

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

**Consolidated Financial Statements  
September 30, 2011 and 2010**

# Fletcher Allen Health Care, Inc. and Subsidiaries

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September 30, 2011 and 2010

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## Report of Independent Auditors

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in net assets, and cash flows present fairly, in all material respects, the financial position of Fletcher Allen Health Care, Inc. and its Subsidiaries ("the Organization") at September 30, 2011 and 2010, and the results of their operations, their changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements 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 examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental schedules listed in the Index, which include pages 35-41, are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and changes in net assets of the individual subsidiaries or the obligated group. Accordingly, we do not express an opinion on the financial position, results of operations and changes in net assets of the individual subsidiaries or the obligated group. However, the supplemental schedules have been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*PricewaterhouseCoopers LLP*

December 21, 2011

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Consolidated Balance Sheets

### September 30, 2011 and 2010

(in thousands)

	2011	2010
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 110,301	\$ 78,632
Patient and other trade accounts receivable - net of allowance for doubtful accounts of \$18,817 and \$15,891 in 2011 and 2010, respectively	123,696	115,278
Short-term investments	1,568	1,599
Inventories	17,845	16,883
Current portion of restricted assets	5,965	6,390
Estimated receivables from third-party payers	5,239	11,462
Prepaid and other current assets	18,118	13,616
Total current assets	282,732	243,860
Assets whose use is limited or restricted		
Board-designated assets	208,960	189,950
Assets held by trustee under bond indenture agreements	36,940	38,655
Restricted assets	37,953	39,916
Donor-restricted assets for specific purposes	13,768	12,416
Donor-restricted assets for permanent endowment	24,991	24,951
Total assets whose use is limited or restricted	322,612	305,888
Property and equipment, net	413,890	430,937
Other assets		
Deferred financing costs, net	15,307	16,106
Notes receivable and other assets	8,063	7,830
Investment in affiliated companies	4,905	4,714
Pledges receivable	1,162	1,130
Total other assets	29,437	29,780
	<u>\$ 1,048,671</u>	<u>\$ 1,010,465</u>
<b>Liabilities and net assets</b>		
Current liabilities		
Current installments of long-term debt	\$ 9,039	\$ 8,706
Accounts payable	21,360	19,428
Accrued expenses and other liabilities	35,608	38,328
Accrued payroll and related benefits	57,792	55,120
Estimated third-party payer settlements	17,283	15,418
Estimated amounts for incurred but not reported claims	24,693	26,150
Total current liabilities	165,775	163,150
Long-term liabilities		
Long-term debt - excluding current installments	391,821	400,934
Reserve for outstanding losses on malpractice and workers' compensation claims	18,677	20,206
Pension and other postretirement benefit obligations	31,479	31,762
Other long-term liabilities	16,835	15,833
Total long-term liabilities	458,812	468,735
Total liabilities	624,587	631,885
Commitments and contingent liabilities (note 11)		
Net assets		
Unrestricted	382,467	338,691
Temporarily restricted	16,626	14,938
Permanently restricted	24,991	24,951
Total net assets	424,084	378,580
	<u>\$ 1,048,671</u>	<u>\$ 1,010,465</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2011 and 2010**

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(in thousands)

	2011	2010
<b>Unrestricted revenue and other support</b>		
Net patient service revenue	\$ 842,254	\$ 803,931
Less: Provision for bad debts	(25,375)	(24,516)
Net patient service revenue after provision for bad debts	816,879	779,415
Premium revenue	85,384	79,967
Other revenue	29,635	29,024
Total unrestricted revenue and other support	931,898	888,406
<b>Expenses</b>		
Salaries, payroll taxes, and fringe benefits	547,432	530,861
Supplies and other	212,126	203,138
Purchased services	33,315	33,673
Depreciation and amortization	45,537	43,942
Interest expense	20,233	19,980
Underwriting expenses	2,742	4,654
Medical claims	39,170	32,646
Total expenses	900,555	868,894
Income from operations	31,343	19,512
<b>Nonoperating gains (losses)</b>		
Investment income	13,332	27,301
Loss on interest rate swap contracts	(856)	(4,101)
Other	2,476	554
Total nonoperating gains (losses), net	14,952	23,754
Excess of revenue over expenses	46,295	43,266
Net change in unrealized losses on investments	(185)	(3,475)
Assets released from restrictions for capital purchases	510	939
Pension related adjustments	(2,844)	(4,200)
Increase in unrestricted net assets	\$ 43,776	\$ 36,530

The accompanying notes are an integral part of these consolidated financial statements.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Consolidated Statements of Changes in Net Assets**  
**For the Years Ended September 30, 2011 and 2010**

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(in thousands)

	2011	2010
<b>Unrestricted net assets</b>		
Excess of revenue over expenses	\$ 46,295	\$ 43,266
Net change in unrealized losses on investments	(185)	(3,475)
Assets released from restrictions for capital purchases	510	939
Pension related adjustments	(2,844)	(4,200)
Increase in unrestricted net assets	<u>43,776</u>	<u>36,530</u>
<b>Temporarily restricted net assets</b>		
Gifts, grants, and bequests	2,708	1,655
Investment income	474	337
Net change in unrealized gains (losses) on investments	272	(841)
Net realized gains on investments	158	1,759
Net assets released from restrictions used in operations	(1,143)	(777)
Net assets released from restrictions used for nonoperating purposes	(208)	(191)
Net assets released from restrictions used for capital purchases	(510)	(939)
Transfer of net assets	(63)	(23)
Increase in temporarily restricted net assets	<u>1,688</u>	<u>980</u>
<b>Permanently restricted net assets</b>		
Gifts, grants, and bequests	54	59
Change in beneficial interest in perpetual trusts	(77)	(160)
Transfer of net assets	63	23
Increase (decrease) in permanently restricted net assets	<u>40</u>	<u>(78)</u>
Increase in net assets	45,504	37,432
<b>Net assets</b>		
Beginning of year	<u>378,580</u>	<u>341,148</u>
End of year	<u>\$ 424,084</u>	<u>\$ 378,580</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**For the Years Ended September 30, 2011 and 2010**

(in thousands)

	2011	2010
<b>Cash flows from operating activities</b>		
Increase in net assets	\$ 45,504	\$ 37,432
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	45,537	43,942
Provision for bad debts	25,375	24,516
Contributions restricted for long-term use	(3,238)	(2,050)
Pension related adjustments	2,844	4,200
Loss on disposal of property and equipment	291	51
Loss on interest rate swap contracts	856	4,101
Realized and unrealized gains on investments	(3,342)	(15,872)
Undistributed gains of affiliated companies	(191)	(239)
Change in beneficial interest in perpetual trusts	77	160
Changes in operating assets and liabilities		
Increase in patient and other accounts receivable	(33,793)	(26,707)
Increase in other current and noncurrent assets	(6,127)	(4,303)
Decrease (increase) in estimated receivables from third-party payers	6,223	(7,236)
Decrease in accounts payable and accrued expenses	(660)	(893)
Increase in accrued payroll and related expenses	2,672	8,252
(Decrease) increase in other current and noncurrent liabilities	(987)	1,911
Decrease in pension and other postretirement benefit obligations	(3,127)	(2,775)
Net cash provided by operating activities	<u>77,914</u>	<u>64,490</u>
<b>Cash flows from investing activities</b>		
Acquisitions of property and equipment	(28,138)	(38,219)
Purchase of investments	(252,162)	(506,044)
Proceeds from sale of investments	239,160	495,814
Proceeds from sale of affiliated company	397	397
Net cash used in investing activities	<u>(40,743)</u>	<u>(48,052)</u>
<b>Cash flows from financing activities</b>		
Contributions restricted for long-term use	3,238	2,050
Repayment of long-term debt	(8,740)	(9,564)
Net cash used in financing activities	<u>(5,502)</u>	<u>(7,514)</u>
Net increase in cash and cash equivalents	31,669	8,924
<b>Cash and cash equivalents</b>		
Beginning of year	<u>78,632</u>	<u>69,708</u>
End of year	<u>\$ 110,301</u>	<u>\$ 78,632</u>
<b>Supplemental cash flow information</b>		
Cash paid during the year for interest	\$ 20,580	\$ 21,062
Capital expenditures included in accounts payable	1,156	1,028
Assets acquired under capital lease	-	761

The accompanying notes are an integral part of these consolidated financial statements.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **1. Organization**

Fletcher Allen Health Care, Inc. (FAHC) is a tertiary care teaching hospital that, in affiliation with The University of Vermont, serves as Vermont's Academic Medical Center. As a regional referral center, FAHC provides advanced level care throughout Vermont and Northern New York, with a full time emergency department, also certified as a Level 1 Trauma Center. It is our mission to improve the health of the people in the communities that we serve by integrating patient care, education, and research in a caring environment. As a charitable organization, FAHC lives its mission through a number of community benefit programs, many done in collaborative partnership with other community based organizations. These include but are not limited to community wellness programs, education, direct grants, free access to a community health resource center, direct financial assistance to patients, and other subsidized programs.

FAHC is the sole member of the following subsidiaries: Fletcher Allen Health Ventures, Inc. (FAHV); Fletcher Allen Medical Group, PLLC (FAMG); University of Vermont Medical Group (UVM Medical Group); Fletcher Allen Coordinated Transport, LLC (FACT); Fletcher Allen Skilled Nursing Care, LLC (FASN); Fletcher Allen Health Care Foundation, Inc.; Fletcher Allen Executive Services, LLC (FAES); 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 have been prepared on the accrual basis of accounting and 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 contractual allowances, receivables and accruals for estimated settlements with third-party payers, contingencies, self-insurance program liabilities, accrued medical claims, pension, and postretirement costs, and the valuation of investments and interest rate swaps. Actual results could differ from those estimates.

##### **Cash and Cash Equivalents**

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

Most of FAHC's banking activity, including cash and cash equivalents, is maintained with several national banks and from time to time cash deposits exceed federal insurance limits. It is FAHC's policy to monitor these banks' financial strength on an ongoing basis.

##### **Inventories**

Inventories are stated using the lesser of average cost or market value.



# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **Prepaid and Other Current Assets**

Prepaid and other current assets include miscellaneous nonpatient receivable billings and prepaid expenses primarily related to software maintenance and other contracts. The carrying value of prepaid and other current assets is reviewed if the facts and circumstances suggest that it may be impaired.

#### **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 present value of estimated future cash flows has been measured at the time of the contribution using rates indicative of the market and credit risk associated with the contribution. Amortization of the discount is included in other 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. Investment income or loss (including realized gains and losses on investments, interest, and dividends), to the extent not capitalized, is included in nonoperating gains (losses), 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. 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 consolidated balance sheets, statements of operations, and changes in net assets.

#### **Other-Than-Temporary Impairment of Investments**

FAHC reviews its investments to identify those for which fair value is below cost. FAHC then makes a determination as to whether the investment should be considered other-than-temporarily impaired. FAHC recognized \$10,118,000 and \$0 in losses related to declines in value that were other-than-temporary in nature in the years ended September 30, 2011 and 2010, respectively.

#### **Investment in Affiliates**

Investments in 50%-owned affiliates are accounted for using the equity method of accounting and reported within investment in affiliated companies on the consolidated balance sheet. These include 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 assets and is computed using the straight-line method. Equipment under capital lease obligations is amortized using 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.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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Depreciation is calculated using the following estimated useful lives, as recommended by the American Hospital Association:

Land improvements	15 - 20 years
Building and improvements	7 - 30 years
Fixed equipment	5 - 15 years
Major moveable equipment	2 - 15 years

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 costs 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 \$279,000 and \$858,000 of interest was capitalized during the years ended September 30, 2011 and 2010, respectively. Net deferred financing costs totaled \$15,307,000 and \$16,106,000 at September 30, 2011 and 2010, respectively. Such amounts are reported within other assets and are amortized over the period the related obligations are outstanding using the effective interest method. Accumulated amortization of deferred financing costs totaled \$6,522,000 and \$5,723,000 at September 30, 2011 and 2010, respectively.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by FAHC has been limited by donors or law 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 unrestricted revenue and other support and expenses. Peripheral or incidental transactions are reported as nonoperating gains.

#### **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), contributions of long-lived assets (including assets acquired using contributions restricted by donors for acquiring such assets), and pension-related adjustments.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. 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 payers. 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 \$1,162,000 and \$3,713,000 in the years ended September 30, 2011 and 2010, respectively.

FAHC has agreements with third-party payers that provide for payments to FAHC at amounts different from its established rates. A summary of the payment arrangements with major third-party payers 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 services 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 Audit Contractor (MAC). 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 derived from the Medicare program was approximately 29% and 30% in the years ended September 30, 2011 and 2010, respectively.

#### **Medicaid**

Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. As with Medicare, reimbursement is based on a diagnosis-related group (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. 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. The Vermont Medicaid program accounts for approximately 9% and 8% of FAHC's net revenue in the years ended September 30, 2011 and 2010, respectively.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### ***Managed Care and 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 47% and 46% of FAHC's net revenues were derived from contracted insurers in the years ended September 30, 2011 and 2010, respectively. Approximately 10% of FAHC's net revenues were derived from noncontracted insurers in the years ended September 30, 2011 and 2010.

VMC negotiates contracts with insurers and other payers for the provision of health care services through participating providers associated with its network. As a result, VMC is currently managing and/or has entered into contracts with managed care plans on behalf of FAHC and its network providers. Under the terms of these agreements, VMC provides managed care services to subscribers of the managed care plans who select VMC as their primary health plan provider. Payments to FAHC from VMC for services on behalf of respective managed care plan subscribers are based on a discounted fee for service or a predetermined fee schedule.

VMC has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, VMC receives monthly capitation payments based on the number of each HMO's participants regardless of services actually performed. These revenues are subsequently disbursed to participating providers based on both discounted fee for service schedules and predetermined payment rates. Participating providers share a limited degree of risk through a set withhold that is only paid if cost and utilization targets are met.

#### **Other Revenue**

Other revenue consists primarily of research revenue, sales of pharmaceuticals and related products, cafeteria sales, meaningful use revenue under the Medicaid Electronic Health Records Incentive program, 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 within accrued expenses. Amounts expended in advance of the receipt of funding are included within patient and other trade accounts receivable.

#### **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 current operations.

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

September 30, 2011 and 2010

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### Income Taxes

FAHC, UVM Medical Group, 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, UVM Medical Group, and FAMG are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. FACT, FAES and FASN are single-member limited liability corporations. As such, for tax purposes, FACT, FAES, and FASN 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. The tax provisions and related tax assets and liabilities for these entities are not material to the consolidated financial statements.

For tax years beginning after December 15, 2008, nonpublic companies adopted guidance under ASC 740, *Income Taxes*, that prescribe a model for the recognition and measurement of uncertain tax benefits. This guidance did not have an impact on Fletcher Allen Health Care and its subsidiaries.

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.

### Accounting for Asset Retirement Obligations

FAHC recognizes a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists. The types of asset retirement obligations that FAHC considers are those for which it has a legal obligation to perform an asset retirement activity, however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within its control. The fair value of a liability for the legal obligation associated with an asset retirement is recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized.

The estimated future undiscounted value of the asset retirement obligation is approximately \$1,293,000 at September 30, 2011, substantially all of which relates to the estimated costs to remove asbestos that is contained within FAHC's facilities. The initial asset retirement obligation was calculated using a discount rate of 4.5%. The asset retirement obligation at September 30, 2011 and 2010 was approximately \$1,055,000 and \$1,043,000, respectively.

### Accounting for Postretirement Benefit Plans

FAHC recognizes the overfunded or underfunded status of its defined benefit pension and other postretirement benefit plans (collectively, "postretirement benefit plans") in the balance sheet. Changes in the funded status of the plans are reported in the year in which the changes occur as a change in unrestricted net assets presented below the excess of revenue over expenses in the consolidated statements of operations and changes in net assets.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **Reclassifications**

Certain amounts for the year ended September 30, 2010 have been reclassified to conform to the current year presentation.

#### **Adoption of New Accounting Guidance**

In July 2011, the Financial Accounting Standards Board issued Accounting Standards Update 2011-7 (ASU 2011-7), *Health Care Entities: Presentation and Disclosure of Net Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*. Under the new guidance, bad debts relating to patient service revenue will be separately disclosed in the statement of operations and reported as a component of net patient service revenue. Bad debts associated with activities other than patient service revenue will continue to be reported as an operating expense. For FAHC ASU 2011-7 would be effective for fiscal years beginning after December 15, 2011, but early adoption is permitted.

FAHC elected to early adopt ASU 2011-7 for 2011 and changed its reporting of the provision for bad debts. Accordingly, certain amounts in the 2010 financial statements have been reclassified to conform with the 2011 presentation. The previously reported provision for bad debts of \$24,516,000 has been reclassified as a reduction to net patient service revenue. The reclassification had no impact on the previously reported excess of revenues over expenses for 2010.

#### **Subsequent Events**

FAHC has evaluated subsequent events through December 21, 2011, which is the date the financial statements were issued and has concluded that aside from the following item, there were no such events that require adjustments to the consolidated financial statements or disclosure in the notes to the consolidated financial statements.

Under an Affiliation Agreement, dated as of December 31, 2010 (the "Affiliation Agreement"), between FAHC and Central Vermont Medical Center ("CVMC"), FAHC agreed to affiliate with CVMC by organizing a new nonprofit, tax-exempt Vermont corporation named Fletcher Allen Partners, Inc., to be the sole corporate member of both FAHC and CVMC with substantial reserved powers to establish an integrated regional health care system. The Affiliation Agreement subsequently received all necessary regulatory approvals and became effective on October 1, 2011, when both FAHC and CVMC amended their organizational documents to make Fletcher Allen Partners, Inc., their sole member.

Effective as of November 1, 2011, CVMC has withdrawn from the Dartmouth-Hitchcock Obligated Group ("D-H Obligated Group"), and has been admitted as a member of the Fletcher Allen Obligated Group pursuant to the Fletcher Allen Obligated Group Master Trust Indenture. In connection with CVMC's admission to the Fletcher Allen Obligated Group, all existing debt, totaling \$27,875,000, issued by the D-H Obligated Group for the benefit of CVMC has been refinanced or modified such that it has become an obligation of the Fletcher Allen Obligated Group. The Vermont Educational and Health Buildings Financing Agency Revenue Refunding Bonds (Central Vermont Hospital and Nursing Home Project) Series 1996 were redeemed with the proceeds of a term loan made to CVMC by People's United Bank in the amount of \$11,600,000. The Central Vermont Medical Center Project Revenue Bonds Series 2009A and Series 2009B have been modified to become obligations of the Fletcher Allen Obligated Group, totaling \$16,275,000.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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**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 \$22,289,000 and \$19,513,000 in 2011 and 2010, respectively.

**4. Assets Whose Use is Limited or Restricted**

Assets whose use is limited or restricted at September 30, 2011 and 2010 consisted of the following:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
Mutual funds	\$ 32,332	\$ 24,030
Money market funds	12,528	14,117
Bonds and notes	24,414	24,538
Common collective trusts	250,151	240,364
Beneficial interest in perpetual trusts	9,152	9,229
	<u>328,577</u>	<u>312,278</u>
Less: Current portion	<u>(5,965)</u>	<u>(6,390)</u>
	<u><u>\$ 322,612</u></u>	<u><u>\$ 305,888</u></u>

Investment income and gains (losses) for the years ended September 30, 2011 and 2010 consisted of the following:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Nonoperating revenue and expenses</b>		
Investment income	\$ 10,235	\$ 8,873
Net realized gains	3,097	18,428
	<u>13,332</u>	<u>27,301</u>
Net change in unrealized losses on investments	<u>(185)</u>	<u>(3,475)</u>
<b>Changes in temporarily restricted net assets</b>		
Investment income	474	337
Net change in unrealized gains (losses) on investments	272	(841)
Net realized gains on investments	158	1,759
	<u>904</u>	<u>1,255</u>
<b>Changes in permanently restricted net assets</b>		
Change in beneficial interest in perpetual trusts	<u>(77)</u>	<u>(160)</u>
	<u><u>\$ 13,974</u></u>	<u><u>\$ 24,921</u></u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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As a result of the recognition of \$10,118,000 in losses related to declines in value that were other-than-temporary in nature during the year ended September 30, 2011, there were \$139,000 of investments that had a fair value less than their cost at September 30, 2011.

The cost and estimated fair value of securities classified as available-for-sale by the organization, which excludes beneficial interest in perpetual trusts of \$9,152,000 and \$9,229,000, and includes short-term investments of \$1,568,000 and \$1,599,000 as of September 30, 2011 and 2010, respectively, is as follows:

<i>(in thousands)</i>	<b>Cost</b>	<b>Gross Unrealized Gains (Losses)</b>	<b>Estimated Fair Value</b>
<b>September 30, 2011</b>			
Mutual funds	\$ 34,039	\$ (139)	\$ 33,900
Money market funds	12,528	-	12,528
Bonds and notes	24,332	82	24,414
Common collective trusts	238,162	11,989	250,151
	<u>\$ 309,061</u>	<u>\$ 11,932</u>	<u>\$ 320,993</u>
<b>September 30, 2010</b>			
Mutual funds	\$ 22,719	\$ 1,311	\$ 24,030
Money market funds	15,716	-	15,716
Bonds and notes	24,333	205	24,538
Common collective trusts	230,035	10,329	240,364
	<u>\$ 292,803</u>	<u>\$ 11,845</u>	<u>\$ 304,648</u>

**5. Property and Equipment**

A summary of property and equipment at September 30, 2011 and 2010 is as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
Land	\$ 8,016	\$ 8,016
Land improvements	10,612	10,551
Leasehold improvements	37,895	35,707
Buildings	488,677	486,702
Equipment, furniture, and fixtures	221,731	195,932
	<u>766,931</u>	<u>736,908</u>
Less: Accumulated depreciation	<u>(358,681)</u>	<u>(316,606)</u>
	408,250	420,302
Construction-in-progress	5,640	10,635
	<u>\$ 413,890</u>	<u>\$ 430,937</u>



# Fletcher Allen Health Care, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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FAHC wrote off approximately \$3,381,000 in assets in the year ended September 30, 2011. In conjunction with these write offs, a loss on disposal of property and equipment of \$291,000 was recorded, and is included in supplies and other expense. At September 30, 2011, FAHC had commitments to purchase approximately \$6,529,000 of property and equipment.

FAHC recorded depreciation expense of \$44,776,000 and \$43,136,000 for the years ended September 30, 2011 and 2010, respectively.

#### 6. Investment in Affiliated Companies

Investment in affiliated companies at September 30, 2011 and 2010 consisted of the following:

<i>(in thousands)</i>	2011	2010
Starr Farm Partnership	\$ 4,713	\$ 4,522
OB Net Services, LLC	192	192
	<u>\$ 4,905</u>	<u>\$ 4,714</u>

Distributions from these affiliated organizations totaled \$700,000 and \$500,000 for the years ended September 30, 2011 and 2010, respectively. FAHC's share of the income of these affiliates is reported as other nonoperating gains and totaled approximately \$891,000 and \$739,000 for the years ended September 30, 2011 and 2010, respectively.

Summarized financial information from the unaudited financial statements of the Starr Farm Partnership as of and for the years ended September 30, 2011 and 2010 was as follows:

<i>(in thousands)</i>	Ownership Percentage	Total Assets	Net Assets	Change in Net Assets
<b>September 30, 2011</b>				
Starr Farm Partnership	50 %	\$ 10,254	\$ 9,425	\$ 381
<b>September 30, 2010</b>				
Starr Farm Partnership	50 %	\$ 10,167	\$ 9,044	\$ 478

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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**7. Long-Term Debt**

Long-term debt at September 30, 2011 and 2010 consisted of the following:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Vermont Educational and Health Buildings Financing Agency</b>		
<b>Hospital Revenue Bonds</b>		
Series 2008A Bonds, variable rate (0.14% and 0.23% at September 30, 2011 and 2010, respectively), payable through 2030	\$ 54,705	\$ 54,705
Series 2007A Bonds, fixed rate (4.00% to 4.75%), payable through 2037 (including unamortized premium of \$98 and \$101)	56,217	56,321
Series 2004B Bonds, fixed rate (4.00% to 5.50%), payable through 2035 (including unamortized premium of \$136 and \$142)	152,662	155,017
Series 2004A Bonds, fixed rate (3.00% to 5.00%), payable through 2025 (including unamortized premium of \$1,195 and \$1,293)	37,430	39,398
Series 2000A Bonds, fixed rate (5.50% to 6.25%), payable through 2028 (including unamortized discount of \$533 and \$566)	93,737	94,399
Select Auction Variable-Rate Securities (SAVRS) 1994 Bonds, variable rate (4.93% and 4.93% at September 30, 2011 and 2010, respectively), payable through 2013 (including unamortized discount of \$70 and \$106)	5,680	8,345
Capital leases and other notes payable	429	1,455
	<u>400,860</u>	<u>409,640</u>
Less: Current portion	(9,039)	(8,706)
Long-term debt	<u>\$ 391,821</u>	<u>\$ 400,934</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. As of September 30, 2011 and 2010, the reserve fund balance was approximately \$15,345,000 and \$14,834,000, respectively.

Also on May 21, 2008, FAHC in connection with the Vermont Educational and Health Buildings 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 \$1,577,000. The Series 2008A bonds are collateralized by an irrevocable letter of credit from a local bank in the amount of \$55,334,000, which expires in 2015. 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 nonmarketable 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 four years from the date of the borrowing under the letter of credit or the stated expiration date, currently, April 30, 2015.

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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In conjunction with these transactions, the notional amount of the original swap agreement covering the 2004B bonds (see Note 8) was reduced from \$135,000,000 to \$55,190,000 and transferred to 2008A bonds in exchange for the payment of \$3,128,000.

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 an interest in its gross receipts, as defined in connection with the issuance of its long-term debt.

#### **Scheduled Maturities of Long-Term Debt**

As of September 30, 2011, scheduled maturities of long-term debt and payments on capital lease obligations, not including a net unamortized premium of \$826,000, for the next five years and thereafter are as follows:

*(in thousands)*

#### **Years Ending September 30**

2012	\$	9,039
2013		8,305
2014		6,260
2015		9,265
2016		9,685
Thereafter		357,480
	\$	<u>400,034</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.

#### **Letter of Credit**

The 2008A letter credit was not drawn upon as of September 30, 2011, and the scheduled maturities of long-term debt assumes the Series 2008A bonds are not put back to FAHC. If the letter of credit was drawn upon, the repayment would begin one year and one day from the date of the letter of credit being drawn upon. The repayment schedule would occur over the remaining three years of the letter of credit term. The repayment would be as follows: \$21,176,000 in year two, \$21,176,000 in year three and \$12,353,000 in the final year.

## **8. Interest Rate Swap Agreements**

FAHC utilizes interest rate swap agreements to manage interest rate risk related to the variable rate Series 2008A Bonds and variable rate SAVRS 1994 Bonds. These agreements had aggregate notional amounts of \$55,190,000 and \$5,750,000, respectively, as of September 30, 2011. 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.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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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. Under certain circumstances, FAHC may be required to post collateral to secure its obligations under the 1994 interest rate swap 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, 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.

FAHC and its counterparty under the 1994 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. The replacement of fair value of the interest rate swap agreement with a like instrument would cause FAHC to pay approximately \$361,000 and \$815,000 at September 30, 2011 and 2010, respectively, to the counterparty. The counterparty to the 1994 swap agreement has declared bankruptcy and FAHC has made payments to the trustee in the bankruptcy during the years ended September 30, 2011 and 2010. FAHC's payment is based on a 4.93% interest rate; however, FAHC pays net the 35 day floating amount due from Lehman Brothers Special Finance, Inc. FAHC receives no payment from Lehman Brothers Special Finance, Inc. for this transaction. The termination date of the 1994 swap agreement is September 12, 2013.

The fair value of interest rate swap agreements at September 30 is as of follows:

	2011		2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
(in thousands)				
1994 Swap	Other long-term liabilities	\$ (361)	Other long-term liabilities	\$ (815)
2008A Swap	Other long-term liabilities	\$ (12,715)	Other long-term liabilities	\$ (11,405)

The effects of interest rate swap agreements on the consolidated statements of operations and changes in net assets for 2011 and 2010 are as follows:

	Location of Loss Recognized in Statement of Operations	Amount of Loss Recognized in Statement of Operations	
		2011	2010
2008A Swap	Loss on interest rate swap contracts	\$ (856)	\$ (4,101)

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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**9. Operating Leases**

FAHC has entered into certain operating lease agreements for the rental of building space and equipment. Rental expense, inclusive of common area maintenance for the year, amounted to \$11,018,000 and \$11,468,000 for the years ended September 30, 2011 and 2010, respectively.

Minimum future lease payments required under noncancelable operating leases at September 30, 2011, were as follows:

*(in thousands)*

**Years Ending September 30**

2012	\$	7,647
2013		5,504
2014		3,810
2015		3,445
2016		2,801
Thereafter		4,952
	\$	<u>28,159</u>

**10. Net Assets**

**Temporarily Restricted Net Assets**

At September 30, 2011 and 2010, temporarily restricted net assets are available for the following purposes:

*(in thousands)*

	<b>2011</b>	<b>2010</b>
Indigent care	\$ 674	\$ 503
Education and research	8,337	7,497
Children's programs	2,036	2,092
Capital projects	1,112	1,385
Other health case services	4,467	3,461
	<u>\$ 16,626</u>	<u>\$ 14,938</u>

At September 30, 2011 and 2010, temporarily restricted net assets include approximately \$8,891,000 and \$8,319,000, respectively, of accumulated gains on permanently restricted net assets, which are subject to board appropriation in accordance with state law.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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**Permanently Restricted Net Assets**

At September 30, 2011 and 2010, permanently restricted net assets are restricted to:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Investments to be held in perpetuity, income expendable to support</b>		
Indigent care	\$ 3,809	\$ 4,012
Education and research	4,769	3,923
Other health care services	16,413	17,016
	<u>\$ 24,991</u>	<u>\$ 24,951</u>

**Endowment Funds**

FAHC's endowment consists of approximately 79 funds established for a variety of purposes. FAHC does not currently have any unrestricted funds designated by the Board of Trustees (the "Board") to function as endowment. Accordingly, for the purposes of this disclosure, endowment funds include only donor-restricted endowment funds. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

***Interpretation of Relevant Law***

FAHC has interpreted state law as requiring realized and unrealized gains of permanently restricted net assets to be retained in a temporarily restricted net asset classification until appropriated by the Board and expended. State law allows the Board to appropriate the net appreciation of permanently restricted net assets as is prudent considering FAHC's long and short-term needs, present and anticipated financial requirements, and expected total return on its investments, price level trends, and general economic conditions. In the years ended September 30, 2011 and 2010, \$269,000 and \$72,000, respectively, was appropriated.

As a result of this interpretation, FAHC classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment when explicit donor stipulations requiring permanent maintenance of the historical fair value are present, and (b) the original value of subsequent gifts to the permanent endowment when explicit donor stipulations requiring permanent maintenance of the historical fair value are present. The remaining portion of the donor-restricted endowment fund is comprised of accumulated gains not required to be maintained in perpetuity. These amounts are classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the donor's stipulations. FAHC considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: duration and preservation of the fund, purposes of the donor-restricted endowment funds, general economic conditions, the possible effect of inflation and deflation, and the expected total return from income and the appreciation of investments, other resources of FAHC, and the investment policies of FAHC.

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***Endowment Net Asset Composition and Changes in Endowment Net Assets***

The following is a summary of the endowment net asset composition by type of fund at September 30, 2011 and 2010, and the changes therein for the years then ended:

**Endowment net asset composition by type of fund**

<i>(in thousands)</i>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
<b>September 30, 2011</b>			
Donor-restricted endowment funds	\$ 8,891	\$ 15,839	\$ 24,730
<b>September 30, 2010</b>			
Donor-restricted endowment funds	\$ 8,319	\$ 15,722	\$ 24,041

**Changes in endowment net assets**

<i>(in thousands)</i>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
<b>Endowment net assets at September 30, 2009</b>	\$ 7,159	\$ 15,640	\$ 22,799
Investment return			
Investment income	337	-	337
Net appreciation	918	-	918
Total investment return	1,255	-	1,255
Appropriations of endowment assets for expenditure	(72)	-	(72)
Other	(23)	82	59
<b>Endowment net assets at September 30, 2010</b>	8,319	15,722	24,041
Investment return			
Investment income	474		474
Net appreciation	430		430
Total investment return	904	-	904
Appropriations of endowment assets for expenditure	(269)		(269)
Other	(63)	117	54
<b>Endowment net assets at September 30, 2011</b>	\$ 8,891	\$ 15,839	\$ 24,730

***Beneficial Interest in Perpetual Trusts***

The above amounts exclude FAHC's beneficial interest in perpetual trusts, which are not within management's investment control. Such beneficial interests totaled \$9,152,000 and \$9,229,000 at September 30, 2011 and 2010, respectively.

***Charitable Remainder Trust***

FAHC has received an irrevocable charitable remainder trust, for which FAHC does not serve as trustee. For this trust, FAHC recorded its beneficial interest in those assets as contributions revenue and pledges receivable at the present value of the expected future cash inflows. Trusts are recorded at the date FAHC has been notified of the trust's existence and sufficient information regarding the trust has been accumulated to form the basis for an accrual. Changes in the value of these assets are recorded as a nonoperating change in the valuation of pledges receivable of either temporarily or permanently restricted net assets.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

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#### ***Funds with Deficiencies***

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor requires FAHC to retain as a fund of perpetual duration. There were no such deficiencies at September 30, 2011 or 2010.

#### ***Investment Return Objectives and Spending Policy***

FAHC has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to the programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s). Under this policy, the endowment assets are invested in a manner to generate returns at least equal to and preferably greater than the consumer price index. To satisfy its return objective, FAHC targets a diversified asset allocation that provides for a balanced portfolio.

## **11. 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, and maintains an excess insurance policy to limit its exposure on claims to \$750,000 per occurrence and \$600,000 per occurrence in the years ended September 30, 2011 and 2010, respectively, with a \$25,000,000 aggregate.

The reserves for outstanding losses have been discounted at a rate of 3% at September 30, 2011 and 2010, resulting in a reduction in the reserve of approximately \$1,621,000 and \$1,820,000 in the years ended September 30, 2011 and 2010, respectively, for professional liability and a reduction in the reserve of approximately \$290,000 and \$274,000 at September 30, 2011 and 2010, respectively, for worker's compensation.



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Activity in the reserve for outstanding losses and loss-related expenses for malpractice at VMCIC and for workers' compensation claims for the years ended September 30, 2011 and 2010 is summarized as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Balance at beginning of year</b>	\$ 33,379	\$ 35,850
Less: Reinsurance receivables	<u>(4,171)</u>	<u>(4,711)</u>
Net balance - beginning of year	<u>29,208</u>	<u>31,139</u>
Losses incurred related to		
Current period	9,549	9,552
Prior acts and tail coverage assumed	<u>(2,820)</u>	<u>(4,716)</u>
Total incurred	<u>6,729</u>	<u>4,836</u>
Paid losses related to		
Current period	1,149	933
Prior period	<u>7,530</u>	<u>5,834</u>
Total paid	<u>8,679</u>	<u>6,767</u>
Net balance - end of year	27,258	29,208
Reinsurance recoverables	<u>4,165</u>	<u>4,171</u>
<b>Balance at end of year</b>	<u>\$ 31,423</u>	<u>\$ 33,379</u>

As a result of changes in estimates of incurred events in prior years, primarily professional liability, the estimate of incurred losses decreased by approximately \$2,820,000 for the year ended September 30, 2011 and decreased by \$4,716,000 for the year ended September 30, 2010.

The reserve for losses, which was determined with the assistance of an actuarial consultant, includes estimates of claims incurred but not reported. Approximately \$12,746,000 and \$13,173,000 of the reserve for medical malpractice and workers' compensation claims at September 30, 2011 and 2010, 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 consolidated balance sheets at September 30, 2011 and 2010. Also included in the current portion of estimated amounts for incurred but not reported claims are \$5,918,000 and \$6,996,000 related to medical claims associated with VMC, and \$6,029,000 and \$5,981,000 related to employee health claims for FAHC at September 30, 2011 and 2010, respectively.

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **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 cumulative claims between \$150,000 and \$100,000 per member per year in the years ended September 30, 2011 and 2010, with a per-year benefit maximum equal to the amount of premiums paid under the policy. In addition to the self-insurance plan, FAHC maintained a commercial policy to limit its exposure on cumulative claims exceeding \$200,000 and \$175,000 per member per year for the years ended September 30, 2011 and 2010, respectively.

#### **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 Agreements**

The organization is subject to a collective bargaining agreement with respect to its Registered Nurse ("RN") and Licensed Practical Nurse ("LPN") nursing staff. The current agreement runs through July 9, 2012, and covered approximately 1,649 and 1,631 staff at September 30, 2011 and 2010, respectively. The organization is also subject to a collective bargaining agreement with the technical bargaining unit. The current agreement runs from March 19, 2010 through March 1, 2013 and covers approximately 307 and 306 staff in various technical positions at September 30, 2011 and 2010, respectively.

### **12. Statutory Capital and Surplus**

VMCIC is registered under the Bermuda Insurance Act of 1978 and related regulations (the "Act") and is obligated to comply with various provisions of the Act regarding minimum levels of solvency and liquidity. Statutory capital and surplus at September 30, 2011 and 2010, was \$21,034,000 and \$23,599,000, respectively, and the amount required to be maintained by VMCIC, and not available for distribution, was \$2,295,000 and \$2,570,000, 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 \$18,739,000 and \$19,295,000 at September 30, 2011 and 2010, respectively. FAHC reports all of VMCIC's investments in marketable securities as restricted assets in the accompanying consolidated balance sheets.

### **13. 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, and the benefit accruals provided for a small group of grandfathered employees are based on a percentage of five year average pay. It is FAHC's policy to fund at least the required minimum contribution under Internal Revenue Code, Section 412.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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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 service and all employees who are eligible for 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 for accounting purposes for postretirement healthcare benefits.

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, 2011 and 2010 is as follows:

<i>(in thousands)</i>	<b>FAHC Defined Benefit Plan</b>	
	<b>2011</b>	<b>2010</b>
<b>Changes in benefit obligations</b>		
Projected benefit obligations - beginning of year	\$ (133,534)	\$ (123,701)
Service cost	(605)	(495)
Interest cost	(7,150)	(7,230)
Benefits paid	6,250	6,060
Actuarial loss	(2,935)	(8,695)
Administrative expenses paid	469	527
Projected benefit obligation - end of year	<u>(137,505)</u>	<u>(133,534)</u>
Accumulated benefit obligation	<u>(136,383)</u>	<u>(132,495)</u>
<b>Changes in plan assets</b>		
Fair value of plan assets - beginning of year	101,772	93,388
Actual gain on plan assets	5,282	9,696
Contributions	5,491	5,275
Benefits paid	(6,250)	(6,060)
Administrative expenses paid	(469)	(527)
Fair value of plan assets - end of year	<u>105,826</u>	<u>101,772</u>
Funded status of the plan	<u>\$ (31,679)</u>	<u>\$ (31,762)</u>

Unrestricted net assets at September 30, 2011 include unrecognized actuarial losses of \$59,527,000 related to the defined benefit plan. Of this amount, \$1,817,000 is expected to be recognized in net periodic pension costs in the year ending September 30, 2012.

Unrestricted net assets at September 30, 2010 include unrecognized actuarial losses of \$56,683,000 related to the defined benefit plan. Of this amount, \$1,681,000 was recognized in net periodic pension costs in the year ended September 30, 2011.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
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Amounts included in unrestricted net assets related to the postretirement health care plan are not significant.

The cost components of the net periodic benefit cost for the years ended September 30, 2011 and 2010 are as follows:

	<b>FAHC Defined Benefit Plan</b>	
	<b>2011</b>	<b>2010</b>
<i>(in thousands)</i>		
Service cost	\$ 605	\$ 495
Interest cost	7,150	7,230
Expected return on plan assets	(6,968)	(6,791)
Amortization of unrecognized net loss	1,681	1,518
Net periodic benefit cost	<u>\$ 2,468</u>	<u>\$ 2,452</u>

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

	<b>FAHC Defined Benefit Plan</b>	
	<b>2011</b>	<b>2010</b>
Weighted-average assumptions used to determine the benefit liability		
Discount rates	5.4 %	5.5 %
Rates of increase in future compensation levels	3.5	3.5
Weighted-average assumptions used to determine expense		
Discount rates	5.5	6.0
Rates of increase in future compensation levels	3.5	3.5
Expected long-term rate of return on plan assets	7.0	7.5

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, 2011 and 2010, by asset category, are as follows:

	<b>2011</b>	<b>2010</b>
<b>Asset category</b>		
Money market	1 %	1 %
Mutual fund	11	11
Common collective trusts	88	88
	<u>100 %</u>	<u>100 %</u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

The following table presents information as of September 30, 2011 and 2010, about FAHC's pension assets that are measured at fair value on a recurring basis:

<i>(in thousands)</i>	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Other Observable Inputs (Level 2)</b>	<b>Unobservable Inputs (Level 3)</b>	<b>Fair Value</b>
<b>2011</b>				
Money market	\$ 776	\$ -	\$ -	\$ 776
Mutual fund	11,521	-	-	11,521
Common collective trusts	-	93,529	-	93,529
Total	<u>\$ 12,297</u>	<u>\$ 93,529</u>	<u>\$ -</u>	<u>\$ 105,826</u>
<b>2010</b>				
Money market	\$ 577	\$ -	\$ -	\$ 577
Mutual fund	11,672	-	-	11,672
Common collective trusts	-	89,523	-	89,523
Total	<u>\$ 12,249</u>	<u>\$ 89,523</u>	<u>\$ -</u>	<u>\$ 101,772</u>

The investment strategy 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.

There was no Level 3 activity for the years ended September 30, 2011 and 2010.

**Cash Flows - Contributions**

FAHC expects to contribute \$5,500,000 to its pension plan in the year ending September 30, 2012.

**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**

2012	\$ 7,689
2013	8,153
2014	8,619
2015	9,025
2016	9,369
2017-2021	50,236

**Medical Center of Vermont (MCHV) - 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.

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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#### **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.

#### **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.

#### **Fletcher Allen Health Care, Inc. - Retirement Plan**

In accordance with ERISA guidelines, FAHC provided a new retirement plan for employees of the former MCHV, FAH, and UHC, effective July 1, 1996. 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 incurred. Benefit plan costs amounted to \$29,818,000 and \$27,918,000 for the years ended September 30, 2011 and 2010, respectively. These amounts do not include the amounts paid to UVM as discussed in Note 15.

#### **14. 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 gross receivables from patients and third-party payers at September 30, 2011 and 2010 is as follows:

	2011	2010
Medicare	31 %	31 %
Medicaid	16	14
Blue cross	14	15
Other third-party payers	26	25
Patients	13	15
	<u>100 %</u>	<u>100%</u>

# **Fletcher Allen Health Care, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2011 and 2010**

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#### **15. Transactions With UVM**

FAHC has an Affiliation Agreement with UVM that was most recently renewed as of August 1, 2010, for a five year term. The Agreement automatically renews for subsequent five-year terms unless either party gives written notice of nonrenewal at least one year prior to the end of a five-year term. The Affiliation Agreement expresses the shared goals of UVM and FAHC for teaching, clinical care and research, documents the many points of close collaboration between the two organizations, provides the underpinnings for FAHC's status as an academic medical center, and obligates FAHC to provide substantial, annual financial support to UVM.

Under the Affiliation Agreement, UVM recognizes UVM Medical Group, a FAHC subsidiary, as the clinical practice group for physician faculty of UVM's College of Medicine, and FAHC agrees to meet its physician-employee staffing needs primarily through physicians who are employed by UVM Medical Group and are eligible for faculty appointments to the College of Medicine. The Agreement 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.

The current Affiliation Agreement provides for four components of financial support to UVM: (1) monthly payments by FAHC, known as the "commitment," to fund a portion of the salary, benefits and related expenses paid through UVM to physician-faculty who are jointly employed by both UVM and UVM Medical Group; (2) an academic support payment paid by FAHC; (3) a Dean's Tax paid by UVM Medical Group; and (4) reimbursement by FAHC of certain UVM expenses for joint functions.

The commitment is an annual undertaking by FAHC to fund a portion of the salary, benefits and related expenses of physician-faculty paid through UVM's payroll process. The minimum commitment payment for each full-time faculty member is \$30,000 for salary plus the cost of UVM benefits. The total amount of the commitment is subject to variation each year based upon the needs of FAHC and UVM for physician staffing; the availability of funding sources apart from FAHC to pay for such personnel; and the allocation of the time and effort of physician-faculty among clinical, teaching, research and administrative activities. The amounts of the commitment for physician-faculty salaries and fringe benefits approximated \$17,731,000 and \$13,069,000 in the years ended September 30, 2011 and 2010, respectively. In addition, FAHC reimburses UVM for equipment rental, research, and certain other administrative expenses through the commitment.

In addition to the commitment, FAHC also makes academic support payments. The academic support payment is paid to UVM in monthly installments. The amount of the academic support payment was \$4,750,000 and \$4,011,000 in the years ended September 30, 2011 and 2010, respectively. This payment increases to \$4,807,000 for the year ending September 30, 2012 and includes a \$434,000 payment to support UVM's Dana Medical Library. The payment increases on each anniversary date of the Agreement by a percentage published by the Centers for Medicare and Medicaid Services, if available, or by the percentage increase in FAHC's Medicare inpatient hospital reimbursement.

Under the prior Affiliation Agreement, the Dean's Tax was paid by FAHC and was a percentage of the base compensation of faculty physicians. Under the new Affiliation Agreement, the Dean's Tax is paid to UVM by FAHC in an amount equal to the greater of two percent (2.0%) of the Medical Group's net patient service revenues for that fiscal year or \$4,600,000. The amount of the Dean's Tax was \$4,909,000 and \$4,940,000 in the years ended September 30, 2011 and 2010, respectively. Approximately 50% of the Dean's Tax may be expended, with the approval of the Dean, on research and education initiatives of FAHC's health care services as long as the research and education initiatives are consistent with the shared goals within the Affiliation Agreement. For the year ended September 30, 2011, approximately \$251,000 of the \$4,909,000 Dean's Tax was appropriated to research and education initiatives within FAHC.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

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In addition to providing financial support of the UVM's Dana Medical Library, FAHC also pays UVM's Institutional Review Board a fee, currently \$2,500 per review, for review of clinical trials and reimburses UVM for its expenses in the administration of FAHC-conducted clinical trials.

**16. Functional Expenses**

FAHC provides general health care services to residents within its geographic location. Expenses related to providing these services, for the years ended September 30, 2011 and 2010, are as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
Education and research	\$ 1,546	\$ 1,436
Health care services	774,543	756,444
Management and general	<u>125,756</u>	<u>112,205</u>
Total functional expenses	901,845	870,085
Less: Nonoperating expenses	<u>1,290</u>	<u>1,191</u>
Total operating expenses	<u>\$ 900,555</u>	<u>\$ 868,894</u>

**17. Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as an "exit price"). A fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. In determining fair value, the use of various valuation approaches, including market, income, and cost approaches, is permitted.

GAAP establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumption about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

FAHC uses the following fair value hierarchy to present its fair value disclosures:

Level 1 - Quoted (unadjusted) prices for identical assets or liabilities in active markets. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 - Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets in active markets
- Quoted prices for identical or similar assets in nonactive markets (few transactions, limited information, noncurrent prices, high variability over time)
- Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates)



# Fletcher Allen Health Care, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2011 and 2010

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- Inputs that are derived principally from or corroborated by other observable market data

Level 3 - Unobservable inputs that cannot be corroborated by observable market data.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value:

#### ***Mutual Funds***

The fair values of mutual funds are based on quoted market prices for identical assets in active markets.

#### ***Money Market Funds***

The fair values of money market funds are based on quoted market prices.

#### ***Bonds and Notes***

The estimated fair values of debt securities are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices. The marketable debt securities classified as Level 2 were classified as such due to the usage of observable market prices for similar securities that are traded in less active markets or when observable market prices for identical securities are not available. Marketable debt instruments are priced using: nonbinding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. These Level 2 debt securities primarily include corporate bonds, notes and other debt securities.

#### ***Common Collective Trusts***

The estimated fair values of common collective trusts are determined based upon the net asset value ("NAV") provided by the fund managers and assessed for reasonableness by management. Such information is generally based on the pro-rata interest in the net assets of the underlying investments. There are no unfunded commitments or liquidity restrictions related to these common collective trusts at September 30, 2011 and 2010.

#### ***Beneficial Interest in Perpetual Trusts***

The estimated fair values of FAHC's beneficial interests in perpetual trusts are determined based upon information provided by the trustees and assessed for reasonableness by management. Such information is generally based on the pro-rata interest in the net assets of the underlying investments, which approximates fair value.

#### ***Interest Rate Swap Agreements***

Interest rate swap agreements are valued at the present value of the estimated series of cash flows resulting from the exchange of fixed rate payments for floating rate payments from the counterparty over the remaining life of the contract from the balance sheet date. Each floating rate payment is calculated based on forward market rates at the valuation date for each respective payment date. The valuation based on the estimated series of cash flows is obtained from third parties and assessed by management for reasonableness. Because the inputs used to value the contract can generally be corroborated by market data, the fair value is categorized as Level 2.

#### ***Long-Term Debt***

The estimated fair values of FAHC's long-term debt is based on current traded value. Such amounts at September 30, 2011 and 2010 are approximately \$392,633,000 and \$413,027,000, respectively.

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

The following table presents information as of September 30, 2011 and 2010, about FAHC's financial assets and liabilities that are measured at fair value on a recurring basis:

<b>2011</b> <i>(in thousands)</i>	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Other Observable Inputs (Level 2)</b>	<b>Unobservable Inputs (Level 3)</b>	<b>Fair Value</b>
Mutual funds	\$ 33,203	\$ 697	\$ -	\$ 33,900
Money market funds	12,528	-	-	12,528
Bonds and notes	-	24,414	-	24,414
Common collective trusts	-	250,151	-	250,151
Beneficial interest in perpetual trusts	-	-	9,152	9,152
	<u>\$ 45,731</u>	<u>\$ 275,262</u>	<u>\$ 9,152</u>	<u>\$ 330,145</u>
Interest rate swap agreements	<u>\$ -</u>	<u>\$ 13,076</u>	<u>\$ -</u>	<u>\$ 13,076</u>

  

<b>2010</b> <i>(in thousands)</i>	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Other Observable Inputs (Level 2)</b>	<b>Unobservable Inputs (Level 3)</b>	<b>Fair Value</b>
Mutual funds	\$ 23,377	\$ 653	\$ -	\$ 24,030
Money market funds	15,716	-	-	15,716
Bonds and notes	-	24,538	-	24,538
Common collective trusts	-	240,364	-	240,364
Beneficial interest in perpetual trusts	-	-	9,229	9,229
	<u>\$ 39,093</u>	<u>\$ 265,555</u>	<u>\$ 9,229</u>	<u>\$ 313,877</u>
Interest rate swap agreements	<u>\$ -</u>	<u>\$ 12,220</u>	<u>\$ -</u>	<u>\$ 12,220</u>

A roll forward of those marketable securities and investments whose use is limited that have been classified by FAHC as Level 3 within the fair value hierarchy (defined above) for the years ended September 30, 2011 and 2010 is as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Beginning of year</b>	\$ 9,229	\$ -
Reclassification of beneficial interest in perpetual trusts from level 2 to level 3	-	9,389
Decrease in fair value of beneficial interest in perpetual trusts	(77)	(160)
<b>End of year</b>	<u>\$ 9,152</u>	<u>\$ 9,229</u>
Decrease in fair value of level 3 investments held at September 30, included in the statement of changes in net assets	<u>\$ (77)</u>	<u>\$ (160)</u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

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**18. Pledges Receivable**

Pledges receivable represent unconditional promises to give and are net of allowances for uncollectible amounts. Pledges are recorded at the present value of their estimated future cash flows, which has been measured at the time of the contribution using rates indicative of the market and credit risk associated with the pledge. Pledges collectible within one year are classified as other current assets and total \$1,196,000 and \$894,000 as of September 30, 2011 and 2010, respectively. Estimated cash flows due after one year are discounted using the risk adjusted rate of 5.16% and 5.14% for the years ended September 30, 2011 and 2010, respectively.

Pledges are expected to be collected as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Amounts due</b>		
Within one year	\$ 1,247	\$ 961
In one to five years	1,009	819
In more than five years	<u>748</u>	<u>1,248</u>
	3,004	3,028
Less: Unamortized discount	<u>492</u>	<u>797</u>
	2,512	2,231
Less: Allowance for uncollectables	<u>168</u>	<u>207</u>
Net pledges receivables	<u>\$ 2,344</u>	<u>\$ 2,024</u>

**19. Allowance for Doubtful Accounts**

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, FAHC analyzes its past history and identifies trends for each of its major categories of revenue (inpatient, outpatient, and professional) to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major categories of revenue in evaluating the sufficiency of the allowance for doubtful accounts. Throughout the year, FAHC, after all reasonable collection efforts have been exhausted, will write off the difference between the standard rates (or discounted rates if negotiated) and the amounts actually collected against the allowance for doubtful accounts. In addition to the review of the categories of revenue, management monitors the write offs against established allowances as of a point in time to determine the appropriateness of the underlying assumptions used in estimating the allowance for doubtful accounts.

Accounts receivable, prior to adjustment for doubtful accounts, is summarized as follows at September 30, 2011 and 2010:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Receivables</b>		
Patients	\$ 31,004	\$ 28,574
Third-party payers	101,139	89,303
Non Patient	<u>10,370</u>	<u>13,292</u>
	<u>\$ 142,513</u>	<u>\$ 131,169</u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**September 30, 2011 and 2010**

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The allowance for doubtful accounts is summarized as follows at September 30, 2011 and 2010:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Allowance for doubtful accounts</b>		
Patients	\$ 7,740	\$ 6,763
Third-party payers	10,270	8,302
Non Patient	807	826
	<u>\$ 18,817</u>	<u>\$ 15,891</u>

Bad debt expense for nonpatient related accounts receivable is reflected in total operating expenses on the Statement of Operations. Patient related bad debt is reflected as a reduction in patient service revenues on the Statements of Operations.

Net patient service revenue before the provision for bad debts for the years ended September 30, 2011 and 2010 is summarized as follows:

<i>(in thousands)</i>	<b>2011</b>	<b>2010</b>
<b>Net patient service revenue</b>		
Patients	\$ 33,404	\$ 35,478
Third-party payers	808,850	768,453
	<u>\$ 842,254</u>	<u>\$ 803,931</u>

## **Supplemental Schedules**

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Consolidating Balance Sheet

### September 30, 2011

(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 Executive Services	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
<b>Assets</b>									
Current assets									
Cash and cash equivalents	\$ 95,464	\$ 12,808	\$ 934	\$ -	\$ 128	\$ 100	\$ 867	\$ -	\$ 110,301
Patient and other trade accounts receivable - net	122,346	1,123	90	-	-	-	137	-	123,696
Due from related parties	5,820	-	-	-	657	-	-	(6,477)	-
Short-term investments	1,568	-	-	-	-	-	-	-	1,568
Inventories	17,845	-	-	-	-	-	-	-	17,845
Current portion of restricted assets	-	-	-	-	5,965	-	-	-	5,965
Estimated receivable from third - party payers	5,239	-	-	-	-	-	-	-	5,239
Prepaid and other current assets	9,653	4,194	85	-	4,168	-	18	-	18,118
Total current assets	257,935	18,125	1,109	-	10,918	100	1,022	(6,477)	282,732
Assets whose use is limited or restricted									
Board-designated assets	208,960	-	-	-	-	-	-	-	208,960
Assets held by trustee under bond indenture agreements	36,940	-	-	-	-	-	-	-	36,940
Restricted assets	697	-	-	-	37,256	-	-	-	37,953
Donor restricted assets for specific purposes	13,768	-	-	-	-	-	-	-	13,768
Donor restricted assets for permanent endowment	24,991	-	-	-	-	-	-	-	24,991
Total assets whose use is limited or restricted	285,356	-	-	-	37,256	-	-	-	322,612
Property and equipment - net	413,582	124	-	-	-	-	184	-	413,890
Other assets									
Deferred financing costs - net	15,307	-	-	-	-	-	-	-	15,307
Notes receivable and other assets	7,813	250	-	-	-	-	-	-	8,063
Investment in affiliated companies	28,788	-	-	4,713	-	-	-	(28,596)	4,905
Pledges receivable	1,162	-	-	-	-	-	-	-	1,162
Total other assets	53,070	250	-	4,713	-	-	-	(28,596)	29,437
	<u>\$ 1,009,943</u>	<u>\$ 18,499</u>	<u>\$ 1,109</u>	<u>\$ 4,713</u>	<u>\$ 48,174</u>	<u>\$ 100</u>	<u>\$ 1,206</u>	<u>\$ (35,073)</u>	<u>\$ 1,048,671</u>

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Consolidating Balance Sheet

### September 30, 2011

(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 Executive Services	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
<b>Liabilities and net assets</b>									
<b>Current liabilities</b>									
Current installments of long-term debt	\$ 9,039	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9,039
Accounts payable	21,308	6	2	-	26	-	18	-	21,360
Accrued expenses and other liabilities	28,653	4,450	58	-	-	-	16	2,431	35,608
Accrued payroll and related benefits	57,734	202	58	-	-	-	-	(202)	57,792
Estimated third-party payers settlements	17,283	-	-	-	-	-	-	-	17,283
Due to related parties	-	7,617	986	-	-	103	-	(8,706)	-
Estimated amounts for incurred but not reported claims	11,955	5,918	-	-	6,820	-	-	-	24,693
Total current liabilities	145,972	18,193	1,104	-	6,846	103	34	(6,477)	165,775
<b>Long-term liabilities</b>									
Long-term debt - excluding current installments	391,821	-	-	-	-	-	-	-	391,821
Reserve for outstanding losses on malpractice and workers' compensation claims	-	-	-	-	18,677	-	-	-	18,677
Pension and other postretirement benefit obligations	31,479	-	-	-	-	-	-	-	31,479
Other long-term liabilities	16,585	250	-	-	-	-	-	-	16,835
Total long-term liabilities	439,885	250	-	-	18,677	-	-	-	458,812
Total liabilities	585,857	18,443	1,104	-	25,523	103	34	(6,477)	624,587
<b>Net assets</b>									
Unrestricted	382,469	-	5	4,713	-	(3)	1,172	(5,889)	382,467
Temporarily restricted	16,626	-	-	-	-	-	-	-	16,626
Permanently restricted	24,991	-	-	-	-	-	-	-	24,991
Retained earnings	-	56	-	-	22,651	-	-	(22,707)	-
Total net assets	424,086	56	5	4,713	22,651	(3)	1,172	(28,596)	424,084
	\$ 1,009,943	\$ 18,499	\$ 1,109	\$ 4,713	\$ 48,174	\$ 100	\$ 1,206	\$ (35,073)	\$ 1,048,671

# Fletcher Allen Health Care, Inc. and Subsidiaries

## Consolidating Statement of Operations

### Year Ended September 30, 2011

(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 Executive Services	Fletcher Allen Coordinated Transport, LLC	Eliminations	Total
<b>Unrestricted revenue and other support</b>									
Net patient service revenue	\$ 878,344	\$ -	\$ 705	\$ -	\$ -	\$ -	\$ 1,383	\$ (38,178)	\$ 842,254
Less: Provision for Bad Debts	(25,217)	-	(39)	-	-	-	(119)	-	(25,375)
Net Patient service revenue after provision for Bad debt	853,127	-	666	-	-	-	1,264	(38,178)	816,879
Premium revenue	4,338	84,301	-	-	-	-	-	(3,255)	85,384
Other revenue	29,648	409	512	-	8,755	296	-	(9,985)	29,635
Total unrestricted revenue and other support	887,113	84,710	1,178	-	8,755	296	1,264	(51,418)	931,898
<b>Expenses</b>									
Salaries, payroll taxes, and fringe benefits	543,100	3,794	824	-	-	286	2,460	(3,032)	547,432
Supplies and other	220,568	860	132	-	69	12	312	(9,827)	212,126
Purchased services	29,830	2,620	285	-	703	-	135	(258)	33,315
Depreciation and amortization	45,312	37	-	-	-	-	188	-	45,537
Interest expense	20,233	-	-	-	-	-	-	-	20,233
Underwriting expenses	-	-	-	-	2,742	-	-	-	2,742
Medical claims	-	77,470	-	-	-	-	-	(38,300)	39,170
Total expenses	859,043	84,781	1,241	-	3,514	298	3,095	(51,417)	900,555
Income (loss) from operations	28,070	(71)	(63)	-	5,241	(2)	(1,831)	(1)	31,343
<b>Nonoperating gains (losses)</b>									
Investment income	11,674	22	1	-	1,634	-	1	-	13,332
Loss on interest rate swap contracts	(856)	-	-	-	-	-	-	-	(856)
Other	(2,605)	51	-	891	-	-	100	4,039	2,476
Total nonoperating gains	8,213	73	1	891	1,634	-	101	4,039	14,952
Excess (deficiency) of revenue over expenses	36,283	2	(62)	891	6,875	(2)	(1,730)	4,038	46,295
Net change in unrealized gains (losses) on investments	(185)	-	-	-	209	-	-	(209)	(185)
Assets released from restrictions for capital purchases	510	-	-	-	-	-	-	-	510
Capital contributions	-	-	-	-	-	-	-	-	-
Pension related adjustments	(2,844)	-	-	-	-	-	-	-	(2,844)
Transfer of net assets	10,000	-	-	(700)	(10,000)	-	1,678	(978)	-
Increase (decrease) in unrestricted net assets	\$ 43,764	\$ 2	\$ (62)	\$ 191	\$ (2,916)	\$ (2)	\$ (52)	\$ 2,851	\$ 43,776



**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Obligated Group Balance Sheets**  
**September 30, 2011 and 2010**

(in thousands)

	2011	2010
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 95,464	\$ 67,961
Patient and other trade accounts receivable-net	122,346	111,405
Due from related parties	5,820	
Short-term investments	1,568	1,599
Inventories	17,845	16,883
Estimated receivable from third - party payers	5,239	11,462
Prepaid and other current assets	9,653	6,681
Total current assets	<u>257,935</u>	<u>215,991</u>
Assets whose use is limited or restricted		
Board-designated assets	208,960	189,950
Assets held by trustee under bond indenture agreements	36,940	38,655
Restricted assets	697	653
Donor restricted assets for specific purposes	13,768	12,416
Donor restricted assets for permanent endowment	24,991	24,951
Total assets whose use is limited or restricted	<u>285,356</u>	<u>266,625</u>
Property and equipment-net	<u>413,582</u>	<u>430,536</u>
Other assets		
Deferred financing costs-net	15,307	16,106
Notes receivable and other assets	7,813	7,580
Investment in affiliated companies	28,788	31,640
Pledges receivable	1,162	1,130
Total other assets	<u>53,070</u>	<u>56,456</u>
	<u>\$ 1,009,943</u>	<u>\$ 969,608</u>
<b>Liabilities and net assets</b>		
Current liabilities		
Current installments of long-term debt	\$ 9,039	\$ 8,706
Accounts payable	21,308	19,272
Accrued expenses and other liabilities	28,653	28,424
Accrued payroll and related benefits	57,734	55,065
Estimated third-party payer settlements	17,283	15,418
Due to related parties	-	4,545
Estimated amounts for incurred but not reported claims	11,955	11,305
Total current liabilities	<u>145,972</u>	<u>142,735</u>
Long-term liabilities		
Long-term debt-excluding current installments	391,821	400,934
Pension and other postretirement benefit obligations	31,479	31,762
Other long-term liabilities	16,585	15,583
Total long-term liabilities	<u>439,885</u>	<u>448,279</u>
Total liabilities	<u>585,857</u>	<u>591,014</u>
Commitments and contingent liabilities		
Net assets		
Unrestricted	382,469	338,705
Temporarily restricted	16,626	14,938
Permanently restricted	24,991	24,951
Total net assets	<u>424,086</u>	<u>378,594</u>
Total liabilities and net assets	<u>\$ 1,009,943</u>	<u>\$ 969,608</u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Obligated Group Statements of Operations**  
**Years Ended September 30, 2011 and 2010**

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(in thousands)

	2011	2010
<b>Unrestricted revenue and other support</b>		
Net patient service revenue	\$ 878,344	\$ 841,382
Less: Provision for Bad debts	(25,217)	(24,364)
Net Patient service revenue after provision for Bad debt	853,127	817,018
Premium revenue	4,338	4,414
Other revenue	29,648	29,379
Total unrestricted revenue and other support	887,113	850,811
<b>Expenses</b>		
Salaries, payroll taxes, and fringe benefits	543,100	527,487
Supplies and other	220,568	211,481
Purchased services	29,830	30,198
Depreciation and amortization	45,312	43,731
Interest expense	20,233	19,980
Total expenses	859,043	832,877
Income from operations	28,070	17,934
<b>Nonoperating gains (losses)</b>		
Investment income	11,674	19,416
Loss on interest rate swap contracts	(856)	(4,101)
Other	(2,605)	10,036
Total nonoperating gains	8,213	25,351
Excess of revenue over expenses	36,283	43,285
Net change in unrealized losses on investments	(185)	(3,480)
Assets released from restrictions for capital purchases	510	939
Pension related adjustments	(2,844)	(4,200)
Transfer of net assets	10,000	-
Increase in unrestricted net assets	\$ 43,764	\$ 36,544

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Obligated Group Statements of Changes in Net Assets**  
**Years Ended September 30, 2011 and 2010**

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*(in thousands)*

	2011	2010
<b>Unrestricted net assets</b>		
Excess of revenues over expenses	\$ 36,283	\$ 43,285
Net change in unrealized losses on investments	(185)	(3,480)
Assets released from restrictions for capital purchases	510	939
Pension-related adjustments	(2,844)	(4,200)
Transfer of net assets	10,000	-
Increase in unrestricted net assets	<u>43,764</u>	<u>36,544</u>
<b>Temporarily restricted net assets</b>		
Gifts, grants, and bequests	2,708	1,655
Investment income	474	337
Net unrealized gains (losses) on investments	272	(841)
Net realized gains on investments	158	1,759
Net assets released from restrictions used in operations	(1,143)	(777)
Net assets released from restrictions used for nonoperating purposes	(208)	(191)
Net assets released from restrictions used for capital purchases	(510)	(939)
Transfer of net assets	(63)	(23)
Increase in temporarily restricted net assets	<u>1,688</u>	<u>980</u>
<b>Permanently restricted net assets</b>		
Gifts, grants, and bequests	54	59
Change in beneficial interest in perpetual trusts	(77)	(160)
Transfer of net assets	63	23
Increase (decrease) in permanently restricted net assets	<u>40</u>	<u>(78)</u>
Increase in net assets	<u>45,492</u>	<u>37,446</u>
<b>Net assets</b>		
Beginning of year	<u>378,594</u>	<u>341,148</u>
End of year	<u>\$ 424,086</u>	<u>\$ 378,594</u>

**Fletcher Allen Health Care, Inc. and Subsidiaries**  
**Note to Supplemental Schedules**  
**September 30, 2011 and 2010**

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**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.