# Fletcher Allen Health Care, Inc. and Subsidiaries

Consolidated Financial Statements and
Additional Information as of and for the
Years Ended September 30, 2007 and 2006, and
Independent Auditors' Reports

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

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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, 2007 and 2006, 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, 2007 and 2006, 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 4, 2007

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS
## AS OF SEPTEMBER 30, 2007 AND 2006
## (In thousands)

| ASSETS | 2007 | 2006 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 44,614 | $ 44,519 |
| Patient and other trade accounts receivable, net of allowance for doubtful accounts of $15,525 in 2007 and $14,223 in 2006 | 110,813 | 107,852 |
| Short-term investments | 881 | 177 |
| Inventories | 10,782 | 10,338 |
| Current portion of restricted assets | 8,000 | 7,000 |
| Prepaid and other current assets | 19,252 | 16,080 |
| Total current assets | 194,342 | 185,966 |
| ASSETS WHOSE USE IS LIMITED OR RESTRICTED: | | |
| Board-designated assets | 190,691 | 122,742 |
| Assets held by trustee under bond indenture agreements | 38,472 | 31,301 |
| Restricted assets | 22,793 | 22,192 |
| Donor-restricted assets for specific purposes | 11,915 | 9,169 |
| Donor-restricted assets for permanent endowment | 24,909 | 23,593 |
| Total assets whose use is limited or restricted | 288,780 | 208,997 |
| PROPERTY AND EQUIPMENT — Net | 426,369 | 437,313 |
| OTHER ASSETS: | | |
| Deferred financing costs — net | 19,213 | 19,102 |
| Notes receivable and other assets | 3,786 | 1,803 |
| Investment in affiliated companies | 11,522 | 13,131 |
| Pledges receivable | 1,490 | 1,626 |
| Total other assets | 36,011 | 35,662 |
| TOTAL | $945,502 | $867,938 |

| LIABILITIES AND NET ASSETS | 2007 | 2006 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current installments of long-term debt | $ 7,529 | $ 7,450 |
| Accounts payable | 16,938 | 31,828 |
| Accrued expenses and other liabilities | 33,284 | 46,699 |
| Accrued payroll and related benefits | 38,439 | 35,566 |
| Estimated third-party payor settlements | 8,591 | 9,069 |
| Estimated amounts for incurred but unreported claims | 21,090 | 19,611 |
| Total current liabilities | 125,871 | 150,223 |
| LONG-TERM LIABILITIES: | | |
| Long-term debt — excluding current installments | 423,857 | 372,612 |
| Reserve for outstanding losses on malpractice and workers' compensation claims | 24,094 | 19,816 |
| Pension and other postretirement benefit obligations | 2,213 | 10,478 |
| Other long-term liabilities | 1,939 | 1,991 |
| Total long-term liabilities | 452,103 | 404,897 |
| Total liabilities | 577,974 | 555,120 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | |
| NET ASSETS: | | |
| Unrestricted | 325,924 | 276,576 |
| Temporarily restricted | 16,695 | 12,649 |
| Permanently restricted | 24,909 | 23,593 |
| Total net assets | 367,528 | 312,818 |
| TOTAL | $945,502 | $867,938 |

See notes to consolidated financial statements.

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS
## FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006
## (In thousands)

| | 2007 | 2006 |
|---|---|---|
| UNRESTRICTED REVENUE AND OTHER SUPPORT: | | |
| Net patient service revenue | $ 692,651 | $ 634,697 |
| Premium revenue | 59,401 | 56,210 |
| Other revenue | 20,175 | 20,684 |
| Total unrestricted revenue and other support | 772,227 | 711,591 |
| EXPENSES: | | |
| Salaries, payroll taxes, and fringe benefits | 437,396 | 409,660 |
| Supplies and other | 176,921 | 166,201 |
| Purchased services | 30,738 | 26,857 |
| Depreciation and amortization | 33,496 | 35,060 |
| Interest expense | 18,407 | 16,890 |
| Loss on disposal of property and equipment | 1,841 | 512 |
| Provision for bad debts | 20,506 | 14,872 |
| Underwriting expenses | 7,427 | 3,415 |
| Medical claims | 25,088 | 21,283 |
| Total expenses | 751,820 | 694,750 |
| INCOME FROM OPERATIONS | 20,407 | 16,841 |
| NONOPERATING REVENUE (EXPENSE): | | |
| Investment income and losses | 12,842 | 14,933 |
| Unrealized gain on interest rate swap contracts | 1,440 | 3,963 |
| Other | (1,489) | (394) |
| Total nonoperating revenue | 12,793 | 18,502 |
| EXCESS OF REVENUE OVER EXPENSES | 33,200 | 35,343 |
| NET UNREALIZED GAINS (LOSSES) ON INVESTMENTS | 11,320 | (2,524) |
| ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES | 1,164 | 3,106 |
| ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT | 5,298 | 18,240 |
| ADJUSTMENT TO INITIALLY APPLY THE RECOGNITION PROVISIONS OF SFAS No. 158 | (1,634) | |
| TRANSFER OF NET ASSETS | | 4,843 |
| INCREASE IN UNRESTRICTED NET ASSETS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | 49,348 | 59,008 |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | | (861) |
| INCREASE IN UNRESTRICTED NET ASSETS | $ 49,348 | $ 58,147 |

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, 2007 AND 2006
## (In thousands)

| | 2007 | 2006 |
|---|---|---|
| UNRESTRICTED NET ASSETS: | | |
| Excess of revenue over expenses | $ 33,200 | $ 35,343 |
| Net unrealized gains (losses) on investments | 11,320 | (2,524) |
| Assets released from restrictions for capital purchases | 1,164 | 3,106 |
| Additional minimum pension liability adjustment | 5,298 | 18,240 |
| Adjustment to initially apply the recognition provisions of SFAS No. 158 | (1,634) | |
| Transfer of net assets | | 4,843 |
| Cumulative effect of change in accounting principle | | (861) |
| Increase in unrestricted net assets | 49,348 | 58,147 |
| TEMPORARILY RESTRICTED NET ASSETS: | | |
| Gifts, grants, and bequests | 3,430 | 2,581 |
| Investment income | 290 | 1,794 |
| Net unrealized gains (losses) on investments | 910 | (901) |
| Net realized gains on investments | 2,407 | 1,486 |
| Net assets released from restrictions used in operations | (1,584) | (759) |
| Net assets released from restrictions used for nonoperating purposes | (243) | (232) |
| Net assets released from restrictions used for capital purchases | (1,164) | (3,106) |
| Transfer of net assets | | (2,939) |
| Increase (decrease) in temporarily restricted net assets | 4,046 | (2,076) |
| PERMANENTLY RESTRICTED NET ASSETS: | | |
| Gifts, grants, and bequests | 285 | 104 |
| Change in beneficial interest in perpetual trusts | 1,031 | 493 |
| Transfer of net assets | | (1,904) |
| Increase (decrease) in permanently restricted net assets | 1,316 | (1,307) |
| INCREASE IN NET ASSETS | 54,710 | 54,764 |
| NET ASSETS — Beginning of year | 312,818 | 258,054 |
| NET ASSETS — End of year | $ 367,528 | $ 312,818 |

See notes to consolidated financial statements.

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS
### FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006
### (In thousands)

| | 2007 | 2006 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES AND GAINS: | | |
| Increase in net assets | $ 54,710 | $ 54,764 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities and gains: | | |
| Depreciation and amortization | 33,496 | 35,060 |
| Provision for bad debts | 20,506 | 14,872 |
| Restricted contributions and investment income received | (4,005) | (4,479) |
| Additional minimum pension liability adjustment | (5,298) | (18,240) |
| Adjustment to initially apply the recognition provisions of SFAS No. 158 | 1,634 | |
| Loss on disposal of property and equipment | 1,841 | 512 |
| Unrealized (gain) loss on interest rate swap contracts | (1,440) | (3,963) |
| Realized and unrealized losses (gains) on investments | (14,424) | 1,939 |
| Undistributed losses (earnings) of affiliated companies | 359 | (640) |
| Cumulative effect of change in accounting principle | | 861 |
| Change in beneficial interest in perpetual trusts | (1,031) | (493) |
| Change in operating assets and liabilities: | | |
| Increase in patient and other accounts receivable | (23,467) | (29,955) |
| Decrease in pledges receivable | 136 | 1,019 |
| Increase in other current and noncurrent assets | (4,211) | (4,217) |
| Decrease in accounts payable and accrued expenses | (25,836) | (3,265) |
| Increase in accrued payroll and related expenses | 2,873 | 6,006 |
| Increase (decrease) in current and other liabilities | 5,279 | (5,908) |
| Decrease in pension and other postretirement benefit obligations | (4,601) | (7,767) |
| Net cash provided by operating activities and gains | 36,521 | 36,106 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Acquisitions of property and equipment | (23,220) | (26,304) |
| Purchase of investments | (195,800) | (65,788) |
| Proceeds from sale of investments | 129,768 | 69,837 |
| Proceeds from distribution of equity investees | 1,250 | 500 |
| Net cash used in investing activities | (88,002) | (21,755) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from restricted contributions and restricted investment income | 4,005 | 4,479 |
| Repayment of long-term debt | (7,875) | (6,657) |
| Change in long-term liabilities | | 250 |
| Deferred financing costs | (929) | |
| Proceeds from issuance of long-term debt | 56,375 | |
| Net cash provided by (used in) financing activities | 51,576 | (1,928) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 95 | 12,423 |
| CASH AND CASH EQUIVALENTS — Beginning of year | 44,519 | 32,096 |
| CASH AND CASH EQUIVALENTS — End of year | $ 44,614 | $ 44,519 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid during the year for interest | $ 18,158 | $ 17,035 |
| Assets acquired under capital lease | $ 2,824 | $ |

See notes to consolidated financial statements.

## 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 inter-company 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. 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. The accounting for pension plan assets is discussed in Note 12.

**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 $193,500 and $627,000 of interest was capitalized during 2007 and 2006, respectively. Net deferred financing costs totaled $19,213,000 and $19,102,000 as of September 30, 2007 and 2006, 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 $3,179,000 and $3,069,000 at September 30, 2007 and 2006, 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, the adjustment to initially apply Statement of Financial Accounting Standards (SFAS) No. 158, 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 $5,520,000 in 2007 and $5,800,000 in 2006.

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 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 derived from the Medicare program was approximately 37% in fiscal year 2007 and 36% in 2006, 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 service 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. Approximately 13% of FAHC's net revenue in 2007 and 2006 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 29% of FAHC's net revenues in 2007 and 28% in 2006 was derived from Blue Cross subscribers.

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, 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, 2007 and 2006, the carrying value of goodwill totaled $156,000 and $260,000, respectively. Goodwill is stated at cost and is amortized using the straight-line method over its estimated useful life.

**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. 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-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 FASB Staff Position Nos. FAS 115-1 and FAS 124-1: *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. FAHC recognized $436,000 in losses related to declines in value that were other than temporary in nature in 2007. No losses related to declines in value that were other than temporary in nature were recognized in 2006.

**Accounting for Asset Retirement Obligations** — Effective September 30, 2006, FAHC adopted the provisions of SFAS No. 143, *Accounting for Asset Retirement Obligations*, as clarified by FASB Interpretation (FIN) No. 47, *Accounting for Conditional Asset Retirement Obligations,* 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. SFAS 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, 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 No. 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 No. 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 No. 47 relates to estimated costs to remove asbestos that is contained within FAHC's facilities. If FAHC had adopted FIN No. 47 effective October 1, 2005, the liability would not have been materially different from the liability recorded at September 30, 2006, and the impact on operating results in 2006 would have been immaterial. The adjustment to the obligation in 2007 was not significant.

**Adoption of New Accounting Pronouncement —** In September 2006, the 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)*. SFAS 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 SFAS No. 158. The effect of adopting SFAS No. 158 was a decrease in unrestricted net assets of $1,634,000 (a $2,433,000 decrease in net assets relates to defined benefit plans and a $799,000 increase relates to other postretirement benefit plans). This amount has been recognized as an adjustment to unrestricted net assets in the accompanying consolidated statements of operations and changes in net assets. SFAS No. 158 did not have an effect on FAHC's consolidated financial position at September 30, 2006. SFAS 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 SFAS No. 158 on FAHC's accompanying consolidated financial statements.

**Recently Issued Accounting Pronouncements —** In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS 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 SFAS No. 157 will have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of SFAS No. 115.* Under this statement, 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. SFAS No. 159 is effective for FAHC commencing in 2009. FAHC is evaluating the potential impact that the adoption of SFAS No. 159 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 $17,700,000 and $15,300,000 in 2007 and 2006, 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, 2007 and 2006, consisted of the following (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Cash and cash equivalents | $ 8,417 | $ 4,794 |
| Money market funds | 1,947 | 2,833 |
| Bonds and notes | 38,472 | 31,804 |
| Mutual funds | 222,475 | 145,342 |
| Limited partnerships (at cost) | 12,862 | 19,640 |
| Beneficial interest in perpetual trusts | 11,448 | 10,417 |
| Other | 1,159 | 1,167 |
| | $ 296,780 | $ 215,997 |

Assets held by trustee under bond indenture agreements included approximately $38,385,000 and $31,170,000 held in debt service reserve funds at September 30, 2007 and 2006, respectively, none of which are reported as current assets.

Investment income and gains for the years ended September 30, 2007 and 2006, consisted of the following (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Nonoperating revenue and expenses: | | |
| Investment income | $ 13,055 | $ 10,300 |
| Net realized gains (losses) on sales of securities | (213) | 4,633 |
| | 12,842 | 14,933 |
| Other changes in unrestricted net assets — net unrealized gain (loss) on investments | 11,320 | (2,524) |
| Changes in temporarily restricted net assets: | | |
| Investment income | 290 | 1,794 |
| Net unrealized gains (losses) on investments | 910 | (901) |
| Net realized gains on investments | 2,407 | 1,486 |
| | 3,607 | 2,379 |
| Changes in permanently restricted net assets — change in beneficial interest in perpetual trusts | 1,031 | 493 |
| Total | $ 28,800 | $ 15,281 |

At September 30, 2007 and 2006, FAHC held investments that had a fair market value of approximately $298,000 and $1,351,000, respectively, less than their cost as adjusted for other than temporary impairment. The cost of these investments has exceeded the market value for in excess of one year.

The amortized cost and estimated fair value of securities classified as available for sale by FAHC's for-profit subsidiaries at September 30, 2007 and 2006, were as follows (in thousands):

| 2007 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Mutual funds | $ 25,603 | $ 4,355 | $ (298) | $ 29,660 |

| 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 |

Proceeds from sales of available-for-sale securities were $1,945,000 and $7,300,000 for the years ended September 30, 2007 and 2006, respectively.

The U.S. Treasury securities classified as available for sale at September 30, 2006, were due in 2007.

## 5. PROPERTY AND EQUIPMENT

A summary of property and equipment at September 30, 2007 and 2006, is as follows (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Land | $ 7,796 | $ 7,796 |
| Land improvements | 14,180 | 13,941 |
| Leasehold improvements | 38,331 | 37,105 |
| Buildings | 478,629 | 465,565 |
| Equipment, furniture, and fixtures | 235,321 | 226,528 |
| | 774,257 | 750,935 |
| Less accumulated depreciation and amortization | (352,430) | (324,050) |
| | 421,827 | 426,885 |
| Construction-in-progress | 4,542 | 10,428 |
| | $ 426,369 | $ 437,313 |

Accounts payable and accrued expenses include approximately $531,000 and $3,000,000 at September 30, 2007 and 2006, respectively, related to a construction project. In addition, FAHC is committed to contracts approximating $343,000 at September 30, 2007, for the completion of the project.

## 6. INVESTMENT IN AFFILIATED COMPANIES

Investment in affiliated companies at September 30, 2007 and 2006, consisted of the following (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Starr Farm Partnership | $ 3,349 | $ 3,788 |
| The Vermont Health Plan | 8,027 | 9,139 |
| Other | 146 | 204 |
| | $ 11,522 | $ 13,131 |

Distributions from these affiliated organizations totaled $1,250,000 and $500,000 for the years ended September 30, 2007 and 2006, respectively. FAHC's share of the (losses) earnings of these affiliates is reported as nonoperating revenue (expense) and totaled approximately $(359,000) and $640,000 for the years ended September 30, 2007 and 2006, respectively. Summarized financial information from the unaudited financial statements of these organizations at September 30, 2007 and 2006, and for the years then ended is as follows (in thousands of dollars):

| 2007 | Ownership Percentage | Total Assets | Net Assets | Change in Net Assets |
|---|---|---|---|---|
| Starr Farm Partnership | 50 % | $ 8,995 | $ 6,698 | $ (878) |
| The Vermont Health Plan | 29 | 53,265 | 21,665 | (4,726) |
| **2006** | | | | |
| Starr Farm Partnership | 50 % | $ 10,066 | $ 7,576 | $ 202 |
| The Vermont Health Plan | 29 | 49,794 | 26,391 | (369) |

## 7. LONG-TERM DEBT

Long-term debt at September 30, 2007 and 2006, consisted of the following (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Vermont Educational and Health Buildings Financing Agency Hospital Revenue Bonds: | | |
| Series 2007A Bonds, variable rate (4.71% at September 30, 2007), net of unamortized bond premium of $113 payable through 2037 | $ 56,373 | $ - |
| Series 2004B Bonds, variable rate (3.95% to 3.60% at September 30, 2007), payable through 2035 | 165,400 | 168,025 |
| Series 2000A Bonds, 4.3% to 6.25%, payable through 2028, net of unamortized bond discount of $664 and $730 | 96,206 | 96,878 |
| Series 2004A Bonds, 2.0% to 5.0%, payable through 2025, net of unamortized bond premium of $1,586 and $1,781 | 44,975 | 46,713 |
| Series 2000B Bonds, variable rate (3.95% to 3.55% at September 30, 2007), payable through 2031 | 50,000 | 50,000 |
| Select Auction Variable Rate Securities (SAVRS) 1994 Bonds, variable rate (4.10% to 4.93% at September 30, 2007), payable through 2013 — net of unamortized discount of $203 and $262 | 15,447 | 17,667 |
| Capital leases and other notes payable | 2,985 | 779 |
| | 431,386 | 380,062 |
| Less current portion | (7,529) | (7,450) |
| Long-term debt | $ 423,857 | $ 372,612 |

**Revenue Bonds** — On January 25, 2007, FAHC, in connection with the Vermont Educational and Health Building Financing Agency (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 (collectively, the “Renaissance Project”) as defined. A debt service reserve fund of $5,666,000 was required to be established under the terms of the Series 2007A bonds.

On April 15, 2004, FAHC, in connection with 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 Renaissance Project.

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. 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.

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 and payments on capital lease obligations for the next five years and thereafter are as follows (in thousands):

| Years Ending September 30 | |
|---|---|
| 2008 | $ 7,529 |
| 2009 | 8,212 |
| 2010 | 8,550 |
| 2011 | 8,381 |
| 2012 | 9,051 |
| Thereafter | 388,832 |
| Total | $ 430,555 |

**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, 2007 and 2006, 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 swap 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 $828,000 and $880,000 at September 30, 2007 and 2006, respectively, to the counterparty.

FAHC's only derivatives are the interest rate swaps described above. As of September 30, 2007 and 2006, the net fair value of the swap agreements of approximately $1,530,000 and $100,000, respectively, were included in notes receivable and other assets and 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 $1,200,000. The letters of credit remain unused at September 30, 2007 and 2006.

## 8. OPERATING LEASES

FAHC has entered into certain operating lease agreements for the rental of building space and equipment. Rental expense amounted to $10,604,000 and $9,954,000 for 2007 and 2006, respectively.

Minimum future lease payments required under noncancelable operating leases at September 30, 2007, were as follows (in thousands):

| Years Ending September 30 | |
|---|---|
| 2008 | $ 9,594 |
| 2009 | 7,674 |
| 2010 | 6,479 |
| 2011 | 5,155 |
| 2012 | 4,779 |
| Thereafter | 16,277 |
| | $ 49,958 |

The above payments exclude anticipated payments under fair market purchase options. FAHC expects to exercise fair market purchase options totaling approximately $5,558,000 under leases in effect at September 30, 2007.

## 9. RESTRICTIONS ON NET ASSETS

At September 30, 2007 and 2006, temporarily restricted net assets are available for the following purposes (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Indigent care | $ 501 | $ 432 |
| Education and research | 6,562 | 4,698 |
| Children's programs | 1,883 | 1,799 |
| Capital projects | 1,502 | 2,247 |
| Other health care services | 6,247 | 3,473 |
| | $ 16,695 | $ 12,649 |

At September 30, 2007, temporarily restricted net assets include approximately $3,293,000 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):

| | 2007 | 2006 |
|---|---|---|
| Investments to be held in perpetuity, the income from which is expendable to support: | | |
| Indigent care | $ 4,644 | $ 4,298 |
| Education and research | 4,453 | 4,280 |
| Other health care services | 15,812 | 15,015 |
| | $ 24,909 | $ 23,593 |

## 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, 2007 and 2006, resulting in a reduction in the reserve of approximately $3,917,000 in 2007 and $3,398,000 in 2006.

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):

| | 2007 | 2006 |
|---|---|---|
| Balance — beginning of year | $ 26,816 | $ 29,261 |
| Less reinsurance receivables | 3,343 | 1,537 |
| Net balance at October 1 | 23,473 | 27,724 |
| Losses incurred related to: | | |
| Current period | 8,110 | 7,355 |
| Prior acts and tail coverage assumed | (684) | (3,940) |
| Total incurred | 7,426 | 3,415 |
| Paid losses related to: | | |
| Current period | 714 | 614 |
| Prior period | 2,851 | 7,052 |
| Total paid | 3,565 | 7,666 |
| Net balance — end of year | 27,334 | 23,473 |
| Reinsurance recoverables | 4,760 | 3,343 |
| Balance — end of year | $ 32,094 | $ 26,816 |

As a result of changes in estimates of incurred events in prior years, primarily professional liability, the estimate of incurred losses decreased by approximately $684,000 and $3,583,000 as of September 30, 2007 and 2006, respectively.

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 and $7,000,000 of the reserve at September 30, 2007 and 2006, 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, 2007 and 2006, 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 2007 and 2006, with a per-year benefit maximum of $1,500,000. FAHC has recorded a reserve of approximately $5,088,000 and $5,324,000 at September 30, 2007 and 2006, 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 1,600 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, 2007 and 2006, was $17,651,000 and $21,326,000, respectively, and the amount required to be maintained by VMCIC was $3,085,000 and $2,647,000, 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 $23,183,000 and $20,059,000 at September 30, 2007 and 2006, respectively. As of September 30, 2007 and 2006, 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, 2007 and 2006, retained earnings and additional paid-in capital of VMCIC, amounting to $3,085,000 and $2,647,000, 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 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 health care benefits.

On September 30, 2007, FAHC adopted the recognition and disclosure provisions of SFAS No. 158. SFAS 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 SFAS 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 SFAS No. 158.

The incremental effects of applying the recognition provisions of SFAS 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) |
| Increase in unrestricted net assets | 52,982 | (1,634) | 51,348 |

The adoption of SFAS 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, 2007 include unrecognized actuarial losses of $19,936,000 related to the defined benefit plan. Of this amount, $828,000 is expected to be recognized in net periodic pension costs in 2008. Amounts included in unrestricted net assets related to the post retirement health care plan are not significant.

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. 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, 2007 and 2006, follows (in thousands):

| | FAHC Defined Benefit Plan | | Postretirement Health Care Plan |
|---|---|---|---|
| | 2007 | 2006 | 2006 |
| Changes in benefit obligations: | | | |
| Projected benefit obligations — beginning of year | $ (109,953) | $ (122,505) | $ - |
| Service cost | (749) | (825) | |
| Interest cost | (6,720) | (6,015) | |
| Benefits paid | 5,198 | 4,631 | |
| Actuarial gain (loss) | (2,768) | 14,760 | |
| Projected benefit obligation — end of year | $ (114,992) | $ (109,954) | $ - |
| Accumulated benefit obligation | $ (112,559) | $ (107,692) | |
| Changes in plan assets: | | | |
| Fair value of plan assets — beginning of year | $ 86,273 | $ 78,453 | $ - |
| Actual return on plan assets | 14,043 | 8,058 | |
| Contributions | 9,015 | 4,393 | |
| Benefits paid | (5,198) | (4,631) | |
| Fair value of plan assets — end of year | $ 104,133 | $ 86,273 | $ - |
| Funded status: | | | |
| Funded status of the plan | $ (10,859) | $ (23,679) | $ - |
| Contributions after June 30 | 8,637 | 2,465 | |
| Unrecognized net loss (gain) | | 25,026 | (615) |
| Unrecognized prior service costs | | | 403 |
| Unrecognized transition asset | | | (809) |
| | (2,222) | 3,812 | (1,021) |
| Additional minimum liability | | (22,765) | |
| Total benefit liability | $ (2,222) | $ (18,953) | $ (1,021) |

At September 30, 2006, approximately $9,496,000 of the above liability was reported with accrued expense in the accompanying balance sheet. Under the requirements of SFAS No. 87, *Employers' Accounting for Pensions*, an additional minimum pension liability representing the excess of accumulated benefits over plan assets and accrued pension costs, was recognized at both September 30, 2007 and 2006. 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, 2007 and 2006, are as follows (in thousands):

| | FAHC Defined Benefit Plan | | FAHC Defined Benefit Postretirement Health Care Plan | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | $ 749 | $ 825 | $ - | $ - |
| Interest cost | 6,720 | 6,015 | | |
| Expected return on plan assets | (7,517) | (6,619) | | |
| Amortization of unrecognized net loss (gain) | 1,333 | 2,937 | (19) | (19) |
| Amortization of transitional asset | | | (202) | (202) |
| Net periodic benefit cost (benefit) | $ 1,285 | $ 3,158 | $ (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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Weighted-average assumptions used to determine the benefit liability: | | | | |
| Discount rates | 6.25 % | 6.25 % | N/A | 6.25 % |
| Rates of increase in future compensation levels | 3.50 | 3.50 | | |
| Weighted-average assumptions used to determine expense: | | | | |
| Discount rates | 6.25 | 5.00 | | |
| 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 at September 30, 2007 and 2006, by asset category, are as follows:

| Asset Category | 2007 | 2006 |
|---|---|---|
| Equity securities | 59 % | 58 % |
| Debt securities | 26 | 26 |
| Real estate investment trusts | 2 | 2 |
| Other | 13 | 14 |
| | 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.

At September 30, 2007, the Plan held investments totaling $4,378,000 in limited partnerships that are carried at fair value, as estimated by the investment managers. The fair value of the remaining pension assets is based on quoted market values.

**Cash Flows** — **Contributions** — FAHC expects to make no contributions to its pension plan in 2008.

**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 | |
|---|---|
| 2008 | $ 5,570 |
| 2009 | 6,044 |
| 2010 | 6,508 |
| 2011 | 6,925 |
| 2012 | 7,372 |
| 2013–2017 | 42,967 |

**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 $20,271,000 and $20,592,000 for the years ended September 30, 2007 and 2006, 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:

| | 2007 | 2006 |
|---|---|---|
| Medicare | 32 % | 38 % |
| Medicaid | 12 | 13 |
| Blue Cross | 18 | 16 |
| Other third-party payors | 28 | 25 |
| Patients | 10 | 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%, 2008–2.50%, 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.

Certain goods and services related to the affiliation with UVM were received in the ordinary course of business during the years ended September 30, 2007 and 2006.

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 $11,471,000 and $11,026,000 in 2007 and 2006, respectively. In addition, FAHC reimburses UVM for equipment rental, research, and certain other administrative expenses. Total reimbursements, including salaries and benefits, approximated $20,481,000 and $18,819,000 in 2007 and 2006, respectively. At September 30, 2007 and 2006, amounts due to UVM approximated $4,470,000 and $6,818,000, 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. As of September 30, 2007, the remaining amount receivable from UVM totals $267,000 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):

| | 2007 | 2006 |
|---|---|---|
| Education and research | $ 20,753 | $ 19,853 |
| Health care services | 523,280 | 477,137 |
| Management and general | 207,787 | 197,760 |
| | $ 751,820 | $ 694,750 |

## 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 $16,021,000 and $21,879,000 at September 30, 2007 and 2006, respectively, as determined by the investment managers.

*Debt* — The fair value of FAHC's debt, which approximates $431,299,000 and $388,684,000 at September 30, 2007 and 2006, 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, 2007 and 2006, the following pledges were receivable (in thousands):

| | 2007 | 2006 |
|---|---|---|
| Due in less than one year | $ 888 | $ 1,433 |
| Due in one to five years | 1,601 | 1,514 |
| Due in over five years | | 194 |
| | 2,489 | 3,141 |
| Less allowances for uncollectible amounts | (186) | (160) |
| | $ 2,303 | $ 2,981 |

* * * * * *

# SUPPLEMENTAL SCHEDULES

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEET INFORMATION
## AS OF SEPTEMBER 30, 2007
## (In thousands)

| ASSETS | Fletcher Allen Health Care, Inc. | Fletcher Allen Health Ventures, 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 | $ 25,309 | $ 6,014 | $ 589 | $ - | $12,390 | $312 | $ - | $ 44,614 |
| Patient and other trade accounts receivable — net | 106,949 | 2,965 | 485 | | | 414 | | 110,813 |
| Due from related parties | | | | | 6,513 | | (6,513) | - |
| Short-term investments | 881 | | | | | | | 881 |
| Inventories | 10,782 | | | | | | | 10,782 |
| Current portion of restricted assets | | | | | 8,000 | | | 8,000 |
| Prepaid and other current assets | 12,486 | 2,002 | 1 | | 4,763 | | | 19,252 |
| Total current assets | 156,407 | 10,981 | 1,075 | - | 31,666 | 726 | (6,513) | 194,342 |
| ASSETS WHOSE USE IS LIMITED OR RESTRICTED: | | | | | | | | |
| Board-designated assets | 190,691 | | | | | | | 190,691 |
| Assets held by trustee under bond indenture agreements | 38,472 | | | | | | | 38,472 |
| Restricted assets | 1,133 | | | | 21,660 | | | 22,793 |
| Donor restricted assets for specific purposes | 11,915 | | | | | | | 11,915 |
| Donor restricted assets for permanent endowment | 24,909 | | | | | | | 24,909 |
| Total assets whose use is limited or restricted | 267,120 | - | - | - | 21,660 | - | - | 288,780 |
| PROPERTY AND EQUIPMENT — Net | 426,180 | 85 | | | | 104 | | 426,369 |
| OTHER ASSETS: | | | | | | | | |
| Deferred financing costs — net | 19,213 | | | | | | | 19,213 |
| Notes receivable and other assets | 3,536 | 250 | | | | | | 3,786 |
| Investment in and advances to affiliated companies | 34,946 | | | 3,349 | | | (26,773) | 11,522 |
| Pledges receivable | 1,490 | | | | | | | 1,490 |
| Total other assets | 59,185 | 250 | - | 3,349 | - | - | (26,773) | 36,011 |
| TOTAL | $908,892 | $11,316 | $1,075 | $3,349 | $53,326 | $830 | $(33,286) | $945,502 |

See notes to supplemental schedule

(Continued)

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEET INFORMATION
## AS OF SEPTEMBER 30, 2007
## (In thousands)

| LIABILITIES AND NET ASSETS | Fletcher Allen Health Care, Inc. | Fletcher Allen Health Ventures, 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 | $ 7,529 | $ - | $ - | $ - | $ - | $ - | $ - | $ 7,529 |
| Accounts payable | 16,821 | 55 | | | 62 | | | 16,938 |
| Accrued expenses and other liabilities | 28,672 | 2,645 | | | | 18 | 1,949 | 33,284 |
| Accrued payroll and related benefits | 38,272 | 144 | | | | 63 | (40) | 38,439 |
| Estimated third-party payor settlements | 8,591 | | | | | | | 8,591 |
| Due to related parties | 6,795 | 1,671 | 17 | | | 6,142 | (14,625) | - |
| Estimated amounts for incurred but unreported claims | 6,571 | 6,519 | | | 8,000 | | | 21,090 |
| Total current liabilities | 113,251 | 11,034 | 17 | - | 8,062 | 6,223 | (12,716) | 125,871 |
| LONG-TERM LIABILITIES: | | | | | | | | |
| Long-term debt — excluding current installments | 423,857 | | | | | | | 423,857 |
| Reserve for outstanding losses on malpractice and workers' compensation claims | | | | | 24,094 | | | 24,094 |
| Pension and other postretirement benefit obligations | 2,213 | | | | | | | 2,213 |
| Other long-term liabilities | 1,689 | 250 | | | | | | 1,939 |
| Total long-term liabilities | 427,759 | 250 | - | - | 24,094 | - | - | 452,103 |
| Total liabilities | 541,010 | 11,284 | 17 | - | 32,156 | 6,223 | (12,716) | 577,974 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | | | | | | | |
| NET ASSETS: | | | | | | | | |
| Unrestricted | 326,278 | | 1,058 | 3,349 | | (5,393) | 632 | 325,924 |
| Temporarily restricted | 16,695 | | | | | | | 16,695 |
| Permanently restricted | 24,909 | | | | | | | 24,909 |
| Retained earnings | | 32 | | | 21,170 | | (21,202) | - |
| Total net assets (deficit) | 367,882 | 32 | 1,058 | 3,349 | 21,170 | (5,393) | (20,570) | 367,528 |
| TOTAL | $908,892 | $11,316 | $1,075 | $3,349 | $53,326 | $ 830 | $ (33,286) | $945,502 |

See note to supplemental schedules.

(Concluded)

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## CONSOLIDATING STATEMENT OF OPERATIONS INFORMATION
## FOR THE YEAR ENDED SEPTEMBER 30, 2007
## (In thousands)

| | Fletcher Allen Health Care, Inc. | Fletcher Allen Health Ventures, 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 | $717,716 | $ - | $962 | $ - | $ - | $ 1,034 | $ (27,061) | $692,651 |
| Premium revenue | 4,200 | 58,173 | | | | | (2,972) | 59,401 |
| Other revenue | 22,145 | | | | 10,426 | | (12,396) | 20,175 |
| Total unrestricted revenue and other support | 744,061 | 58,173 | 962 | - | 10,426 | 1,034 | (42,429) | 772,227 |
| EXPENSES: | | | | | | | | |
| Salaries, payroll taxes, and fringe benefits | 435,451 | 2,594 | | | | 2,057 | (2,706) | 437,396 |
| Supplies and other | 188,081 | 796 | 3 | | 46 | 165 | (12,170) | 176,921 |
| Purchased services | 26,814 | 2,582 | 100 | | 1,391 | 78 | (227) | 30,738 |
| Depreciation and amortization | 33,434 | 45 | | | | 17 | | 33,496 |
| Interest expense | 18,404 | | 2 | | | 1 | | 18,407 |
| Loss on disposal of fixed assets | 1,841 | | | | | | | 1,841 |
| Provision for bad debts | 20,366 | | 72 | | | 68 | | 20,506 |
| Underwriting expenses | | | | | 7,427 | | | 7,427 |
| Medical claims | | 52,414 | | | | | (27,326) | 25,088 |
| Total expenses | 724,391 | 58,431 | 177 | - | 8,864 | 2,386 | (42,429) | 751,820 |
| INCOME (LOSS) FROM OPERATIONS | 19,670 | (258) | 785 | - | 1,562 | (1,352) | - | 20,407 |
| NONOPERATING REVENUE (EXPENSE): | | | | | | | | |
| Investment income and losses | 10,252 | 350 | | | 2,240 | | | 12,842 |
| Unrealized gain on interest rate swap contracts | 1,440 | | | | | | | 1,440 |
| Other | 1,984 | (60) | | 811 | | | (4,224) | (1,489) |
| Total nonoperating revenue (expense) | 13,676 | 290 | - | 811 | 2,240 | - | (4,224) | 12,793 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSE | 33,346 | 32 | 785 | 811 | 3,802 | (1,352) | (4,224) | 33,200 |
| NET UNREALIZED GAINS ON INVESTMENTS | 11,320 | | | | 1,634 | | (1,634) | 11,320 |
| ASSETS RELEASED FROM RESTRICTIONS — For capital purchases | 1,164 | | | | | | | 1,164 |
| ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT | 5,298 | | | | | | | 5,298 |
| TRANSFER OF NET ASSETS | | | | (1,250) | (8,602) | | 9,852 | - |
| ADJUSTMENT TO INITIALLY APPLY THE RECOGNITION PROVISIONS OF SFAS No. 158 | (1,634) | | | | | | | (1,634) |
| INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS | $ 49,494 | $ 32 | $785 | $ (439) | $(3,166) | $(1,352) | $ 3,994 | $ 49,348 |

See note to supplemental schedules.

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## OBLIGATED GROUP BALANCE SHEET INFORMATION
## AS OF SEPTEMBER 30, 2007 AND 2006
## (In thousands)

| ASSETS | 2007 | 2006 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 25,309 | $ 32,801 |
| Patient and other trade accounts receivable—net | 106,949 | 104,466 |
| Short-term investments | 881 | 177 |
| Inventories | 10,782 | 10,338 |
| Prepaid and other current assets | 12,486 | 9,795 |
| Total current assets | 156,407 | 157,577 |
| ASSETS WHOSE USE IS LIMITED OR RESTRICTED: | | |
| Board-designated assets | 190,691 | 122,742 |
| Assets held by trustee under bond indenture agreements | 38,472 | 31,301 |
| Donor restricted assets for specific purposes | 11,915 | 9,169 |
| Donor restricted assets for permanent endowment | 24,909 | 23,593 |
| Total assets whose use is limited or restricted | 265,987 | 186,805 |
| PROPERTY AND EQUIPMENT—Net | 426,180 | 437,168 |
| OTHER ASSETS: | | |
| Deferred financing costs—net | 19,213 | 19,102 |
| Notes receivable and other assets | 3,536 | 1,580 |
| Investment in and advances to affiliated companies | 34,946 | 33,906 |
| Pledges receivable | 1,490 | 1,626 |
| Total other assets | 59,185 | 56,214 |
| TOTAL | $ 907,759 | $ 837,764 |

(Continued)

# FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

## OBLIGATED GROUP BALANCE SHEET INFORMATION
## AS OF SEPTEMBER 30, 2007 AND 2006
## (In thousands)

| LIABILITIES AND NET ASSETS | 2007 | 2006 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current installments of long-term debt | $ 7,529 | $ 7,418 |
| Accounts payable | 16,821 | 31,178 |
| Accrued expenses and other liabilities | 28,672 | 38,157 |
| Accrued payroll and related benefits | 38,272 | 35,543 |
| Estimated third-party payor settlements | 8,591 | 9,069 |
| Due to related parties | 6,795 | 13,526 |
| Estimated amounts for incurred but unreported claims | 6,571 | 6,154 |
| Total current liabilities | 113,251 | 141,045 |
| LONG-TERM LIABILITIES: | | |
| Long-term debt — excluding current installments | 423,857 | 372,612 |
| Pension and other postretirement benefit obligations | 2,213 | 10,478 |
| Other long-term liabilities | 1,689 | 1,741 |
| Total long-term liabilities | 427,759 | 384,831 |
| Total liabilities | 541,010 | 525,876 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | |
| NET ASSETS: | | |
| Unrestricted | 325,145 | 275,646 |
| Temporarily restricted | 16,695 | 12,649 |
| Permanently restricted | 24,909 | 23,593 |
| Total net assets | 366,749 | 311,888 |
| TOTAL | $ 907,759 | $ 837,764 |

(Concluded)

See note to supplemental schedules.

## FLETCHER ALLEN HEALTH CARE, INC. AND SUBSIDIARIES

### OBLIGATED GROUP STATEMENT OF OPERATIONS INFORMATION
### FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006
### (In thousands)

| | 2007 | 2006 |
|---|---|---|
| UNRESTRICTED REVENUE AND OTHER SUPPORT: | | |
| Net patient service revenue | $ 717,716 | $ 661,305 |
| Premium revenue | 4,200 | 4,283 |
| Other revenue | 22,145 | 20,762 |
| Total unrestricted revenue and other support | 744,061 | 686,350 |
| EXPENSES: | | |
| Salaries, payroll taxes, and fringe benefits | 435,451 | 408,018 |
| Supplies and other | 188,081 | 171,722 |
| Purchased services | 26,810 | 23,502 |
| Depreciation and amortization | 33,434 | 34,894 |
| Interest expense | 18,404 | 16,883 |
| Loss on disposal of fixed assets | 1,841 | 512 |
| Provision for bad debts | 20,366 | 14,784 |
| Total expenses | 724,387 | 670,315 |
| INCOME FROM OPERATIONS | 19,674 | 16,035 |
| NONOPERATING REVENUE (EXPENSE): | | |
| Investment income and losses | 10,252 | 11,717 |
| Unrealized gain on interest rate swap contracts | 1,440 | 3,963 |
| Other | 1,985 | 3,368 |
| Total nonoperating revenue | 13,677 | 19,048 |
| EXCESS OF REVENUE OVER EXPENSES | 33,351 | 35,083 |
| NET UNREALIZED GAINS ON INVESTMENTS | 11,320 | 954 |
| ASSETS RELEASED FROM RESTRICTIONS FOR CAPITAL PURCHASES | 1,164 | 3,106 |
| ADDITIONAL MINIMUM PENSION LIABILITY ADJUSTMENT | 5,298 | 18,240 |
| ADJUSTMENT TO INITIALLY APPLY THE RECOGNITION PROVISIONS OF SFAS No. 158 | (1,634) | |
| TRANSFER OF NET ASSETS | | 4,843 |
| INCREASE IN UNRESTRICTED NET ASSETS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | 49,499 | 62,226 |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | | (861) |
| INCREASE IN UNRESTRICTED NET ASSETS | $ 49,499 | $ 61,365 |

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, 2007 AND 2006
### (In thousands)

| | 2007 | 2006 |
|---|---|---|
| UNRESTRICTED NET ASSETS: | | |
| Excess of revenues over expenses | $ 33,351 | $ 35,083 |
| Net unrealized gains on investments | 11,320 | 954 |
| Assets released from restrictions for capital purchases | 1,164 | 3,106 |
| Transfer of net assets | | 4,843 |
| Additional minimum pension liability adjustment | 5,298 | 18,240 |
| Adjustment to initially apply the recognition provisions of SFAS No. 158 | (1,634) | |
| Cumulative effect of change in accounting principle | | (861) |
| Increase in unrestricted net assets | 49,499 | 61,365 |
| TEMPORARILY RESTRICTED NET ASSETS: | | |
| Gifts, grants, and bequests | 3,430 | 2,581 |
| Investment income | 290 | 1,794 |
| Net unrealized gains (losses) on investments | 910 | (901) |
| Net realized gains on investments | 2,407 | 1,486 |
| Net assets released from restrictions used in operations | (1,584) | (759) |
| Net assets released from restrictions used for nonoperating purposes | (243) | (232) |
| Net assets released from restrictions used for capital purchases | (1,164) | (3,106) |
| Transfer of net assets | | (2,939) |
| Increase (decrease) in temporarily restricted net assets | 4,046 | (2,076) |
| PERMANENTLY RESTRICTED NET ASSETS: | | |
| Gifts, grants, and bequests | 285 | 104 |
| Change in beneficial interest in perpetual trusts | 1,031 | 493 |
| Transfer of net assets | | (1,904) |
| Increase (decrease) in permanently restricted net assets | 1,316 | (1,307) |
| INCREASE IN NET ASSETS | 54,861 | 57,982 |
| NET ASSETS — Beginning of year | 311,888 | 253,906 |
| NET ASSETS — End of year | $ 366,749 | $ 311,888 |

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, 2007 AND 2006

### 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.