

Fletcher Allen Health Care, Inc. and Subsidiaries

Consolidated Financial Statements
and Additional Information as of and for the
Years Ended September 30, 2008 and 2007, and
Independent Auditors' Report

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, 2008 AND 2007:	
Balance Sheets	2
Statements of Operations	3
Statements of Changes in Net Assets	4
Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6–28
SUPPLEMENTAL SCHEDULES AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007:	29
Consolidating Balance Sheet Information	30–31
Consolidating Statement of Operations Information	32
Obligated Group Balance Sheet Information	33–34
Obligated Group Statement of Operations Information	35
Obligated Group Statement of Changes in Net Assets Information	36
Note to Supplemental Schedules	37
Obligated Group Computation of Long-Term Debt Service Coverage Ratio	38

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, 2008 and 2007, 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, 2008 and 2007, and the results of its operations, changes in net assets, 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.

In connection with our audit of the 2008 consolidated financial statements, nothing came to our attention that caused us to believe that the Company failed to comply with the terms, covenants, provisions, or conditions of Article III, Section 3.07 of the Amended and Restated Master Trust Indenture between Fletcher Allen Health Care, Inc. and Chittenden Trust Company, as Master Trustee, dated as of March 1, 2004 insofar as they relate to the financial and accounting matters. However, our audit was not directed primarily toward obtaining knowledge of noncompliance with such provisions.

This report is intended solely for the information and use of the Board of Trustees and management of Fletcher Allen Health Care, Inc. and Chittenden Trust Company and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

January 16, 2009

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007		2008	2007
ASSETS			LIABILITIES AND NET ASSETS		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash and cash equivalents	\$ 62,583	\$ 44,614	Current installments of long-term debt	\$ 8,178	\$ 7,529
Patient and other trade accounts receivable — net of allowance for doubtful accounts of \$16,432 in 2008 and \$15,525 in 2007	102,233	110,813	Accounts payable	16,774	16,938
Short-term investments	459	881	Accrued expenses and other liabilities	40,625	33,284
Inventories	11,533	10,782	Accrued payroll and related benefits	44,391	38,439
Current portion of restricted assets	8,000	8,000	Estimated third-party payor settlements	7,563	8,591
Prepaid and other current assets	<u>26,748</u>	<u>19,252</u>	Estimated amounts for incurred but unreported claims	<u>19,129</u>	<u>21,090</u>
Total current assets	<u>211,556</u>	<u>194,342</u>	Total current liabilities	<u>136,660</u>	<u>125,871</u>
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:			LONG-TERM LIABILITIES:		
Board-designated assets	167,226	190,691	Long-term debt — excluding current installments	417,803	423,857
Assets held by trustee under bond indenture agreements	37,068	38,472	Reserve for outstanding losses on malpractice and workers' compensation claims	29,325	24,094
Restricted assets	30,829	22,793	Pension and other postretirement benefit obligations	5,619	2,213
Donor-restricted assets for specific purposes	8,941	11,915	Other long-term liabilities	<u>4,841</u>	<u>1,939</u>
Donor-restricted assets for permanent endowment	<u>26,266</u>	<u>24,909</u>	Total long-term liabilities	<u>457,588</u>	<u>452,103</u>
Total assets whose use is limited or restricted	<u>270,330</u>	<u>288,780</u>	Total liabilities	<u>594,248</u>	<u>577,974</u>
PROPERTY AND EQUIPMENT — Net	<u>423,875</u>	<u>426,369</u>	COMMITMENTS AND CONTINGENT LIABILITIES (Note 10)		
OTHER ASSETS:			NET ASSETS:		
Deferred financing costs — net	17,703	19,213	Unrestricted	305,347	325,924
Notes receivable and other assets	1,324	3,786	Temporarily restricted	11,470	16,695
Investment in affiliated companies	11,325	11,522	Permanently restricted	<u>26,266</u>	<u>24,909</u>
Pledges receivable	<u>1,218</u>	<u>1,490</u>	Total net assets	<u>343,083</u>	<u>367,528</u>
Total other assets	<u>31,570</u>	<u>36,011</u>	TOTAL	<u>\$937,331</u>	<u>\$945,502</u>
TOTAL	<u>\$937,331</u>	<u>\$945,502</u>			

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
UNRESTRICTED REVENUE AND OTHER SUPPORT:		
Net patient service revenue	\$733,153	\$692,651
Premium revenue	64,454	59,401
Other revenue	<u>21,660</u>	<u>20,175</u>
Total unrestricted revenue and other support	<u>819,267</u>	<u>772,227</u>
EXPENSES:		
Salaries, payroll taxes, and fringe benefits	463,043	437,396
Supplies and other	187,819	176,921
Purchased services	29,556	30,738
Depreciation and amortization	34,402	33,496
Interest expense	22,492	18,407
Loss on disposal of property and equipment	3	1,841
Provision for bad debts	26,227	20,506
Underwriting expenses	9,582	7,427
Medical claims	<u>26,726</u>	<u>25,088</u>
Total expenses	<u>799,850</u>	<u>751,820</u>
INCOME FROM OPERATIONS	<u>19,417</u>	<u>20,407</u>
NONOPERATING REVENUE (EXPENSE):		
Investment income and losses	(3,625)	12,842
(Loss) gain on interest rate swap contracts	(8,292)	1,440
Other	<u>(3,152)</u>	<u>(1,489)</u>
Total nonoperating (expense) revenue	<u>(15,069)</u>	<u>12,793</u>
EXCESS OF REVENUE OVER EXPENSES	4,348	33,200
NET CHANGE IN UNREALIZED (LOSSES) GAINS ON INVESTMENTS	(23,926)	11,320
ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES	1,814	1,164
CAPITAL CONTRIBUTIONS	1,362	
PENSION RELATED ADJUSTMENTS	(4,175)	5,298
ADJUSTMENT TO INITIALLY APPLY THE RECOGNITION PROVISIONS OF FASB STATEMENT NO. 158	<u> </u>	<u>(1,634)</u>
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	<u>\$ (20,577)</u>	<u>\$ 49,348</u>

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, 2008 AND 2007

(In thousands)

	2008	2007
UNRESTRICTED NET ASSETS:		
Excess of revenue over expenses	\$ 4,348	\$ 33,200
Net change in unrealized (losses) gains on investments	(23,926)	11,320
Assets released from restrictions for capital purchases	1,814	1,164
Capital contributions	1,362	
Pension-related adjustments	(4,175)	5,298
Adjustment to initially apply the recognition provisions of FASB Statement No. 158		(1,634)
	<u>(20,577)</u>	<u>49,348</u>
(Decrease) increase in unrestricted net assets		
TEMPORARILY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	1,972	3,430
Investment income	473	290
Net change in unrealized (losses) gains on investments	(3,258)	910
Net realized gains on investments	904	2,407
Net assets released from restrictions used in operations	(1,193)	(1,584)
Net assets released from restrictions used for nonoperating purposes	(219)	(243)
Net assets released from restrictions used for capital purchases	(1,814)	(1,164)
Transfer of net assets	(2,090)	
	<u>(5,225)</u>	<u>4,046</u>
(Decrease) increase in temporarily restricted net assets		
PERMANENTLY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	739	285
Change in beneficial interest in perpetual trusts	(1,472)	1,031
Transfer of net assets	2,090	
	<u>1,357</u>	<u>1,316</u>
Increase in permanently restricted net assets		
(DECREASE) INCREASE IN NET ASSETS	(24,445)	54,710
NET ASSETS — Beginning of year	<u>367,528</u>	<u>312,818</u>
NET ASSETS — End of year	<u>\$ 343,083</u>	<u>\$ 367,528</u>

See notes to consolidated financial statements.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES AND GAINS:		
(Decrease) increase in net assets	\$ (24,445)	\$ 54,710
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities and gain		
Depreciation and amortization	34,402	33,496
Provision for bad debts	26,227	20,506
Restricted contributions and investment income received	(3,184)	(4,005)
Pension-related adjustments	4,175	(5,298)
Adjustment to initially apply the recognition provisions of FASB Statement No. 158		1,634
Loss on disposal of property and equipment	3	1,841
Loss on extinguishment of debt	2,304	
Unrealized loss (gain) on interest rate swap contracts	5,165	(1,440)
Realized and unrealized losses (gains) on investments	38,209	(14,424)
Undistributed losses of affiliated companies	197	359
Change in beneficial interest in perpetual trusts	1,472	(1,031)
Changes in operating assets and liabilities:		
Increase in patient and other accounts receivable	(17,647)	(23,467)
Decrease in pledges receivable	272	136
Increase in other current and noncurrent assets	(8,247)	(4,211)
Increase (decrease) in accounts payable and accrued expenses	7,177	(25,836)
Increase in accrued payroll and related expenses	5,952	2,873
(Decrease) increase in current and other liabilities	2,337	5,279
Decrease in pension and other postretirement benefit obligations	(769)	(4,601)
Net cash provided by operating activities and gains	<u>73,600</u>	<u>36,521</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(31,040)	(23,220)
Purchase of investments	(715,940)	(195,800)
Proceeds from sale of investments	695,131	129,768
Proceeds from distribution of equity investees		1,250
Net cash used in investing activities	<u>(51,849)</u>	<u>(88,002)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from restricted contributions and restricted investment income	3,184	4,005
Repayment of long-term debt	(220,750)	(7,875)
Deferred financing costs	(1,602)	(929)
Proceeds from issuance of long-term debt	<u>215,386</u>	<u>56,375</u>
Net cash (used in) provided by financing activities	<u>(3,782)</u>	<u>51,576</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	17,969	95
CASH AND CASH EQUIVALENTS — Beginning of year	<u>44,614</u>	<u>44,519</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 62,583</u>	<u>\$ 44,614</u>
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year for interest	<u>\$ 19,838</u>	<u>\$ 18,158</u>
Assets acquired under capital lease	<u>\$ -</u>	<u>\$ 2,824</u>

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, 2008 AND 2007

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

Principles 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 amounts 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. Significant estimates include the allowances for doubtful accounts and contracted allowances, estimated settlements with third-party payors, self-insurance program liabilities, accrued medical claims, pension and postretirement costs, and the valuation of investments. 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, mutual funds, and common collective trusts 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 or the net asset values of common collective trusts. In 2007, FAHC had investments in limited partnerships and limited liability corporations that were carried at cost. Such investments were sold in 2008. 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. The accounting for pension plan assets is discussed in Note 12.

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 consolidated balance sheets and consolidated statements of operations and changes in net assets. Subsequent to September 30, 2008, conditions in the worldwide debt and equity markets have deteriorated significantly. These conditions have had a negative effect on the fair value of FAHC's investments since September 30, 2008.

Other-Than-Temporary 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 Financial Accounting Standards Board (FASB) Staff Position (FSP) FAS 115-1 and FAS 124-1: *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. FAHC recognized \$34,814,000 and \$436,000 in losses related to declines in value that were other than temporary in nature in 2008 and 2007, respectively.

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; and OB Net 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. 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 \$160,000 and \$193,500 of interest was capitalized during 2008 and 2007, respectively. Net deferred financing costs totaled \$17,703,000 and \$19,213,000 as of September 30, 2008 and 2007, respectively. Such amounts are reported with other assets and are amortized over the period the related obligations are outstanding. Accumulated amortization of deferred financing costs totaled \$4,126,000 and \$3,179,000 at September 30, 2008 and 2007, 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.

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 initially apply FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, and certain other pension related adjustments.

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 \$5,306,000 in 2008 and \$5,520,000 in 2007.

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 rehabilitation services are paid based on a prospective per discharge methodology. These rates vary according to a patient classification system based upon service provided, the patient's level of functionality and other factors. Outpatient services are paid based upon a prospective standard rate for procedures performed or services rendered. FAHC is reimbursed for cost-reimbursable items at tentative rates, 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 derived from the Medicare program was approximately 35% in fiscal year 2008 and 37% in fiscal year 2007.

Medicaid — Prior to January 1, 2008, inpatient services rendered to Medicaid program beneficiaries were reimbursed under prospectively determined per diem rates. As of January 1, 2008, inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. As with Medicare, reimbursement is based on a DRG system that is based on clinical, diagnostic, and other factors. For inpatient rehabilitation and neonatal cases, additional reimbursement is paid through a per diem add-on. For inpatient psychiatric cases, reimbursement is based on a per diem rate calculation, including adjustments for diagnostic factors and length of stay. Prior to May 1, 2008, outpatient services rendered to Medicaid beneficiaries, other than laboratory and radiology, were reimbursed under a reasonable cost methodology. Under that system, FAHC was 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. As of May 1, 2008, outpatient services rendered to Medicaid beneficiaries are paid based upon a prospective standard rate. Certain laboratory, mammography, therapy, and dialysis services are paid on a fee schedule. Medicaid reimbursement for professional services is determined by a standard fee schedule that is determined by the State of Vermont. Approximately 13% of FAHC's net revenue in 2008 and 2007 was derived 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. Approximately 36% of FAHC's net revenues in 2008 and 29% in 2007 was derived from commercial insurers.

VMC 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, cafeteria sales, parking garage income, 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.

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 are incorporated and recognized by the Internal Revenue Service (IRS) as tax-exempt under Section 501(c)(3) of the Internal Revenue Code (the “Code”). Accordingly, the IRS has determined that FAHC, FAPC, and FAMG 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 and VMC are for-profit subsidiaries subject to federal and state taxation. For these entities, FAHC applies the provisions of FASB Statement No. 109, *Accounting for Income Taxes*. The tax provisions and related tax assets and liabilities are not material.

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.

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.

FAHC adopted the provisions of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*, on October 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements in accordance with FASB Statement No. 109. It prescribes an uncertainty threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of adopting FIN No. 48 was not material.

Accounting for Asset Retirement Obligations — Effective September 30, 2006, FAHC adopted the provisions of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, as clarified by FIN No. 47, *Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143*, issued in March 2005. FIN No. 47 clarified 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. FASB Statement No. 143 requires that 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 No. 47, FAHC recorded a liability of approximately \$861,000, calculated using a discount rate of 4.5%. The estimated future undiscounted value of the asset retirement obligation was approximately \$1,337,000.

Substantially all of the impact of adopting FIN No. 47 relates to estimated costs to remove asbestos that is contained within FAHC's facilities. The adjustment to the obligation in 2008 and 2007 was not significant.

Accounting for Postretirement Benefit Plans — In September 2006, the FASB issued FASB Statement No. 158. FASB Statement No. 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "postretirement benefit plans") to recognize the overfunded or underfunded status of their postretirement benefit plans in the balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year end, and provide additional disclosures. The Statement also requires 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 statements of operations and changes in net assets. On September 30, 2007, FAHC adopted the recognition and disclosure provisions of FASB Statement No. 158. The effect of adopting FASB Statement No. 158 was a decrease in unrestricted net assets of \$1,634,000 (a \$2,433,000 decrease in net assets related to the defined benefit plan and a \$799,000 increase related to other postretirement benefit plans). This amount has been recognized as an adjustment to unrestricted net assets in the accompanying consolidated financial statements. FASB Statement No. 158's provision regarding the change in measurement date of postretirement plans will be adopted by FAHC effective September 30, 2009. See Note 12 for further discussion of the effect of adopting FASB Statement No. 158 on FAHC's accompanying consolidated financial statements.

Recently Issued Accounting Pronouncements — In 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*. FASB Statement No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The pronouncement is applicable in cases when assets or liabilities are to be measured at fair value. The provisions of this standard will be effective for FAHC in 2009. FAHC is evaluating the potential impact that the adoption of FASB Statement No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*. Under this standard, FAHC may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in the excess of revenue over expenses. This election is irrevocable. FASB Statement No. 159 is effective for FAHC commencing in 2009. FAHC has not elected to measure any of its financial assets or liabilities at fair value in accordance with this standard as of October 1, 2008.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*. This guidance expands both qualitative and quantitative disclosures on an entity's use of derivatives. The provisions of FASB Statement No. 161 are effective for FAHC for 2009. FAHC is currently assessing the potential impact that the adoption of this statement will have on its financial statements.

In August 2008, the FASB issued FSP FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for all Endowment Funds*. The guidance is intended to improve the quality and consistency of financial reporting of endowments held by not-for-profit organizations. This FSP provides guidance on classifying the net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which serves as a model act for states to modernize their laws governing donor-restricted endowment funds. This FSP also requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations, including those that are not subject to an enacted version of UPMIFA. The provisions of the FSP are effective for FAHC for 2009. FAHC is currently assessing the potential impact that the adoption of this FSP will have on its 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 \$19,400,000 and \$17,700,000 in 2008 and 2007, 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, 2008 and 2007, consisted of the following (in thousands):

	2008	2007
Cash and cash equivalents	\$ 1,492	\$ 8,417
Money market funds	5,329	1,947
Bonds and notes	37,068	38,472
Common collective trusts and mutual funds	223,042	222,475
Limited partnerships (at cost)		12,862
Beneficial interest in perpetual trusts	9,976	11,448
Other	<u>1,423</u>	<u>1,159</u>
	278,330	296,780
Less current portion	<u>(8,000)</u>	<u>(8,000)</u>
	<u>\$ 270,330</u>	<u>\$ 288,780</u>

Investment income and gains (losses) for the years ended September 30, 2008 and 2007, consisted of the following (in thousands):

	2008	2007
Nonoperating revenue and expenses:		
Investment income	\$ 8,305	\$ 13,055
Net realized losses on sales of securities	<u>(11,930)</u>	<u>(213)</u>
	<u>(3,625)</u>	<u>12,842</u>
Other changes in unrestricted net assets — net change in unrealized (loss) gain on investments	<u>(23,926)</u>	<u>11,320</u>
Changes in temporarily restricted net assets:		
Investment income	473	290
Net change in unrealized (losses) gains on investments	(3,258)	910
Net realized gains on investments	<u>904</u>	<u>2,407</u>
	<u>(1,881)</u>	<u>3,607</u>
Changes in permanently restricted net assets — change in beneficial interest in perpetual trusts	<u>(1,472)</u>	<u>1,031</u>
Total	<u>\$ (30,904)</u>	<u>\$ 28,800</u>

At September 30, 2007, FAHC held investments that had a fair market value of approximately \$298,000 less than their cost as adjusted for other-than-temporary impairment. The cost of these investments had exceeded the market value for longer than one year. At September 30, 2008, there were no investments with a fair value less than their cost as adjusted for losses related to declines in value that were determined to be other than temporary in nature.

The amortized cost and estimated fair value of securities classified as available for sale by FAHC's for-profit subsidiaries at September 30, 2008 and 2007, were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2008				
Common collective trusts	<u>\$ 37,406</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 37,406</u>
2007				
Mutual funds	<u>\$ 25,603</u>	<u>\$ 4,355</u>	<u>\$ (298)</u>	<u>\$ 29,660</u>

Proceeds from sales of available-for-sale securities by FAHC's for-profit subsidiaries were \$50,040,000 and \$1,945,000 for the years ended September 30, 2008 and 2007, respectively.

5. PROPERTY AND EQUIPMENT

A summary of property and equipment at September 30, 2008 and 2007, is as follows (in thousands):

	2008	2007
Land	\$ 7,796	\$ 7,796
Land improvements	11,820	14,180
Leasehold improvements	34,709	38,331
Buildings	467,332	478,629
Equipment, furniture, and fixtures	<u>145,961</u>	<u>235,321</u>
	667,618	774,257
Less accumulated depreciation and amortization	<u>(255,215)</u>	<u>(352,430)</u>
	412,403	421,827
Construction-in-progress	<u>11,472</u>	<u>4,542</u>
	<u>\$ 423,875</u>	<u>\$ 426,369</u>

Accounts payable and accrued expenses include approximately \$64,000 and \$531,000 at September 30, 2008 and 2007, respectively, related to construction projects. In addition, FAHC is committed to contracts approximating \$3,076,000 at September 30, 2008, for the completion of these projects.

During 2008, FAHC wrote off approximately \$129,000,000 in fully depreciated assets.

6. INVESTMENT IN AFFILIATED COMPANIES

Investment in affiliated companies at September 30, 2008 and 2007, consisted of the following (in thousands):

	2008	2007
Starr Farm Partnership	\$ 4,248	\$ 3,349
The Vermont Health Plan (TVHP)	6,845	8,027
Other	<u>232</u>	<u>146</u>
	<u>\$ 11,325</u>	<u>\$ 11,522</u>

Distributions from these affiliated organizations totaled \$1,250,000 for the year ended September 30, 2007. There were no distributions in 2008. FAHC's share of the income (losses) of these affiliates is reported as nonoperating revenue (expense) and totaled approximately \$2,941,000 and \$(359,000) for the years ended September 30, 2008 and 2007, respectively. FAHC has committed to sell its share in TVHP for a total of approximately \$6,845,000. As a result, FAHC has recorded a loss of approximately \$3.1 million to recognize the impairment in the value of its investment in TVHP at September 30, 2008. This loss has been recorded in other nonoperating revenue (expense) in the accompanying consolidated statement of operations.

Summarized financial information from the unaudited financial statements of the Starr Farm Partnership and TVHP at September 30, 2008 and 2007, and for the years then ended is as follows (in thousands of dollars):

	Ownership Percentage	Total Assets	Net Assets	Change in Net Assets
2008				
Starr Farm Partnership	50 %	\$ 10,234	\$ 8,495	\$ 1,797
The Vermont Health Plan	29	58,009	29,349	7,684
2007				
Starr Farm Partnership	50 %	\$ 8,995	\$ 6,698	\$ (878)
The Vermont Health Plan	29	53,265	21,665	(4,726)

7. LONG-TERM DEBT

Long-term debt at September 30, 2008 and 2007, consisted of the following (in thousands):

	2008	2007
Vermont Educational and Health Buildings Financing Agency		
Hospital Revenue Bonds:		
Series 2008A Bonds, variable rate (7.8% at September 30, 2008) payable through 2030	\$ 54,705	\$ -
Series 2007A Bonds, fixed rate (4.75% to 4.0%), payable through 2037 (including unamortized premium of \$109 and \$113)	56,369	56,373
Series 2004B Bonds, converted variable-rate auction rate bonds (3.6% at September 30, 2007) to fixed rate (4% to 5.5%), payable through 2035 (including unamortized premium of \$154 at September 30, 2008)	160,679	165,400
Series 2004A Bonds, fixed rate (5.0% to 2.0%), payable through 2025 (including unamortized premium of \$1,488 and \$1,586)	43,173	44,975
Series 2000A Bonds, fixed rate (6.13% to 5.3%), payable through 2028 (net of unamortized bond discount of \$632 and \$664)	95,634	96,206
Series 2000B Bonds, variable rate (3.95% at September 30, 2007)		50,000
Select Auction Variable-Rate Securities (SAVRS) 1994 Bonds, variable rate (4.1% at September 30, 2008), payable through 2013 (net of unamortized discount of \$174 and \$203)	13,226	15,447
Capital leases and other notes payable	<u>2,195</u>	<u>2,985</u>
	425,981	431,386
Less current portion	<u>(8,178)</u>	<u>(7,529)</u>
Long-term debt	<u>\$ 417,803</u>	<u>\$ 423,857</u>

Revenue Bonds — On May 21, 2008, FAHC, converted the Series 2004B auction rate bonds from 35-day variable-rate bonds to fixed-rate bonds through a mandatory tender of the bonds as provided for under the original bond agreement. The tender was financed through the reissuance of \$160,525,000 of Series 2004B bonds as tax-exempt fixed-rate bonds, and a payment of \$2,700,000 from FAHC's debt

service reserve funds. The Series 2004B bonds require FAHC to maintain a debt service reserve fund. On May 21, 2008, the reserve fund requirement was \$13,657,000.

Also on May 21, 2008, FAHC in connection with the Vermont Educational and Health Building Financing Agency (the "Agency"), issued \$54,705,000 of tax-exempt variable-rate hospital revenue bonds ("Series 2008A"), the proceeds of which were used to refund its Series 2000B bonds in the amount of \$50,000,000, pay an early termination payment in the amount of \$3,128,000 on a related interest rate swap, and pay issuance costs in the amount of \$1,602,000. The Series 2008A bonds are secured by an irrevocable letter of credit from a local bank in the amount of \$55,334,000, which expires in 2013. The interest rate on the Series 2008A bonds is set weekly. Series 2008A bondholders have the option to put the bonds back to FAHC. Such bonds would be subject to remarketing efforts by FAHC's remarketing agent. To the extent that such remarketing efforts were unsuccessful, the nonmarketability bonds would be purchased from the proceeds of the letter of credit. Monthly payments of principal on the letter of credit borrowings would commence on the first calendar day of the first month that commences more than one year after the borrowing. Repayment in full of the letter of credit would be required by the earlier of five years from the date of the borrowing under the letter of credit or the stated expiration date (currently, April 30, 2013). The bonds have been classified in accordance with the original maturity in the accompanying consolidated balance sheet and in the table of scheduled maturities of long-term debt.

FAHC recorded a loss on the extinguishment of debt of \$2,304,000 related to the bond refinancing. In conjunction with these transactions, the notional amount of the original swap agreement covering the 2004B bonds (see note below) was reduced from \$135,000,000 to \$55,190,000 and transferred to 2008A bonds in exchange for the payment of \$3,128,000.

On January 25, 2007, FAHC in connection with the Agency, issued \$56,260,000 of tax-exempt revenue bonds ("2007A"), including unamortized premium of \$115,000. The net proceeds from the 2007A bonds were used to reimburse FAHC for prior incurred capital expenses in the amount of \$50,000,000 relating to the construction of a new ambulatory care building and the renovation of existing space. A debt service reserve fund of \$5,666,000 was required to be established under the terms of the Series 2007A bonds.

FAHC and certain of its subsidiaries are obligated under various other revenue bonds, capital leases, and notes payable. Various trustee-held funds are required under the terms of the loan agreements. 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.

FAHC has granted a mortgage on substantially all of its property and a security interest in its gross receipts, as defined in connection with the issuance of its long-term debt.

Scheduled Maturities of Long-Term Debt — Scheduled maturities of long-term debt, assuming the Series 2008A bonds are not put back to FAHC, and payments on capital lease obligations for the next five years and thereafter are as follows (in thousands):

**Years Ending
September 30**

2009	\$ 8,178
2010	8,470
2011	8,281
2012	8,997
2013	8,270
Thereafter	<u>382,840</u>
	<u>\$ 425,036</u>

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, 2008 and 2007, FAHC was in compliance with these requirements.

Interest Rate Swap Agreements — FAHC entered into interest rate exchange agreements in 1993 and again in 2004. The 1993 and 2004 agreements had aggregate notional amounts of approximately \$15 million and \$135 million, respectively, as of September 30, 2007. Pursuant to each agreement, FAHC is obligated to pay the applicable swap counterparty amounts based on a fixed interest rate and is to receive payment from such swap counterparty based on variable interest rates. Under certain circumstances, FAHC may be required to post collateral to secure its obligations under the 1993 interest rate exchange agreements. In addition, each agreement may be terminated following the occurrence of certain events, at which time FAHC may be required to make a termination payment to the applicable swap counterparty.

In connection with the issuance of the Series 2008A bonds, the 2004 swap agreement was terminated as to the Series 2004B bonds, following their conversion, and now relates only to the Series 2008A bonds. FAHC entered into two interest rate swap contracts in the notional principal amount of \$27,595,000 each. Under these contracts, FAHC will pay a fixed rate of 3.76% on a notional amount equal to the outstanding amount of the Series 2008A bonds for the term of the Series 2008A bonds and receive an alternative floating rate derived from a LIBOR based formula, which may or may not equal the rate on the Series 2008A bonds. The termination date of these swap contracts is December 1, 2030.

Under the 1993 interest rate exchange agreements, FAHC pays a fixed rate of 4.93%. The termination date of the 1993 swap agreements is September 1, 2013. The notional principal amount of the 1993 agreements was approximately \$13,720,000 at September 30, 2008.

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 agreements 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 \$815,000 and

\$828,000 at September 30, 2008 and 2007, respectively, to the counterparty. In October 2008, the counterparty on this swap defaulted, so FAHC has neither made nor received payments on this swap since October 2008 and is awaiting final settlement of the swap from the trustee of the counterparty.

FAHC's only derivatives are the interest rate swaps described above. As of September 30, 2008 and 2007, the net fair value of the swap agreements of approximately \$(3,635,000) and \$1,530,000, respectively, were included in other long-term liabilities and notes receivable and other assets, with the change in value recorded as nonoperating revenue (expense).

Other 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 \$1,200,000. The letters of credit remain unused at September 30, 2008 and 2007.

8. OPERATING LEASES

FAHC has entered into certain operating lease agreements for the rental of building space and equipment. Rental expense amounted to \$10,495,000 and \$10,604,000 for 2008 and 2007, respectively.

Minimum future lease payments required under noncancelable operating leases at September 30, 2008, were as follows (in thousands):

Years Ending September 30

2009	\$ 8,934
2010	5,225
2011	4,866
2012	4,843
2013	3,823
Thereafter	<u>10,893</u>
	<u>\$ 38,584</u>

The above payments exclude anticipated payments under fair market purchase options. FAHC expects to exercise fair market purchase options totaling approximately \$3,634,000 under leases in effect at September 30, 2008.

9. RESTRICTIONS ON NET ASSETS

At September 30, 2008 and 2007, temporarily restricted net assets are available for the following purposes (in thousands):

	2008	2007
Indigent care	\$ 415	\$ 501
Education and research	4,886	6,562
Children's programs	1,738	1,883
Capital projects	1,253	1,502
Other health care services	<u>3,178</u>	<u>6,247</u>
	<u>\$ 11,470</u>	<u>\$ 16,695</u>

At September 30, 2008, temporarily restricted net assets include approximately \$6,289,000 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):

	2008	2007
Investments to be held in perpetuity, the income from which is expendable to support:		
Indigent care	\$ 4,153	\$ 4,644
Education and research	4,596	4,453
Other health care services	<u>17,517</u>	<u>15,812</u>
	<u>\$ 26,266</u>	<u>\$ 24,909</u>

10. MALPRACTICE AND OTHER CONTINGENCIES

Malpractice and Workers' Compensation — FAHC is insured against malpractice losses under a claims-made insurance policy with VMCIC, its wholly owned subsidiary. 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 3% and 6% at September 30, 2008 and 2007, respectively, resulting in a reduction in the reserve of approximately \$2,206,000 in 2008 and \$3,917,000 in 2007.

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):

	2008	2007
Balance — beginning of year	\$ 32,094	\$ 26,816
Less reinsurance receivables	<u>4,760</u>	<u>3,343</u>
Net balance at October 1	<u>27,334</u>	<u>23,473</u>
Losses incurred related to:		
Current period	9,297	8,110
Prior acts and tail coverage assumed	<u>285</u>	<u>(684)</u>
Total incurred	<u>9,582</u>	<u>7,426</u>
Paid losses related to:		
Current period	502	714
Prior period	<u>6,310</u>	<u>2,851</u>
Total paid	<u>6,812</u>	<u>3,565</u>
Net balance — end of year	30,104	27,334
Transfer of reserves	1,428	
Reinsurance recoverables	<u>5,793</u>	<u>4,760</u>
Balance — end of year	<u>\$ 37,325</u>	<u>\$ 32,094</u>

As a result of changes in estimates of incurred events in prior years, primarily professional liability, the estimate of incurred losses increased by approximately \$285,000 as of September 30, 2008.

The reserve for losses, which was determined with the assistance of an actuarial consultant, includes estimates of claims incurred but not reported. Approximately \$8,000,000 of the reserve at September 30, 2008 and 2007, 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 consolidated balance sheets at September 30, 2008 and 2007.

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 2008 and 2007, with a per-year benefit maximum of \$1,500,000. FAHC has recorded a reserve of approximately \$5,002,000 and \$5,088,000 at September 30, 2008 and 2007, 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 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 covered approximately 1,800 and 1,600 staff at September 30, 2008 and 2007, respectively.

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, 2008 and 2007, was \$13,031,000 and \$17,651,000, respectively, and the amount required to be maintained by VMCIC was \$3,374,000 and \$3,085,000, 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 \$25,409,000 and \$23,183,000 at September 30, 2008 and 2007, respectively. As of September 30, 2008 and 2007, the liquidity requirements were met. FAHC reports all of VMCIC's investments in marketable securities as restricted assets in the accompanying consolidated 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, 2008 and 2007, retained earnings and additional paid-in capital of VMCIC, amounting to \$3,374,000 and \$3,085,000, respectively, was not available for distribution.

12. PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

Fletcher Allen Health Care Defined Benefit Pension and Postretirement Health Care Plans — Employees of the former Medical Center Hospital of Vermont (MCHV) are covered by a pension plan (the "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 FAHC's 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 health care benefits.

On September 30, 2007, FAHC adopted the recognition and disclosure provisions of FASB Statement No. 158. FASB Statement No. 158 required FAHC to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its postretirement benefit plans in the September 30, 2007, consolidated balance sheet, with a corresponding adjustment to unrestricted net assets. The adjustment to unrestricted net assets at adoption represents the net unrecognized actuarial losses and unrecognized prior-service costs, which were previously netted against FAHC's plans' funded status in the consolidated balance sheets pursuant to the provision of FASB Statement No. 87, *Employers' Accounting for Pensions*. These amounts will be subsequently recognized as net periodic pension cost pursuant to FAHC's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of unrestricted net assets. Those amounts will be subsequently recognized as a component of net periodic pension cost on the same basis as the amounts recognized in unrestricted net assets at adoption of FASB Statement No. 158.

The incremental effects of applying the recognition provisions of FASB Statement No. 158 on the individual line items in the consolidated balance sheet as of September 30, 2007, are as follows (dollars in thousands):

	Before Application of SFAS No. 158	Effect of Adopting SFAS No. 158	After Application of SFAS No. 158
Accrued postretirement liability	\$ (799)	\$ 799	\$ -
Accrued pension asset (liability)	211	(2,433)	(2,222)
Unrestricted net assets	327,558	(1,634)	325,924

The adoption of FASB Statement No. 158 had no effect on FAHC's excess of revenue over expenses for the year ended September 30, 2007, or for any prior period.

Unrestricted net assets at September 30, 2008, include unrecognized actuarial losses of \$24,075,000 related to the defined benefit plan. Of this amount, \$1,319,600 is expected to be recognized in net periodic pension costs in 2009.

Unrestricted net assets at September 30, 2007, include unrecognized actuarial losses of \$19,936,000 related to the defined benefit plan. Of this amount, \$828,000 was recognized in net periodic pension costs in 2008.

Amounts included in unrestricted net assets related to the postretirement health care plan are not significant.

FAHC uses a June 30 measurement date for measuring plan assets and obligations. FAHC intends to change the measurement date to September 30 in 2009. Subsequent to June 30, 2008, conditions in the worldwide debt and equity markets have deteriorated significantly. These conditions have had a negative effect on the fair value of plan assets since the measurement date of June 30, 2008.

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. A reconciliation of the changes in the FAHC defined benefit plan projected benefit obligations and the fair value of assets for the years ended September 30, 2008 and 2007, is as follows (in thousands):

	FAHC Defined Benefit Plan	
	2008	2007
Changes in benefit obligations:		
Projected benefit obligations — beginning of year	\$ (114,992)	\$ (109,953)
Service cost	(628)	(749)
Interest cost	(7,020)	(6,720)
Benefits paid	5,350	5,198
Actuarial gain (loss)	<u>6,068</u>	<u>(2,768)</u>
Projected benefit obligation — end of year	<u>\$ (111,222)</u>	<u>\$ (114,992)</u>
Accumulated benefit obligation	<u>\$ (109,845)</u>	<u>\$ (112,559)</u>
Changes in plan assets:		
Fair value of plan assets — beginning of year	\$ 104,133	\$ 86,273
Actual return on plan assets	(1,791)	14,043
Contributions	8,637	9,015
Benefits paid	<u>(5,350)</u>	<u>(5,198)</u>
Fair value of plan assets — end of year	<u>\$ 105,629</u>	<u>\$ 104,133</u>
Funded status:		
Funded status of the plan	\$ (5,593)	\$ (10,859)
Contributions after June 30	<u> </u>	<u>8,637</u>
Total benefit liability	<u>\$ (5,593)</u>	<u>\$ (2,222)</u>

The cost components of the net periodic benefit cost for the years ended September 30, 2008 and 2007, are as follows (in thousands):

	FAHC Defined Benefit Plan	
	2008	2007
Service cost	\$ 628	\$ 749
Interest cost	7,020	6,720
Expected return on plan assets	(9,245)	(7,517)
Amortization of unrecognized net loss	<u>828</u>	<u>1,333</u>
Net periodic benefit cost (benefit)	<u>\$ (769)</u>	<u>\$ 1,285</u>

The assumptions used in accounting for the defined benefit pension plan are as follows:

	FAHC Defined Benefit Plan	
	2008	2007
Weighted-average assumptions used to determine the benefit liability:		
Discount rates	6.75 %	6.25 %
Rates of increase in future compensation levels	3.50	3.50
Weighted-average assumptions used to determine expense:		
Discount rates	6.25	6.25
Rates of increase in future compensation levels	3.50	3.50
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 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.

Plan Assets — FAHC's pension plan weighted-average asset allocations as of September 30, 2008 and 2007, by asset category, are as follows:

Asset Category	2008	2007
Equity securities	68 %	59 %
Debt securities	22	26
Real estate investment trusts	5	2
Other	5	13
	<u>100 %</u>	<u>100 %</u>

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.

At September 30, 2007, the Plan held investments totaling \$4,378,000 in limited partnerships that were carried at fair value, as estimated by the investment managers. These investments were sold in 2008. The fair value of the remaining pension assets is based on quoted market values or net asset values for common collective trusts.

Cash Flows — Contributions — FAHC has not determined the amount of its contribution to its pension plan in 2009, if any.

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**

2009	\$ 6,248
2010	6,721
2011	7,085
2012	7,540
2013	7,980
2014–2018	45,051

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 plans, including defined contribution plans and postretirement benefit plans, as accrued. Benefit plan costs amounted to \$20,186,000 and \$20,271,000 for the years ended September 30, 2008 and 2007, 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 receivables from patients and third-party payors follows:

	2008	2007
Medicare	31 %	32 %
Medicaid	12	12
Blue Cross	18	18
Other third-party payors	32	28
Patients	<u>7</u>	<u>10</u>
	<u>100 %</u>	<u>100 %</u>

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, there are three components of financial support which FAHC provides to UVM; (1) overall support for medical staff and faculty, known as “the commitment”; (2) financial support for joint functions; and (3) academic support. The commitment is an annually agreed-upon amount of funding to support FAHC’s needs for physician personnel and related staffing. The commitment is based on actual expenses. The financial support for joint functions currently represents the shared use of the Dana Medical Library located on UVM’s campus and the administration UVM provides for the human subjects protection program. Academic support payments are made to a not-for-profit corporation affiliated with UVM for the benefit of the College of Medicine in three components: (a) a base payment, paid in monthly installments, and increases by 5% each year during the term of the Affiliation Agreement; (b) 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 (c) a “Dean’s Tax” equal to the following percentages of base physician compensation for the fiscal years indicated: 2006–0.50%, 2007–1.50%, 2008–2.50%, 2009–3.50%, and 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.

The premise of the commitment is, 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 \$11,357,000 and \$11,471,000 in 2008 and 2007, respectively. In addition, FAHC reimburses UVM for equipment rental, research, and certain other administrative expenses.

Payments in support of the Dana Medical Library were \$398,000 and \$386,000 for fiscal years 2008 and 2007, respectively. The payment increases by 3% annually until 2010, at which time it will be renegotiated. Payments are \$2,000 for the administration of each clinical trial.

In relation to academic support, the base payments for 2008 and 2007 were \$3,969,000 and \$3,780,000, respectively. No supplemental payment was due for 2008. The dean's tax payments for fiscal years 2008 and 2007 were \$2,573,000 and \$1,544,000, respectively.

Total payments, including all agreed-upon financial support, approximated \$20,808,000 and \$20,481,000 in 2008 and 2007, respectively. At September 30, 2008 and 2007, amounts due to UVM net of amounts due from UVM, approximated \$4,894,000 and \$4,470,000, 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 as amended provided that UVM would pay approximately \$8,045,000 of the costs, as therein defined, associated with the design, construction, and equipping of the Education Center, and FAHC would be responsible for paying the balance. As of September 30, 2008 and 2007, the remaining amount receivable from UVM totals \$267,000 and is included in notes receivable and other assets on the balance sheet. FAHC and UVM are in negotiations to settle payment of this amount.

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):

	2008	2007
Education and research	\$ 21,221	\$ 20,753
Health care services	564,051	523,280
Management and general	<u>211,276</u>	<u>207,787</u>
	<u>\$ 796,548</u>	<u>\$ 751,820</u>

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 or net asset values of common collective trusts. The estimated fair value of the limited partnership investments carried at cost was approximately \$16,021,000 at September 30, 2007, as determined by the investment managers. There were no limited partnership investments at September 30, 2008.

Debt — The fair value of FAHC's debt, which approximates \$395,633,000 and \$431,299,000 at September 30, 2008 and 2007, 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, 2008 and 2007, the following pledges were receivable (in thousands):

	2008	2007
Due in less than one year	\$ 887	\$ 888
Due in one to five years	<u>1,310</u>	<u>1,601</u>
	2,197	2,489
Less allowances for uncollectible amounts	<u>(167)</u>	<u>(186)</u>
	<u>\$ 2,030</u>	<u>\$ 2,303</u>

* * * * *

SUPPLEMENTAL SCHEDULES

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION

AS OF SEPTEMBER 30, 2008

(In thousands)

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, PLLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company, Ltd.	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
ASSETS								
CURRENT ASSETS:								
Cash and cash equivalents	\$ 52,062	\$ 8,037	\$ 531	\$ -	\$ 1,427	\$ 526	\$ -	\$ 62,583
Patient and other trade accounts receivable — net	98,769	2,924	207			333		102,233
Due from related parties					8,078		(8,078)	-
Short-term investments	459							459
Inventories	11,533							11,533
Current portion of restricted assets					8,000			8,000
Prepaid and other current assets	17,414	3,522	1		5,811			26,748
Total current assets	180,237	14,483	739	-	23,316	859	(8,078)	211,556
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:								
Board-designated assets	167,226							167,226
Assets held by trustee under bond indenture agreements	37,068							37,068
Restricted assets	1,423				29,406			30,829
Donor restricted assets for specific purposes	8,941							8,941
Donor restricted assets for permanent endowment	26,266							26,266
Total assets whose use is limited or restricted	240,924	-	-	-	29,406	-	-	270,330
PROPERTY AND EQUIPMENT — Net	423,262	64	-	-	-	549	-	423,875
OTHER ASSETS:								
Deferred financing costs — net	17,703							17,703
Notes receivable and other assets	1,074	250						1,324
Investment in and advances to affiliated companies	28,462			4,248			(21,385)	11,325
Pledges receivable	1,218							1,218
Total other assets	48,457	250	-	4,248	-	-	(21,385)	31,570
TOTAL	\$892,880	\$14,797	\$ 739	\$4,248	\$52,722	\$1,408	\$(29,463)	\$937,331

(Continued)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION

AS OF SEPTEMBER 30, 2008

(In thousands)

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, PLLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company, Ltd.	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES:								
Current installments of long-term debt	\$ 8,178	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,178
Accounts payable	16,611	16	5		142			16,774
Accrued expenses and other liabilities	32,254	4,280				36	4,055	40,625
Accrued payroll and related benefits	44,390	170	2				(171)	44,391
Estimated third-party payor settlements	7,563							7,563
Due to related parties	7,735	3,950	276				(11,961)	-
Estimated amounts for incurred but unreported claims	5,053	6,076			8,000			19,129
Total current liabilities	<u>121,784</u>	<u>14,492</u>	<u>283</u>	<u>-</u>	<u>8,142</u>	<u>36</u>	<u>(8,077)</u>	<u>136,660</u>
LONG-TERM LIABILITIES:								
Long-term debt — excluding current installments	417,803							417,803
Reserve for outstanding losses on malpractice and workers' compensation claims					29,325			29,325
Pension and other postretirement benefit obligations	5,619							5,619
Other long-term liabilities	4,591	250						4,841
Total long-term liabilities	<u>428,013</u>	<u>250</u>	<u>-</u>	<u>-</u>	<u>29,325</u>	<u>-</u>	<u>-</u>	<u>457,588</u>
Total liabilities	<u>549,797</u>	<u>14,742</u>	<u>283</u>	<u>-</u>	<u>37,467</u>	<u>36</u>	<u>(8,077)</u>	<u>594,248</u>
NET ASSETS:								
Unrestricted	305,347		456	4,248		1,372	(6,076)	305,347
Temporarily restricted	11,470							11,470
Permanently restricted	26,266							26,266
Retained earnings		55			15,255		(15,310)	-
Total net assets	<u>343,083</u>	<u>55</u>	<u>456</u>	<u>4,248</u>	<u>15,255</u>	<u>1,372</u>	<u>(21,386)</u>	<u>343,083</u>
TOTAL	<u>\$892,880</u>	<u>\$14,797</u>	<u>\$ 739</u>	<u>\$4,248</u>	<u>\$52,722</u>	<u>\$1,408</u>	<u>\$ (29,463)</u>	<u>\$937,331</u>

See note to supplemental schedules.

(Concluded)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS INFORMATION

FOR THE YEAR ENDED SEPTEMBER 30, 2008

(In thousands)

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, PLLC	Fletcher Allen Skilled Nursing Care, LLC	Vermont Managed Care Indemnity Company, Ltd.	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
UNRESTRICTED REVENUE AND OTHER SUPPORT:								
Net patient service revenue	\$761,971	\$ -	\$ 458	\$ -	\$ -	\$ 1,048	\$(30,324)	\$733,153
Premium revenue	4,835	62,693					(3,074)	64,454
Other revenue	23,231				12,135		(13,706)	21,660
Total unrestricted revenue and other support	790,037	62,693	458	-	12,135	1,048	(47,104)	819,267
EXPENSES:								
Salaries, payroll taxes, and fringe benefits	460,001	2,803	859			2,305	(2,925)	463,043
Supplies and other	200,252	768	115		78	243	(13,637)	187,819
Purchased services	25,883	2,161	115		1,384	82	(69)	29,556
Depreciation and amortization	34,225	33				144		34,402
Interest expense	22,492							22,492
Loss on disposal of fixed assets	3							3
Provision for bad debts	26,131		(27)			123		26,227
Underwriting expenses					9,582			9,582
Medical claims		57,199					(30,473)	26,726
Total expenses	768,987	62,964	1,062	-	11,044	2,897	(47,104)	799,850
INCOME (LOSS) FROM OPERATIONS	21,050	(271)	(604)	-	1,091	(1,849)	-	19,417
NONOPERATING REVENUE (EXPENSE):								
Investment income and losses	(3,960)	195	3		137			(3,625)
Unrealized loss on interest rate swap contracts	(8,292)							(8,292)
Other	(4,803)	99		898			654	(3,152)
Total nonoperating (expense) revenue	(17,055)	294	3	898	137	-	654	(15,069)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSE	3,995	23	(601)	898	1,228	(1,849)	654	4,348
NET CHANGE IN UNREALIZED LOSS ON INVESTMENTS	(23,926)				(4,057)		4,057	(23,926)
ASSETS RELEASED FROM RESTRICTIONS — For capital purchases	1,814							1,814
CAPITAL CONTRIBUTION	1,362							1,362
PENSION RELATED ADJUSTMENTS	(4,175)							(4,175)
TRANSFER OF NET ASSETS	-				(3,085)	8,612	(5,527)	-
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	<u>\$ (20,930)</u>	<u>\$ 23</u>	<u>\$ (601)</u>	<u>\$ 898</u>	<u>\$ (5,914)</u>	<u>\$ 6,763</u>	<u>\$ (816)</u>	<u>\$ (20,577)</u>

See note to supplemental schedules.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP BALANCE SHEET INFORMATION

AS OF SEPTEMBER 30, 2008 AND 2007

(In thousands)

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 52,062	\$ 25,309
Patient and other trade accounts receivable — net	98,769	106,949
Short-term investments	459	881
Inventories	11,533	10,782
Prepaid and other current assets	<u>17,414</u>	<u>12,486</u>
Total current assets	<u>180,237</u>	<u>156,407</u>
ASSETS WHOSE USE IS LIMITED OR RESTRICTED:		
Board-designated assets	167,226	190,691
Assets held by trustee under bond indenture agreements	37,068	38,472
Donor restricted assets for specific purposes	8,941	11,915
Donor restricted assets for permanent endowment	<u>26,266</u>	<u>24,909</u>
Total assets whose use is limited or restricted	<u>239,501</u>	<u>265,987</u>
PROPERTY AND EQUIPMENT — Net	<u>423,262</u>	<u>426,180</u>
OTHER ASSETS:		
Deferred financing costs — net	17,703	19,213
Notes receivable and other assets	1,074	3,536
Investment in and advances to affiliated companies	28,462	34,946
Pledges receivable	<u>1,218</u>	<u>1,490</u>
Total other assets	<u>48,457</u>	<u>59,185</u>
TOTAL	<u>\$ 891,457</u>	<u>\$ 907,759</u>

(Continued)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP BALANCE SHEET INFORMATION

AS OF SEPTEMBER 30, 2008 AND 2007

(In thousands)

	2008	2007
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current installments of long-term debt	\$ 8,178	\$ 7,529
Accounts payable	16,611	16,821
Accrued expenses and other liabilities	32,254	28,672
Accrued payroll and related benefits	44,390	38,272
Estimated third-party payor settlements	7,563	8,591
Due to related parties	7,735	6,795
Estimated amounts for incurred but unreported claims	<u>5,053</u>	<u>6,571</u>
Total current liabilities	<u>121,784</u>	<u>113,251</u>
LONG-TERM LIABILITIES:		
Long-term debt — excluding current installments	417,803	423,857
Pension and other postretirement benefit obligations	5,619	2,213
Other long-term liabilities	<u>4,591</u>	<u>1,689</u>
Total long-term liabilities	<u>428,013</u>	<u>427,759</u>
Total liabilities	<u>549,797</u>	<u>541,010</u>
COMMITMENTS AND CONTINGENT LIABILITIES		
NET ASSETS:		
Unrestricted	303,924	325,145
Temporarily restricted	11,470	16,695
Permanently restricted	<u>26,266</u>	<u>24,909</u>
Total net assets	<u>341,660</u>	<u>366,749</u>
TOTAL	<u>\$ 891,457</u>	<u>\$ 907,759</u>

See note to supplemental schedules.

(Concluded)

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP STATEMENT OF OPERATIONS INFORMATION FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
UNRESTRICTED REVENUE AND OTHER SUPPORT:		
Net patient service revenue	\$ 761,971	\$ 717,716
Premium revenue	4,835	4,200
Other revenue	<u>23,231</u>	<u>22,145</u>
Total unrestricted revenue and other support	<u>790,037</u>	<u>744,061</u>
EXPENSES:		
Salaries, payroll taxes, and fringe benefits	460,001	435,451
Supplies and other	200,252	188,081
Purchased services	25,883	26,810
Depreciation and amortization	34,225	33,434
Interest expense	22,492	18,404
Loss on disposal of fixed assets	3	1,841
Provision for bad debts	<u>26,131</u>	<u>20,366</u>
Total expenses	<u>768,987</u>	<u>724,387</u>
INCOME FROM OPERATIONS	<u>21,050</u>	<u>19,674</u>
NONOPERATING REVENUE (EXPENSE):		
Investment income and losses	(3,960)	10,252
Unrealized gain on interest rate swap contracts	(8,292)	1,440
Other	<u>(4,803)</u>	<u>1,985</u>
Total nonoperating (expense) revenue	<u>(17,055)</u>	<u>13,677</u>
EXCESS OF REVENUE OVER EXPENSES	3,995	33,351
NET CHANGE IN UNREALIZED (LOSSES) GAINS ON INVESTMENTS	(23,926)	11,320
ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES	1,814	1,164
CAPITAL CONTRIBUTIONS	1,362	
PENSION RELATED ADJUSTMENTS	(4,175)	5,298
ADJUSTMENT TO INITIALLY APPLY THE RECOGNITION PROVISIONS OF FASB STATEMENT NO. 158		(1,634)
TRANSFER OF NET ASSETS	<u>(291)</u>	<u> </u>
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	<u>\$ (21,221)</u>	<u>\$ 49,499</u>

See note to supplemental schedules.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP STATEMENT OF CHANGES IN NET ASSETS INFORMATION FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

(In thousands)

	2008	2007
UNRESTRICTED NET ASSETS:		
Excess of revenues over expenses	\$ 3,995	\$ 33,351
Net change in unrealized (losses) gains on investments	(23,926)	11,320
Assets released from restrictions for capital purchases	1,814	1,164
Capital contributions	1,362	
Transfer of net assets	(291)	
Pension related adjustments	(4,175)	5,298
Adjustment to initially apply the recognition provisions of FASB Statement No. 158		(1,634)
	<u> </u>	<u> </u>
(Decrease) increase in unrestricted net assets	<u>(21,221)</u>	<u>49,499</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	1,972	3,430
Investment income	473	290
Net unrealized (losses) gains on investments	(3,258)	910
Net realized gains on investments	904	2,407
Net assets released from restrictions used in operations	(1,193)	(1,584)
Net assets released from restrictions used for nonoperating purposes	(219)	(243)
Net assets released from restrictions used for capital purchases	(1,814)	(1,164)
Transfer of net assets to permanently restricted	<u>(2,090)</u>	<u> </u>
	<u> </u>	<u> </u>
(Decrease) increase in temporarily restricted net assets	<u>(5,225)</u>	<u>4,046</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Gifts, grants, and bequests	739	285
Change in beneficial interest in perpetual trusts	(1,472)	1,031
Net assets released from restrictions-capital	<u>2,090</u>	<u> </u>
	<u> </u>	<u> </u>
Increase in permanently restricted net assets	<u>1,357</u>	<u>1,316</u>
(DECREASE) INCREASE IN NET ASSETS	(25,089)	54,861
NET ASSETS — Beginning of year	<u>366,749</u>	<u>311,888</u>
NET ASSETS — End of year	<u>\$ 341,660</u>	<u>\$ 366,749</u>

See note to supplemental schedules.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

NOTE TO SUPPLEMENTAL SCHEDULES

AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

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.

FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

OBLIGATED GROUP COMPUTATION OF LONG-TERM DEBT SERVICE COVERAGE RATIO YEAR ENDED SEPTEMBER 30, 2008 (Dollars in thousands)

EXCESS OF REVENUE OVER EXPENSES	\$ 3,995
ADD:	
Depreciation and amortization	34,225
Interest expense on long-term indebtedness	22,492
Loss on extinguishment of indebtedness	<u>2,304</u>
INCOME AVAILABLE FOR DEBT SERVICE	<u>\$ 63,016</u>
MAXIMUM ANNUAL DEBT SERVICE	<u>\$ 28,181</u>
LONG-TERM DEBT SERVICE COVERAGE RATIO	2.24