginning of year	$(122,505)	$(100,444)	$ -	$ -
Service cost	(825)	(783)		
Interest cost	(6,015)	(6,154)		
Benefits paid	4,631	4,181		
Actuarial gain (loss)	14,760	(19,305)		
Projected benefit obligation—end of year	$(109,954)	$(122,505)	$ -	$ -
Changes in plan assets:				
Fair value of plan assets—beginning of year	$ 78,453	$ 68,039	$ -	$ -
Actual return on plan assets	8,058	6,769		
Contributions	4,393	7,826		
Benefits paid	(4,631)	(4,181)		
Fair value of plan assets—end of year	$ 86,273	$ 78,453	$ -	$ -
Funded status:				
Funded status of the plan	$ (23,679)	$ (44,051)	$ -	$ -
Contributions after June 30	2,465	1,193		
Unrecognized net (gain) loss	25,026	44,162	(615)	(691)
Unrecognized prior service costs			403	461
Unrecognized transition asset			(809)	(1,011)
	3,812	1,304	(1,021)	(1,241)
Additional minimum liability	(22,765)	(41,005)		
Total benefit liability	$ (18,953)	$ (39,701)	$(1,021)	$(1,241)
Accumulated benefit obligation	$ 107,692	$ 119,347		

Approximately $9,496,000 and $4,458,000 of the above liability has been reported with accrued expenses at September 30, 2006 and 2005, respectively, in the accompanying balance sheets. Under the requirements of SFAS No. 87, *Employers' Accounting for Pensions*, an additional minimum pension liability of $22,765,000 and $41,005,000 representing the excess of accumulated benefits over plan assets and accrued pension costs, was recognized at September 30, 2006 and 2005, respectively. The minimum pension liability adjustment was recorded as a change in net assets.

The cost components of the net periodic benefit cost for each of the plans for the years ended September 30, 2006 and 2005, are as follows (in thousands):

	FAHC Defined Benefit Plan		FAHC Defined Benefit Postretirement Health Care Plan	
	2006	2005	2006	2005
Service cost	$ 825	$ 783	$	$ -
Interest cost	6,015	6,154		
Expected return on plan assets	(6,619)	(6,181)		
Amortization of unrecognized net (gain) loss	2,937	1,512	(19)	(19)
Amortization of transitional asset			(202)	(202)
Net periodic benefit cost (benefit)	$ 3,158	$ 2,268	$ (221)	$ (221)

The weighted-average assumptions used in accounting for the defined benefit pension plan and the defined benefit postretirement health care plan are as follows:

	FAHC Defined Benefit Plan		FAHC Defined Benefit Postretirement Health Care Plan	
	2006	2005	2006	2005
Weighted-average assumptions used to determine the benefit liability:				
Discount rates	6.25 %	5.00 %	6.25 %	5.00 %
Rates of increase in future compensation levels	3.50	3.00		
Weighted-average assumptions used to determine expense:				
Discount rates	5.00	6.25		
Rates of increase in future compensation levels	3.50	3.00		
Expected long-term rate of return on plan assets	8.50	8.50		

The expected long-term rate of return for the plans' total assets is based on the expected return of each of its asset categories, weighted based on the median of the target allocation for each class. Equity securities are expected to return 9% to 11% over the long-term, while cash and fixed income is expected to return between 5% and 6%. Based on historical experience, FAHC expects that the plans' asset managers will provide a modest (0.5% to 1.0% per annum) premium to their respective market benchmark indices.

For measurement purposes, a 5.0% annual rate of increase in the per capita cost of covered health benefits was assumed for fiscal 2004 and remains at that level thereafter. Assumed health care cost trend rates may have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates would not have a material effect on total service and interest cost components or the postretirement benefit obligation.

Plan Assets—FAHC's pension plan weighted-average asset allocations at September 30, 2006 and 2005, by asset category are as follows:

Asset Category	2006	2005
Equity securities	58 %	69 %
Debt securities	26	13
Real estate investment trusts	2	2
Other	14	16
	100 %	100 %

The investment strategy as established by FAHC's Finance Committee, for pension plan assets, is to meet present and future benefit obligations to all participants and beneficiaries; cover reasonable expenses incurred to provide such benefits; and provide a total return that maximizes the ratio of assets to liabilities by maximizing investment return at the appropriate level of risk.

Cash Flows—Contributions—FAHC expects to contribute $9,500,000 to its pension plan in 2007.

Cash Flows—Estimated Future Benefit Payments—The following benefit payments, which reflect expected future service as appropriate, are expected to be paid (in thousands):

Years Ending September 30	
2007	$ 4,864
2008	5,199
2009	5,688
2010	6,158
2011	6,594
2012–2016	39,261

Medical Center of Vermont—Retirement Plan—A tax-sheltered annuity benefit plan is maintained covering substantially all of the employees of the former MCHV who have at least one year of continuous service. Contributions are determined based on a percentage of employees' salaries up to 1.5% of pay.

Fanny Allen Hospital ("FAH")—Pension Plan—Substantially all of the employees of the former FAH were covered by a defined contribution retirement plan. Eligibility begins after one year of service. A contribution of 4% of each eligible employee's compensation is made to the plan. A tax-deferred annuity plan covering substantially all employees is also provided. Matching contribution is discretionary.

The Plan was amended on January 1, 1996, to discontinue all contributions effective July 1, 1996. All participants became 100% vested as of that date. The amendment also provided that no person may become a member on and after January 1, 1996. In all other respects, the Plan remained in full force and effect.

University Health Center ("UHC")—Retirement Plan—A tax-sheltered annuity benefit plan is maintained covering substantially all of the employees of the former UHC who have at least two years of continuous service. Contributions are determined based on a percentage of employees' salaries.

In accordance with ERISA guidelines, FAHC provided a new retirement plan for employees effective July 1, 1996. The new plan is described as follows:

Fletcher Allen Health Care, Inc.—Retirement Plan—FAHC maintains a tax-sheltered annuity benefit plan covering substantially all of its employees who have at least six months of continuous service. Contributions are determined based on a percentage of employees' salaries up to 10% of pay.

Benefit Plan Costs—FAHC generally funds the benefit costs related to the above retirement, including defined contribution plans and postretirement benefit plans as accrued which amounted to $20,592,000 and $18,588,000 for the years ended September 30, 2006 and 2005, respectively.

13. CONCENTRATIONS OF CREDIT RISK

FAHC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party agreements. The mix of receivable from patients and third-party payors follows:

	2006	2005
Medicare	38 %	32 %
Medicaid	13	20
Blue Cross	16	15
Other third-party payors	25	25
Patients	8	8
	100 %	100 %

14. TRANSACTIONS WITH UVM

FAHC has an Affiliation Agreement with UVM that was most recently renewed as of August 1, 2005 for a five-year term. The Affiliation Agreement obligates FAHC to seek first to meet its needs for physician-employees from physicians holding appointments in the College of Medicine, and provides that the chairs of academic departments in the College of Medicine will be appointed by FAHC as the clinical leaders of the corresponding clinical services. Under the Affiliation Agreement, FAHC agrees to make annual payments to a not-for-profit corporation affiliated with UVM for the benefit of the College of Medicine in three components: (1) a base payment, which was $3.6 million in fiscal year 2006 and is increased by 5% each year during the term of the Agreement, (2) a supplemental payment beginning in fiscal year 2008 equal to 10% of net operating income, if any, in excess of 3.5% of net revenues provided that the supplemental payment shall not exceed $5 million in any fiscal year, and (3) a "Dean's Tax" equal to the following percentages of base physician compensation for the fiscal years indicated: 2006–0.50%, 2007–1.50%, 2008– .50%, 2009–3.50%, 2010 and subsequent years–4.30%. The current term of the Affiliation Agreement ends August 1, 2010 and will be automatically renewed for subsequent five-year terms in the absence of written notice of nonrenewal.

Certain goods and services related to the affiliation with UVM were received in the ordinary course of business during the years ended September 30, 2006 and 2005.

As UVM clinical faculty, associated group physicians receive a portion of their university salary for patient care activities. That patient care compensation is an expense of FAHC, but is processed in part through the UVM payroll system. The amounts of salaries and fringe benefits for patient care and related effort processed through the UVM system approximated $11,026,000 and $10,498,000 in 2006 and 2005, respectively. In addition, FAHC reimburses UVM for equipment rental, research and certain other administrative expenses. Total reimbursements, including salaries and benefits, approximated $18,819,000 and $17,116,000 in 2006 and 2005, respectively. At September 30, 2006 and 2005, amounts due to UVM approximated $6,818,000 and $3,689,000, respectively, and are included in accrued expenses.

As part of the Renaissance Project, FAHC entered into an Education Center Development Agreement ("Development Agreement") with UVM for the construction of an education center that will provide educational facilities to the staff and employees of FAHC, and the faculty, residents, fellows and students of UVM. The Development Agreement provides that UVM will pay approximately $9,900,000 of the costs, as therein defined, associated with the design, construction and equipping of the Education Center and FAHC will be responsible for paying the balance. Based on revised estimates of costs to complete, FAHC recorded contribution expense in the amount of $538,000 for the year ended September 30, 2005. As of September 30, 2006, the remaining amount receivable from UVM totals $767,000 and is included in notes receivable and other assets on the balance sheet.

15. FUNCTIONAL EXPENSES

FAHC provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows (in thousands):

	2006	2005
Education and research	$ 19,853	$ 15,222
Health care services	477,137	445,968
Management and general	197,760	174,734
	$ 694,750	$ 635,924

16. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash, Accounts Receivable, Accounts Payable, Accrued Expenses, and Accrued Payroll and Related Benefits—The carrying amount approximates fair value because of the short maturity of these instruments.

Investments and Assets Whose Use Is Limited—The fair values of the investments and assets whose use is limited that are carried at fair value are estimated based on quoted market prices for those or similar investments. The estimated fair value of the limited partnership investments carried at cost was approximately $21,879,000 and $19,768,000 at September 30, 2006 and 2005, respectively, as determined by the investment managers.

Debt—The fair value of FAHC's debt, which approximates $388,683,521 and $399,198,930 at September 30, 2006 and 2005, respectively, is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to FAHC for debt with the same remaining maturities.

Interest Rate Swaps—The fair values of interest rate swap agreements are obtained from quotes. These values represent the estimated amounts FAHC would receive or pay to terminate agreements, taking into consideration current interest rates and the current creditworthiness of the counterparty.

17. PLEDGES RECEIVABLE

In connection with the renovation and expansion project on the MCHV campus, FAHC has undertaken a capital fund raising campaign. As of September 30, 2006 and 2005, the following pledges were receivable (in thousands):

	2006	2005
Due in less than one year	$ 1,433	$ 1,602
Due in one to five years	1,514	1,987
Due in over five years	194	814
	3,141	4,403
Less allowances for uncollectible amounts	(160)	(245)
	$ 2,981	$ 4,158

* * * * * *

SUPPLEMENTAL SCHEDULES

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION
AS OF SEPTEMBER 30, 2006
(In thousands)

ASSETS	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Venture, Inc.	Fletcher Allen Medical Group LLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company Ltd.	Fletcher Allen Coordinated Transport	Eliminations	Total
CURRENT ASSETS:								
Cash and cash equivalents	$ 32,801	$ 6,044	$ 47	$ -	$ 5,439	$188	$ -	$ 44,519
Patient and other trade accounts receivable—net	104,466	2,743	325			318		107,852
Due from related parties					14,565		(14,565)	-
Short-term investments	177							177
Inventories	10,338							10,338
Current portion of restricted assets					7,000			7,000
Prepaid and other current assets	9,795	2,915	1		3,369			16,080
Total current assets	157,577	11,702	373	-	30,373	506	(14,565)	185,966
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:								
Board-designated assets	122,742							122,742
Assets held by trustee under bond indenture agreements	31,301							31,301
Restricted assets	1,138				21,054			22,192
Donor restricted assets for specific purposes	9,169				-			9,169
Donor restricted assets for permanent endowment	23,593				-			23,593
Total assets whose use is limited or restricted	187,943	-	-	-	21,054	-	-	208,997
PROPERTY AND EQUIPMENT—Net	437,168	118				27		437,313
OTHER ASSETS:								
Deferred financing costs—net	19,102							19,102
Notes receivable and other assets	1,580	250					(27)	1,803
Investment in affiliated companies	33,906			3,788			(24,563)	13,131
Pledges receivable	1,626							1,626
Total other assets	56,214	250	-	3,788	-	-	(24,590)	35,662
TOTAL	$838,902	$12,070	$373	$3,788	$51,427	$533	$(39,155)	$867,938

See notes to supplemental schedule

(Continued)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION
AS OF SEPTEMBER 30, 2006
(In thousands)

LIABILITIES AND NET ASSETS	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Venture, Inc.	Fletcher Allen Medical Group LLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company Ltd.	Fletcher Allen Coordinated Transport	Eliminations	Total
CURRENT LIABILITIES:								
Current installments of long-term debt	$ 7,418	$ -	$-	$ -	$ -	$ 32	$ -	$ 7,450
Accounts payable	31,178	375	25		275		(25)	31,828
Accrued expenses and other liabilities	38,157	3,612	75			3	(1)	41,846
Accrued payroll and related benefits	35,543	109				62	(148)	35,566
Estimated third-party payor settlements	9,069							9,069
Due to related parties	13,526	1,267				4,477	(14,417)	4,853
Estimated amounts for incurred but unreported claims	6,154	6,457			7,000			19,611
Total current liabilities	141,045	11,820	100	-	7,275	4,574	(14,591)	150,223
LONG-TERM LIABILITIES:								
Long-term debt—excluding current installments	372,612							372,612
Reserve for outstanding losses on malpractice and workers' compensation claims					19,816			19,816
Pension and other postretirement benefit obligations	10,478							10,478
Other long-term liabilities	1,741	250						1,991
Total long-term liabilities	384,831	250	-	-	19,816	-	-	404,897
Total liabilities	525,876	12,070	100	-	27,091	4,574	(14,591)	555,120
COMMITMENTS AND CONTINGENT LIABILITIES								
NET ASSETS:								
Unrestricted	276,784		273	3,788		(4,041)	(228)	276,576
Temporarily restricted	12,649							12,649
Permanently restricted	23,593							23,593
Retained earnings					24,336		(24,336)	-
Total net assets (deficit)	313,026	-	273	3,788	24,336	(4,041)	(24,564)	312,818
TOTAL	$838,902	$12,070	$373	$3,788	$51,427	$ 533	$ (39,155)	$867,938

See note to supplemental schedule.

(Concluded)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS INFORMATION
FOR THE YEAR ENDED SEPTEMBER 30, 2006
(In thousands)

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Venture, Inc.	Fletcher Allen Medical Group LLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company Ltd.	Fletcher Allen Coordinated Transport	Eliminations	Total
UNRESTRICTED REVENUE AND OTHER SUPPORT:								
Net patient service revenue	$661,305	$ -	$366	$ -	$ -	$ 991	$ (27,965)	$634,697
Premium revenue	4,283	54,597					(2,670)	56,210
Other revenue	20,762				6,469		(6,547)	20,684
Total unrestricted revenue and other support	686,350	54,597	366	-	6,469	991	(37,182)	711,591
EXPENSES:								
Salaries, payroll taxes, and fringe benefits	408,018	2,319				1,813	(2,490)	409,660
Supplies and other	172,234	742	1		61	150	(6,475)	166,713
Purchased services	23,502	2,170	75		1,093	90	(73)	26,857
Depreciation and amortization	34,894	62				104		35,060
Interest expense	16,883		1			6		16,890
Provision for bad debts	14,784		16			72		14,872
Underwriting expenses					3,415			3,415
Medical claims		49,427					(28,144)	21,283
Total expenses	670,315	54,720	93	-	4,569	2,235	(37,182)	694,750
INCOME (LOSS) FROM OPERATIONS	16,035	(123)	273	-	1,900	(1,244)	-	16,841
NONOPERATING REVENUE (EXPENSE):								
Investment income and losses on investments	11,717	209			3,007			14,933
Unrealized gain on interest rate swap contracts	3,963							3,963
Other	3,829			528	29		(4,780)	(394)
Total nonoperating revenue (expense)	19,509	209	-	528	3,036	-	(4,780)	18,502
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	35,544	86	273	528	4,936	(1,244)	(4,780)	35,343
NET UNREALIZED GAINS (LOSSES) ON INVESTMENTS	954				(1,055)		(2,423)	(2,524)
ASSETS RELEASED FROM RESTRICTIONS—For capital purchases	3,106							3,106
ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT	18,240							18,240
TRANSFER OF NET ASSETS	4,843							4,843
EQUITY TRANSFER				(500)			500	-
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPL	(861)							(861)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	$ 61,826	$ 86	$273	$ 28	$ 3,881	$(1,244)	$ (6,703)	$ 58,147

See note to supplemental schedule.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP BALANCE SHEETS INFORMATION
AS OF SEPTEMBER 30, 2006 AND 2005
(In thousands)

ASSETS	2006	2005
CURRENT ASSETS:		
Cash and cash equivalents	$ 32,801	$ 19,529
Patient and other trade accounts receivable—net	104,466	88,518
Short-term investments	177	3,515
Inventories	10,338	7,152
Prepaid and other current assets	9,795	8,457
Total current assets	157,577	127,171
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:		
Board-designated assets	122,742	123,620
Assets held by trustee under bond indenture agreements	31,301	30,710
Donor restricted assets for specific purposes	9,169	10,067
Donor restricted assets for permanent endowment	23,593	24,900
Total assets whose use is limited or restricted	186,805	189,297
PROPERTY AND EQUIPMENT—Net	437,168	445,397
OTHER ASSETS:		
Deferred financing costs—net	19,102	20,253
Notes receivable and other assets	1,580	1,296
Investment in affiliated companies	33,906	30,640
Pledges receivable	1,626	2,645
Total other assets	56,214	54,834
TOTAL	$ 837,764	$ 816,699

(Continued)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP BALANCE SHEETS INFORMATION
AS OF SEPTEMBER 30, 2006 AND 2005
(In thousands)

LIABILITIES AND NET ASSETS	2006	2005
CURRENT LIABILITIES:		
Current installments of long-term debt	$ 7,418	$ 6,528
Accounts payable	31,178	20,130
Accrued expenses and other liabilities	38,157	54,927
Accrued payroll and related benefits	35,543	29,537
Estimated third-party payor settlements	9,069	13,798
Due to related parties	13,526	12,313
Estimated amounts for incurred but unreported claims	6,154	5,145
Total current liabilities	141,045	142,378
LONG-TERM LIABILITIES:		
Long-term debt—excluding current installments	372,612	380,065
Pension and other postretirement benefit obligations	10,478	36,485
Other long-term liabilities	1,741	3,865
Total long-term liabilities	384,831	420,415
Total liabilities	525,876	562,793
COMMITMENTS AND CONTINGENT LIABILITIES		
NET ASSETS:		
Unrestricted	275,646	214,281
Temporarily restricted	12,649	14,725
Permanently restricted	23,593	24,900
Total net assets	311,888	253,906
TOTAL	$ 837,764	$ 816,699

See note to supplemental schedule. (Concluded)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP STATEMENTS OF OPERATIONS INFORMATION
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
UNRESTRICTED REVENUE AND OTHER SUPPORT:		
Net patient service revenue	$ 661,305	$ 610,499
Premium revenue	4,283	3,959
Other revenue	20,762	6,523
Total unrestricted revenue and other support	686,350	620,981
EXPENSES:		
Salaries, payroll taxes, and fringe benefits	408,018	371,777
Supplies and other	172,234	157,432
Purchased services	23,502	22,164
Depreciation and amortization	34,894	30,429
Interest expense	16,883	6,614
Provision for bad debts	14,784	12,699
Total expenses	670,315	601,115
NET INCOME FROM OPERATIONS	16,035	19,866
NONOPERATING REVENUE (EXPENSE):		
Investment income and losses	11,717	6,451
Unrealized gain (loss) on interest rate swap contracts	3,963	(1,183)
Other	3,368	5,314
Total nonoperating revenue	19,048	10,582
EXCESS OF REVENUES OVER EXPENSES	35,083	30,448
NET UNREALIZED GAINS ON INVESTMENTS	954	4,867
ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES	3,106	2,573
ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT	18,240	(17,175)
TRANSFER OF NET ASSETS	4,843	3,212
INCREASE IN UNRESTRICTED NET ASSETS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	62,226	23,925
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(861)	
INCREASE IN UNRESTRICTED NET ASSETS	$ 61,365	$ 23,925

See note to supplemental schedule.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP STATEMENTS OF CHANGES IN NET ASSETS INFORMATION FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands)

	2006	2005
UNRESTRICTED NET ASSETS:		
Excess of revenues over expenses	$ 35,083	$ 30,448
Net unrealized gains on investments	954	4,867
Assets released from restrictions for capital purchases	3,106	2,573
Transfer of net assets	4,843	3,212
Additional minimum pension liability adjustment	18,240	(17,175)
Cumulative effect of change in accounting principle	(861)	
Increase in unrestricted net assets	61,365	23,925
TEMPORARILY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	2,581	2,284
Investment income	1,794	531
Net unrealized (losses) gains on investments	(901)	1,050
Net realized gains on investments	1,486	
Net assets released from restrictions used in operations	(759)	(674)
Net assets released from restrictions used for nonoperating purposes	(232)	(153)
Net assets released from restrictions used for capital purchases	(3,106)	(2,573)
Transfer of net assets	(2,939)	
(Decrease) increase in temporarily restricted net assets	(2,076)	465
PERMANENTLY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	104	198
Change in beneficial interest in perpetual trusts	493	641
Transfer of net assets	(1,904)	
(Decrease) increase in permanently restricted net assets	(1,307)	839
INCREASE IN NET ASSETS	57,982	25,229
NET ASSETS—Beginning of year	253,906	228,677
NET ASSETS—End of year	$ 311,888	$ 253,906

See note to supplemental schedule.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

NOTE TO SUPPLEMENTAL SCHEDULES
AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

1. FLETCHER ALLEN HEALTH CARE, INC. OBLIGATED GROUP

Fletcher Allen Health Care, Inc. presently is the sole member of the Obligated Group. The accompanying supplemental schedules have been prepared for the purpose of additional analysis of the basic consolidated financial statements of Fletcher Allen Health Care, Inc. and subsidiaries for purposes of complying with certain requirements related to FAHC's debt agreements and are not intended to present the separate financial statements of the Obligated Group.

FAHC accounts for its investments in affiliated companies in its parent company financial statements using the equity method of accounting. Effective in January 2006, Fletcher Allen Outpatient Pharmacies, LLC ("FAOP)" was merged into Fletcher Allen Health Care, Inc. The merger was accounted for as a pooling-of-interests. Prior period financial statements of the Obligated Group were not restated.