

# **Fletcher Allen Partners, Inc. and Subsidiaries**

**Consolidated Financial Statements  
September 30, 2012**

# Fletcher Allen Partners, Inc. and Subsidiaries

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September 30, 2012

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## Report of Independent Auditors

To the Board of Trustees of  
Fletcher Allen Partners, Inc:

In our opinion, the accompanying consolidated balance sheet 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 Partners, Inc. and its Subsidiaries ("the Organization") at September 30, 2012, and the results of their operations, their changes in net assets and their cash flows for the year 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 audit. We conducted our audit 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 audit provides a reasonable basis for our opinion.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information listed in the Index, which includes pages 40–54, is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is 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 companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and changes in net assets of the individual companies.

*PricewaterhouseCoopers* LLP

December 21, 2012

# Fletcher Allen Partners, Inc. and Subsidiaries

## Consolidated Balance Sheet

### September 30, 2012

(in thousands)

#### Assets

##### Current assets

Cash and cash equivalents	\$ 173,865
Patient and other trade accounts receivable - net of allowance for doubtful accounts of \$26,572	132,939
Short-term investments	1,932
Inventories	23,861
Current portion of assets whose use is limited or restricted	13,132
Estimated receivables from third-party payers	6,140
Prepaid and other current assets	25,156

Total current assets	<u>377,025</u>
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##### Assets whose use is limited or restricted

Board-designated assets	294,100
Assets held by trustee under bond indenture agreements	31,228
Restricted assets	37,319
Donor-restricted assets for specific purposes	25,351
Donor-restricted assets for permanent endowment	29,165

Total assets whose use is limited or restricted	<u>417,163</u>
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Property and equipment, net	<u>471,064</u>
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##### Other assets

Deferred financing costs, net	13,150
Notes receivable and other assets	10,073
Investment in affiliated companies	5,131
Pledges receivable, net of current portion	584

Total other assets	<u>28,938</u>
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Total assets	<u>\$ 1,294,190</u>
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#### Liabilities and net assets

##### Current liabilities

Current installments of long-term debt	\$ 13,489
Accounts payable	25,671
Accrued expenses and other liabilities	50,807
Accrued payroll and related benefits	72,253
Estimated third-party payer settlements	16,916
Estimated amounts for incurred but not reported claims	24,631

Total current liabilities	<u>203,767</u>
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##### Long-term liabilities

Long-term debt - net of current installments	401,833
Reserve for outstanding losses on malpractice and workers' compensation claims	28,982
Pension and other postretirement benefit obligations	81,582
Other long-term liabilities	21,248

Total long-term liabilities	<u>533,645</u>
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Total liabilities	<u>737,412</u>
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##### Commitments and contingent liabilities

##### Net assets

Unrestricted	500,374
Temporarily restricted	27,239
Permanently restricted	29,165

Total net assets	<u>556,778</u>
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	<u>\$ 1,294,190</u>
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The accompanying notes are an integral part of these consolidated financial statements.

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidated Statement of Operations**  
**Year Ended September 30, 2012**

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*(in thousands)*

**Unrestricted revenue and other support**

Net patient service revenue	\$ 1,037,259
Less: Provision for bad debts	<u>(35,856)</u>
Net patient service revenue after provision for bad debts	1,001,403
Premium revenue	106,904
Other revenue	<u>36,242</u>
Total unrestricted revenue and other support	<u>1,144,549</u>

**Expenses**

Salaries, payroll taxes, and fringe benefits	665,704
Supplies and other	264,803
Purchased services	45,660
Depreciation and amortization	57,104
Interest expense	19,951
Underwriting expenses	14,652
Medical claims	<u>47,609</u>
Total expenses	<u>1,115,483</u>
Income from operations	<u>29,066</u>

**Nonoperating gains (losses)**

Investment income	21,668
Loss on interest rate swap agreements	(1,266)
Loss on the extinguishment of debt	(2,834)
Contribution revenue from acquisition	52,453
Other	<u>5,885</u>
Total nonoperating gains	<u>75,906</u>
Excess of revenue over expenses	104,972
Net change in unrealized gains on investments	30,945
Assets released from restrictions for capital purchases	334
Pension related adjustments	<u>(18,343)</u>
Increase in unrestricted net assets	<u>\$ 117,908</u>

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

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidated Statement of Changes in Net Assets**  
**Year Ended September 30, 2012**

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*(in thousands)*

**Unrestricted net assets**

Excess of revenue over expenses	\$ 104,972
Net change in unrealized gains on investments	30,945
Assets released from restrictions for capital purchases	334
Pension related adjustments	(18,343)
Increase in unrestricted net assets	<u>117,908</u>

**Temporarily restricted net assets**

Gifts, grants, and bequests	2,908
Investment income	180
Net change in unrealized gains on investments	3,099
Net realized gains on investments	617
Net assets released from restrictions used in operations	(1,522)
Net assets released from restrictions used for nonoperating purposes	(306)
Net assets released from restrictions used for capital purchases	(334)
Transfer of net assets	(64)
Contribution of temporarily restricted net assets	<u>6,035</u>
Increase in temporarily restricted net assets	<u>10,613</u>

**Permanently restricted net assets**

Gifts, grants, and bequests	67
Change in beneficial interest in perpetual trusts	941
Transfer of net assets	64
Contribution of permanently restricted net assets	<u>3,101</u>
Increase in permanently restricted net assets	<u>4,173</u>
Increase in net assets	132,694

**Net assets**

Beginning of year	<u>424,084</u>
End of year	<u>\$ 556,778</u>

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

# Fletcher Allen Partners, Inc. and Subsidiaries

## Consolidated Statement of Cash Flows

### Year Ended September 30, 2012

(in thousands)

#### Cash flows from operating activities

Increase in net assets	\$ 132,694
Adjustments to reconcile change in net assets to net cash provided by operating activities	
Depreciation and amortization	57,104
Contribution revenue from acquisition	(61,589)
Provision for bad debts	35,856
Contributions restricted for long-term use	(67)
Pension related adjustments	18,343
Loss on extinguishment of debt	2,834
Gain on disposal of property and equipment	(218)
Loss on interest rate swap agreements	1,266
Realized and unrealized gains on investments	(48,943)
Undistributed gains of affiliated companies	(226)
Change in beneficial interest in perpetual trusts	(941)
Changes in operating assets and liabilities	
Increase in patient and other accounts receivable	(28,747)
Increase in other current and noncurrent assets	(5,607)
Increase in estimated receivables from third-party payers	(901)
Increase in accounts payable and accrued expenses	16,843
Increase in accrued payroll and related expenses	7,743
Increase in other current and noncurrent liabilities	11,289
Decrease in estimated settlements with third-party settlements	(3,580)
Decrease in pension and other postretirement benefit obligations	(7,398)
Net cash provided by operating activities	<u>125,755</u>

#### Cash flows from investing activities

Acquisitions of property and equipment	(39,488)
Purchase of investments	(213,760)
Proceeds from sale of investments	201,683
Proceeds from sale of affiliated company	397
Cash received through acquisition	<u>7,336</u>
Net cash used in investing activities	<u>(43,832)</u>

#### Cash flows from financing activities

Contributions restricted for long-term use	67
Proceeds of debt issuance	67,559
Payment of long-term debt	(85,438)
Debt issuance costs	<u>(547)</u>
Net cash used in financing activities	<u>(18,359)</u>
Net increase in cash and cash equivalents	63,564

#### Cash and cash equivalents

Beginning of year	<u>110,301</u>
End of year	<u>\$ 173,865</u>

#### Supplemental cash flow information

Cash paid during the year for interest	\$ 19,459
Capital expenditures included in accounts payable	3,460
Increase in fair value of assets acquired	5,390
Assets acquired under capital lease	571

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

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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#### **1. Organization**

Fletcher Allen Partners, Inc. (FAP), established as of October 1, 2011, is a nonprofit, tax-exempt Vermont corporation and the sole corporate member of Fletcher Allen Health Care, Inc., and Central Vermont Medical Center, Inc. FAP's purpose is to establish an integrated regional health care system to engage in regional planning to develop a highly coordinated health care network that will improve the quality, increase the efficiencies, and lower the costs of health care delivery in the regions it serves.

Fletcher Allen Health Care, Inc (FAHC) is a tertiary care teaching hospital that, in affiliation with The University of Vermont (UVM), 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 FAHC's mission to improve the health of the people in the communities that it serves 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); 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. The following entities are partly owned or controlled by FAHC: Medical Education Center Condominium Association, Inc; OB Net Services, LLC; Copley Woodlands, Inc.; Fletcher Allen Medical Group, PLLC (FAMG); and OneCare Accountable Care Organization, LLC.

Central Vermont Medical Center, Inc. (CVMC) provides health care services under three distinct business units: Central Vermont Hospital, Woodridge Rehabilitation and Nursing, and Central Vermont Medical Group Practice. CVMC works collaboratively to meet the needs and improve the health of the residents of central Vermont. CVMC's hospital provides 24-hour emergency care, with a full spectrum of inpatient and outpatient services.

#### **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 FAP 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.



# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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#### **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 FAP'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 FAP'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.

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

Prepaid and other current assets include miscellaneous nonpatient receivables 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. 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.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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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 sheet and statements of operations and changes in net assets.

FAP reviews its investments to identify those for which fair value is below cost. FAP then makes a determination as to whether the investment should be considered other-than-temporarily impaired. FAP recognized \$778,000 in losses related to declines in value that were other-than-temporary in nature in the year ended September 30, 2012.

#### **Investment in Affiliates**

Investments in noncontrolled 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, OB NET Services, LLC, and OneCare Vermont Accountable Care Organization, 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.

Depreciation is calculated using the following estimated useful lives:

Land improvements	15 – 25 years
Building and improvements	7 – 40 years
Fixed equipment	5 – 20 years
Major moveable equipment	2 – 20 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.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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#### **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 \$339,000 of interest was capitalized during the year ended September 30, 2012. Net deferred financing costs totaled \$13,150,000 at September 30, 2012. 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 \$9,746,000 at September 30, 2012.

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

Temporarily restricted net assets are those whose use by FAP 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 FAP in perpetuity.

#### **Consolidated Statement 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 statement of operations includes 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.

#### **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 \$12,723,000 in the year ended September 30, 2012.

FAP has agreements with third-party payers that provide for payments to FAP 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.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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Outpatient services are paid based upon a prospective standard rate for procedures performed or services rendered. FAP is reimbursed for cost-reimbursable items at tentative rates, with final settlement determined after submission of annual cost reports by FAP 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 28% in the year ended September 30, 2012.

#### ***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 11% of FAP's net revenue in the year ended September 30, 2012.

#### ***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 46% of FAP's net revenues were derived from contracted insurers in the year ended September 30, 2012. Approximately 9% of FAP's net revenues were derived from noncontracted insurers in the year ended September 30, 2012.

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 FAP 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 FAP 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 governmental Electronic Health Records Incentive programs, parking garage income, net assets released from restrictions used for operations, and rental income.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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#### **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.

#### **Income Taxes**

FAP, FAHC, CVMC, 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 FAP, FAHC, CVMC, 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 FAP 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.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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#### **Asset Retirement Obligations**

FAP 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 FAP 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 \$1,272,000 at September 30, 2012, substantially all of which relates to the estimated costs to remove asbestos that is contained within FAP's facilities. The initial asset retirement obligation was calculated using a discount rate of 4.5%. The recorded asset retirement obligation at September 30, 2012 was approximately \$1,082,000.

#### **Defined Benefit Pension and Other Postretirement Benefit Plans**

FAP 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.

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

In August 2010, the Financial Accounting Standards Board issued Accounting Standards Update 2010-23 (ASU 2010-23), *Health Care Entities: Measuring Charity Care for Disclosure*. The standard provides for consistency in practice within charity care disclosures. Under the new guidance, charity care disclosures must be based on estimated costs of providing the services. The estimated costs must include direct and indirect costs, a description of the measurement approach used, and the amount of any funds received to offset or subsidize charity care services provided. ASU 2010-23 is effective for fiscal years beginning after December 15, 2010. Charity care disclosures for FAP adhere to this new guidance.

Additionally in August 2010, the Financial Accounting Standards Board issued Accounting Standards Update 2010-24 (ASU 2010-24), *Health Care Entities: Presentation of Insurance Claims and Related Insurance Recoveries*. The standard provides for consistency in accounting for malpractice claims and similar liabilities by health care entities. Under the new guidance, medical malpractice claims liabilities must be reported at gross and not offset by anticipated insurance recoveries. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010. The adoption of the standard had no impact on excess of revenues over expenses. Included within prepaid and other current assets are \$3,376,000 of reinsurance receivables as of September 30, 2012.

# Fletcher Allen Partners, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2012

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#### 3. Formation of Fletcher Allen Partners, Inc.

On October 1, 2011 Fletcher Allen Health Care, Inc. (FAHC) and Central Vermont Medical Center, Inc., (CVMC) contributed their net assets to form Fletcher Allen Partners, Inc. (FAP). In accordance with applicable accounting guidance on not-for-profit mergers and acquisitions, FAP recorded contribution income of \$61,589,000 reflecting the fair value of the contributed net assets of CVMC on the transaction date. Of this amount, \$52,453,000 represents unrestricted net assets and is included as a nonoperating gain in the accompanying consolidated statement of operations. Temporarily restricted net assets and permanently restricted net assets of \$6,035,000 and \$3,101,000, respectively, were recorded as restricted contribution income in the accompanying consolidated statement of changes in net assets.

The consolidated statement of operations reflects the activity of FAHC and CVMC from the date of the transaction (October 1, 2011) to September 30, 2012. No consideration was exchanged for the net assets contributed. The fair value of assets, liabilities, and net assets contributed by CVMC at October 1, 2011 were as follows:

*(in thousands)*

#### **Assets**

Cash and cash equivalents	\$	7,336
Assets limited as to use and investments		40,120
Patient accounts receivable, net		16,352
Property plant and equipment		74,742
Other assets		8,571
Total assets acquired	\$	<u>147,121</u>

#### **Liabilities**

Accounts payable and accrued expenses	\$	11,616
Estimated amounts due to third party payers		2,264
Long-term debt		31,463
Accrued pension and post-retirement benefits		39,158
Other liabilities		1,031
Total liabilities assumed		<u>85,532</u>

#### **Net assets**

Unrestricted		52,453
Temporary restricted		6,035
Permanently restricted		3,101
Total net assets		<u>61,589</u>
	\$	<u>147,121</u>

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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A summary of the financial results of CVMC included in the consolidated statement of operations and changes in net assets for the year ended September 30, 2012 is as follows:

*(in thousands)*

Total operating revenues	\$ 150,983
Total operating expenses	<u>146,036</u>
Operating income	4,947
Nonoperating gains	<u>1,152</u>
Excess of revenues over expenses	6,099
Net assets released from restriction used for capital purchases	190
Net unrealized gain on investments	1,788
Pension adjustment	(10,208)
Transfer of net assets	<u>52,453</u>
Increase in unrestricted net assets	<u>\$ 50,322</u>

**4. Charity Care and Community Service**

FAP provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because FAP 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 FAP's charity care policy aggregated approximately \$27,685,000.

Of FAP's total expenses reported of \$1,115,483,000, an estimated \$11,640,000 arose from providing services to charity patients. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on FAP's total expenses divided by gross patient service revenue. For the year ended September 30, 2012, FAP used \$285,000 in charitable endowment earnings to help defray the costs of indigent care.



**Fletcher Allen Partners, Inc. and Subsidiaries**  
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**5. Assets Whose Use is Limited or Restricted**

Assets whose use is limited or restricted at September 30, 2012 consisted of the following:

*(in thousands)*

Equities	\$	1,247
Mutual funds		98,922
Money market funds		22,006
Bonds and notes		41,865
Common collective trusts		253,633
Beneficial interest in perpetual trusts		10,093
Hedge Funds		2,229
Real estate		300
		<u>430,295</u>
Less: Current portion		<u>(13,132)</u>
	\$	<u>417,163</u>

Investment income and gains for the years ended September 30, 2012 consisted of the following:

*(in thousands)*

<b>Nonoperating revenue and expenses</b>		
Investment income	\$	7,386
Net realized gains		14,282
		<u>21,668</u>
Net change in unrealized gains on investments		<u>30,945</u>
<b>Changes in temporarily restricted net assets</b>		
Investment income		180
Net change in unrealized gains on investments		3,099
Net realized gains on investments		617
		<u>3,896</u>
<b>Changes in permanently restricted net assets</b>		
Change in beneficial interest in perpetual trusts		941
	\$	<u>57,450</u>

As a result of the recognition of \$778,000 in losses related to declines in value that were other-than-temporary in nature during the year ended September 30, 2012, there were no investments that had a fair value less than cost at September 30, 2012.

**Fletcher Allen Partners, Inc. and Subsidiaries**  
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The cost and estimated fair value of securities classified as available-for-sale by the organization, which excludes beneficial interest in perpetual trusts of \$10,093,000, and includes short-term investments of \$1,932,000 as of September 30, 2012, is as follows:

<i>(in thousands)</i>	<b>Cost</b>	<b>Gross Unrealized Gains</b>	<b>Estimated Fair Value</b>
Mutual funds	\$ 91,027	\$ 9,827	\$ 100,854
Equities	1,073	174	1,247
Real estate	165	135	300
Hedge funds	2,143	86	2,229
Money market funds	22,006	-	22,006
Bonds and notes	41,439	426	41,865
Common collective trusts	218,061	35,572	253,633
	<u>\$ 375,914</u>	<u>\$ 46,220</u>	<u>\$ 422,134</u>

**6. Property and Equipment**

A summary of property and equipment at September 30, 2012 is as follows:

<i>(in thousands)</i>	
Land	\$ 13,526
Land improvements	14,119
Leasehold improvements	40,236
Buildings	568,057
Equipment, furniture, and fixtures	295,786
	<u>931,724</u>
Less: Accumulated depreciation	<u>(472,163)</u>
	459,561
Construction-in-progress	11,503
	<u>\$ 471,064</u>

FAP wrote off approximately \$3,683,000 in assets in the year ended September 30, 2012. In conjunction with these write offs, a gain on disposal of property and equipment of \$218,000 was recorded, and is included in supplies and other expense. At September 30, 2012, FAP had commitments to purchase approximately \$3,460,000 of property and equipment.

FAP recorded depreciation expense of \$56,436,000 for the year ended September 30, 2012.

**Fletcher Allen Partners, Inc. and Subsidiaries**  
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**7. Investment in Affiliated Companies**

Investment in affiliated companies at September 30, 2012 consisted of the following:

*(in thousands)*

Starr Farm Partnership	\$	4,914
OB Net Services, LLC		192
OneCare Vermont Accountable Care Organization, LLC		25
	\$	<u>5,131</u>

Distributions from these affiliated organizations totaled \$500,000 for the year ended September 30, 2012. FAP's share of the income of these affiliates is reported as other nonoperating gains and totaled approximately \$701,000 for the year ended September 30, 2012.

Starr Farm Partnership's beginning net assets as of September 30, 2011, were \$9,425,000. Summarized financial information from the unaudited financial statements of the Starr Farm Partnership as of and for the year ended September 30, 2012 was as follows:

<i>(in thousands)</i>	<b>Ownership Percentage</b>	<b>Total Assets</b>	<b>Net Assets</b>	<b>Change in Net Assets</b>
Starr Farm Partnership	50 %	\$ 10,880	\$ 9,827	\$ 402

**Fletcher Allen Partners, Inc. and Subsidiaries**  
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**8. Long-Term Debt**

Long-term debt at September 30, 2012 consisted of the following:

*(in thousands)*

**Vermont Educational and Health Buildings Financing Agency  
Hospital Revenue Bonds**

Series 2009A loan, fixed rate (5.08% to 7.23%), payable through 2024	\$ 12,642
Series 2009B loan, fixed rate (3.72% at September 30, 2012), payable through 2014	1,771
Series 2008A Bonds, variable rate (0.17% at September 30, 2012), payable through 2030	54,705
Series 2007A Bonds, fixed rate (4.00% to 4.75%), payable through 2037 (including unamortized premium of \$93)	56,098
Series 2004B Bonds, fixed rate (4.00% to 5.50%), payable through 2035 (including unamortized premium of \$130)	149,580
Series 2004A Bonds, fixed rate (3.00% to 5.00%), payable through 2025 (including unamortized premium of \$1,098)	35,513
Series 2000A Bonds, fixed rate (5.50% to 6.13%), payable through 2028 (including unamortized discount of \$174)	32,376
Series 1996 loan, fixed rate (4.23% at September 30, 2012), payable through 2021	11,052
Select Auction Variable-Rate Securities (SAVRS) 1994 Bonds, variable rate (4.93% at September 30, 2012), payable through 2013 (including unamortized discount of \$35)	2,915

**Other long-term debt**

KeyBank loan, fixed rate (3.49% at September 30, 2012), payable through 2023	53,110
KeyBank loan, fixed rate (2.90% at September 30, 2012), payable through 2022	1,750
People's United Bank loan, fixed rate (4.19% at September 30, 2012), payable through 2017	2,710
People's United Bank Revolving Line of Credit, variable rate (3.25% at September 30, 2012), payable through 2013	1,100
	<u>415,322</u>
Less: Current portion	<u>(13,489)</u>
Long-term debt	<u>\$ 401,833</u>

**Fletcher Allen Obligated Group**

Fletcher Allen Health Care and Central Vermont Medical Center presently are the sole members of the Fletcher Allen Obligated Group (Obligated Group).

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **September 30, 2012**

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On November 1, 2011, CVMC withdrew from the D-H Obligated Group, and was admitted as a member to the Obligated Group pursuant to the Obligated Group Master Trust Indenture. In connection with CVMC's admission to the Obligated Group, the Series 1996, 2009A and 2009B Bonds, totaling \$27,875,000, issued by the D-H Obligated Group for benefit of CVMC was refinanced or modified such that it has become an obligation of the Obligated Group. The Master Trust Indenture contains provisions permitting the addition, withdrawal or consolidation of members of the Obligated Group under certain conditions. The Master Trust Indenture constitutes joint and several obligations of the members of Obligated Group.

For presentation purposes, the financial statements of the Obligated Group are presented from the date of affiliation (October 1, 2011) and not from the date of CVMC's admission into the Obligated Group. The inclusion of the one month (October 2011) is deemed immaterial for presentation purposes.

#### **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, 2012, the reserve fund balance was approximately \$13,924,000.

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 bank in the amount of \$55,334,000 (covers principal of \$54,705,000 and interest of \$629,000), which expires in 2016. 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, 2016.

In conjunction with these transactions, the notional amount of the original swap agreement covering the 2004B bonds 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. As of September 30, 2012, 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.

# Fletcher Allen Partners, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### September 30, 2012

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#### Series 1996 Bond Refinancing

In November 2011, the Series 1996 Bonds 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 term loan has a fixed rate of interest of 4.23% and matures November 1, 2021. Interest payments are made monthly and principal payments in the amount of \$582,000 are made semi-annually each May and November, beginning May 1, 2012 and ending on November 1, 2021. The term loan is collateralized with assets, mortgage, and all other collateral securing repayment of the Obligation as defined in the Master Trust Indenture of the Obligated Group. This refinancing resulted in a loss on extinguishment of debt of \$529,000.

#### Series 2000A Bond Partial Refunding

In December 2011, the Series 2000A Bonds with maturities from 2012 through 2023 were refunded and replaced with a taxable private placement loan in the aggregate principal amount of \$54,175,000 with a final maturity date in December 2023. In addition, a portion of the Series 2000A Bonds maturing on December 1, 2027 was redeemed in the aggregate principal amount of \$6,745,000. The remaining balance of the initial aggregate principal amount of the Series 2000A Bonds is \$32,550,000 with maturities between December 2025 and December 2027. Bond issuance costs of \$547,000 are recorded in deferred financing costs, net and will be amortized over the life of the loan. The Series 2000A Bonds were issued with an original issue discount totaling \$917,044 which is recorded in long-term debt. The discount will be amortized using the effective interest method over the life of the respective Bonds. The partial refunding resulted in a loss on extinguishment of debt of \$2,305,000.

#### Scheduled Maturities of Long-Term Debt

As of September 30, 2012, scheduled maturities of long-term debt, not including a net unamortized premium of \$1,112,000, for the next five years and thereafter are as follows:

*(in thousands)*

#### Years Ending September 30

2013	\$	13,489
2014		12,429
2015		12,553
2016		12,972
2017		13,404
Thereafter		349,363
	\$	<u>414,210</u>

#### Loan Covenants

Under the terms of a master indenture, FAHC and CVMC are required to meet certain covenant requirements. In addition, the indenture provides for restrictions on, among other things, additional indebtedness and dispositions of property.

#### Line of Credit

A bank line of credit exists with a maximum borrowing of \$2,000,000. The line matures on May 30, 2013, and bears interest at the Wall Street Journal prime rate adjusted daily with a floor of 3.25%, with advances secured by a portion of board designated funds. The outstanding advance at September 30, 2012 was \$1,100,000.

# Fletcher Allen Partners, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

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#### Letter of Credit

The 2008A letter of credit was not drawn upon as of September 30, 2012, and the scheduled maturities of long-term debt assumes the Series 2008A bonds are not put back to FAP. 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 of principal would be as follows: \$21,176,000 in year two, \$21,176,000 in year three and \$12,353,000 in the final year.

## 9. 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, 2012. 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.

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 agreement. 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 agreements in the notional principal amount of \$27,595,000 each. Under these agreements, 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, 2034.

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 \$128,000 at September 30, 2012, 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 year ended September 30, 2012. 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:

<i>(in thousands)</i>	<b>Balance Sheet</b>	
	<b>Location</b>	<b>Fair Value</b>
1994 Swap	Other long-term liabilities	\$ (128)
2008A Swap	Other long-term liabilities	\$ (14,214)

**Fletcher Allen Partners, Inc. and Subsidiaries**  
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The effect of interest rate swap agreements on the consolidated statement of operations and changes in net assets for 2012 are as follows:

<i>(in thousands)</i>	<b>Location of Gain/Loss Recognized in Statement of Operations</b>	<b>Amount of Gain/Loss Recognized in Statement of Operations</b>
1994 Swap	Gain/Loss on interest rate swap contracts	\$ 234
2008A Swap	Gain/Loss on interest rate swap contracts	(1,500)
		<u>\$ (1,266)</u>

**10. Operating Leases**

FAP has entered into certain operating lease agreements for the rental of building space and equipment. Rental expense, inclusive of common area maintenance charges amounted to \$12,654,000 for the year ended September 30, 2012.

Minimum future lease payments required under noncancelable operating leases at September 30, 2012, were as follows:

*(in thousands)*

**Years Ending September 30**

2013	\$ 7,578
2014	6,613
2015	6,045
2016	5,120
2017	2,473
Thereafter	3,960
	<u>\$ 31,789</u>

**11. Net Assets**

**Temporarily Restricted Net Assets**

At September 30, 2012, temporarily restricted net assets are available for the following purposes:

*(in thousands)*

Indigent care	\$ 1,005
Education and research	10,951
Children's programs	2,437
Capital projects	710
Other health care services	10,501
Long-term care services at Woodridge	1,635
	<u>\$ 27,239</u>



# Fletcher Allen Partners, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

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At September 30, 2012, temporarily restricted net assets include approximately \$16,126,000 of accumulated gains on permanently restricted net assets, which are subject to board appropriation in accordance with state law.

#### **Permanently Restricted Net Assets**

At September 30, 2012, income earned on permanently restricted net assets are restricted to:

*(in thousands)*

Indigent care	\$	4,143
Education and research		6,902
Other health care services		17,391
Long-term care services		729
	\$	<u>29,165</u>

#### **Endowment Funds**

FAP's endowment consists of approximately 79 funds established for a variety of purposes. FAP 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**

FAP 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 FAP'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 year ended September 30, 2012, \$751,000 was appropriated.

As a result of this interpretation, FAP 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. FAP 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 FAP, and the investment policies of FAP.

#### **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, 2012, and the changes therein for the year then ended:

**Fletcher Allen Partners, Inc. and Subsidiaries**  
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**Endowment net asset composition by type of fund**

<i>(in thousands)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>September 30, 2012</b>				
Donor-restricted endowment funds	\$ -	\$ 16,126	\$ 19,072	\$ 35,198
Adjustments for funds with deficiencies	(44)	44	-	-
Total	<u>\$ (44)</u>	<u>\$ 16,170</u>	<u>\$ 19,072</u>	<u>\$ 35,198</u>

**Changes in endowment net assets**

<i>(in thousands)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Endowment net assets at September 30, 2011</b>	\$ -	\$ 8,891	\$ 15,839	\$ 24,730
Acquired endowment net assets at October 1, 2011	(163)	4,408	3,101	7,346
Investment return				
Investment income	-	251	-	251
Net appreciation	-	3,555	-	3,555
Total investment return	-	3,806	-	3,806
Appropriations of endowment assets for expenditure	-	(751)	-	(751)
Adjustment for funds with deficiencies	119	(119)	-	-
Other	-	(65)	132	67
<b>Endowment net assets at September 30, 2012</b>	<u>\$ (44)</u>	<u>\$ 16,170</u>	<u>\$ 19,072</u>	<u>\$ 35,198</u>

***Beneficial Interest in Perpetual Trusts***

The above amounts exclude FAP's beneficial interest in perpetual trusts, which are not within management's investment control. Such beneficial interests totaled \$10,093,000 at September 30, 2012.

***Charitable Remainder Trust***

FAP has received an irrevocable charitable remainder trust, for which FAP does not serve as trustee. For this trust, FAP 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 FAP 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 in either temporarily or permanently restricted net assets.

***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 FAP to retain as a fund of perpetual duration. The deficiencies at September 30, 2012 were \$44,000, associated with one permanently restricted endowment fund which is managed by a trustee outside of the control of FAP management.

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

FAP 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, FAP targets a diversified asset allocation that provides for a balanced portfolio.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

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#### **12. Malpractice and Other Contingencies**

##### **Malpractice and Workers' Compensation**

FAP 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. CVMC purchased comprehensive general and professional liability coverage on an occurrence basis and claims made basis, respectively, from a commercial insurance carrier during fiscal year 2012; however, as of September 30, 2012, tail coverage for CVMC is provided by VMCIC.

FAP is also self-insured for workers' compensation claims, and maintains an excess insurance policy to limit its exposure on claims up to \$750,000 per occurrence in the year ended September 30, 2012, with a \$25,000,000 aggregate.

The reserves for outstanding losses have been discounted at a rate of 3% at September 30, 2012, resulting in a reduction in the reserve of approximately \$1,810,000 in the year ended September 30, 2012, for professional liability and a reduction in the reserve of approximately \$310,000 at September 30, 2012, for worker's compensation.

As a result of changes in estimates of incurred events in prior years, primarily professional liability, the estimate of incurred losses increased by approximately \$7,852,000 for the year ended September 30, 2012.

##### **Employee Health and Dental Insurance**

FAP 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, FAP is responsible for the administration of the plan and any resultant liability incurred. FAP maintained a stop-loss insurance policy to limit its exposure on cumulative claims between \$100,000 and \$150,000 per member per year in the year ended September 30, 2012, with a per-year benefit maximum equal to the amount of premiums paid under the policy. In addition to the self-insurance plan, FAP maintained a commercial policy to limit its exposure on cumulative claims exceeding \$225,000 per member per year for the year ended September 30, 2012.

##### **Other Contingencies**

FAP 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 FAP's consolidated financial position or results of operations.

# **Fletcher Allen Partners, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

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#### **Collective Bargaining Agreements**

FAHC 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, 2015, and covers approximately 1,697 staff at September 30, 2012. FAHC 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 295 staff in various technical positions at September 30, 2012.

#### **13. 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, 2012, was \$17,181,535. The required minimum statutory capital at September 30, 2012 was \$3,263,597. The required minimum surplus as of September 30, 2012 was \$2,263,597. 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 \$24,617,240 at September 30, 2012. The measurement of this at September 30, 2012, is \$50,004,522. FAP reports all of VMCIC's investments in marketable securities as restricted assets in the accompanying consolidated balance sheets.

#### **14. Pension Plans and Other Postretirement Benefits**

##### **Fletcher Allen Healthcare 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 "FAHC Plan"), formerly the Pension Plan for Employees of Vermont Health Foundation, Inc. The FAHC 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.

The FAHC Plan was amended effective January 1, 1995, to provide for the continued participation in the FAHC 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 FAHC 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.

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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 year ended September 30, 2012 is as follows:

<i>(in thousands)</i>	<b>FAHC Defined Benefit Plan</b>
<b>Changes in benefit obligations</b>	
Projected benefit obligations - beginning of year	\$ (137,305)
Service cost	(527)
Interest cost	(7,194)
Benefits paid	6,908
Actuarial loss	(23,044)
Administrative expenses paid	442
Projected benefit obligation - end of year	<u>(160,720)</u>
Accumulated benefit obligation	<u>(160,104)</u>
<b>Changes in plan assets</b>	
Fair value of plan assets - beginning of year	105,826
Actual gain on plan assets	20,348
Contributions	5,975
Benefits paid	(6,908)
Administrative expenses paid	(442)
Fair value of plan assets - end of year	<u>124,799</u>
Funded status of the plan (long-term)	<u>\$ (35,921)</u>

Unrestricted net assets at September 30, 2012 include unrecognized actuarial losses of \$67,679,000 related to the defined benefit plan. Of this amount, \$2,265,000 was recognized in net periodic pension costs in the year ended September 30, 2012. The reconciliation of the unrecognized actuarial losses for the year ended September 30, 2012, is as follows:

<i>(in thousands)</i>	
Unrecognized actuarial losses - beginning of year	\$ 59,527
Net loss amortized during year	(1,821)
Net loss during year	<u>9,973</u>
Unrecognized actuarial losses - end of year	<u>\$ 67,679</u>

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The cost components of the net periodic benefit cost for the year ended September 30, 2012 are as follows:

<i>(in thousands)</i>	<b>FAHC Defined Benefit Plan</b>
Service cost	\$ 527
Interest cost	7,194
Expected return on plan assets	(7,277)
Amortization of unrecognized net loss	<u>1,821</u>
Net periodic benefit cost	<u>\$ 2,265</u>

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

	<b>FAHC Defined Benefit Plan</b>
Weighted-average assumptions used to determine the benefit liability	
Discount rates	4.03 %
Rates of increase in future compensation levels	3.50
Weighted-average assumptions used to determine expense	
Discount rates	5.39
Rates of increase in future compensation levels	3.50
Expected long-term rate of return on plan assets	7.00

The expected long-term rate of return for the FAHC 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, 2012, by asset category, are as follows:

<b>Asset Category</b>	
Money market	1 %
Mutual funds	12
Common collective trusts	<u>87</u>
	<u>100 %</u>

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The following table presents information, as of September 30, 2012, 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>2012</b>				
Money market	\$ 1,063	\$ -	\$ -	\$ 1,063
Mutual funds	14,818	-	-	14,818
Common collective trusts	-	108,918	-	108,918
Total	<u>\$ 15,881</u>	<u>\$ 108,918</u>	<u>\$ -</u>	<u>\$ 124,799</u>

The investment strategy established by FAP'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 year ended September 30, 2012.

**Cash Flows - Contributions**

FAHC expects to contribute \$6,000,000 to its pension plan in the year ending September 30, 2013.

**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**

2013	\$ 8,212
2014	8,702
2015	9,110
2016	9,490
2017	9,819
2018-2022	51,589

**Central Vermont Medical Center Defined Benefit Pension Plan**

Most employees of CVMC who meet certain age and service requirements are covered by a defined benefit pension plan. The benefits are based on years of service and the employee's average compensation. Contributions are intended to provide not only the benefits attributed to the service to date, but also for those expected to be earned in the future. It is CVMC's intent to fund at least the required minimum contribution under Internal Revenue Code, Section 412.

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CVMC froze the defined benefit pension plan for employees under the age of 50, effective January 1, 2012. The defined benefit pension plan will continue to accrue and vest for future services for employees who are participants of the plan and are 50 years and older before January 1, 2012. For employees who are participants of the defined benefit plan and are under 50 years of age before January 1, 2012, accruing and vesting of services under this plan were frozen as of January 1, 2012. The employees along with newly hired employees are covered under a CVMC sponsored ERISA defined contribution pension plan. The defined contribution plan is an IRS Section 403(b) retirement plan in which CVMC contributes and matches discretionary and nondiscretionary funds in accordance with plan participation guidelines.

The following table sets forth the change in the projected benefit obligation and in fair value of the CVMC defined benefit pension plan assets based on the measurement date as of September 30, 2012:

<i>(in thousands)</i>	<b>CVMC Defined Benefit Plan</b>
<b>Changes in benefit obligations</b>	
Projected benefit obligations - beginning of year	\$ (94,645)
Service cost	(3,930)
Interest cost	(4,942)
Benefits paid	2,788
Actuarial loss	(17,746)
Administrative expenses paid	272
Projected benefit obligation - end of year	<u>(118,203)</u>
Accumulated benefit obligation	<u>(110,052)</u>
<b>Changes in plan assets</b>	
Fair value of plan assets - beginning of year	55,487
Actual gain on plan assets	10,074
Contributions	10,041
Benefits paid	(2,788)
Administrative expenses paid	(272)
Fair value of plan assets - end of year	<u>72,542</u>
Funded status of the plan (long-term)	<u>\$ (45,661)</u>

Unrestricted net assets at September 30, 2012 include unrecognized actuarial losses of \$37,592,000 related to the defined benefit plan. Of this amount, \$6,190,000 is recognized in net periodic pension costs in the year ending September 30, 2012. The reconciliation of the unrecognized actuarial losses for the year ended September 30, 2012, is as follows:

<i>(in thousands)</i>	
Unrecognized actuarial losses - beginning of year	\$ 27,237
Net loss amortized during year	(1,671)
Net prior service cost amortized during year	(107)
Net loss during year	<u>12,133</u>
Unrecognized actuarial losses - end of year	<u>\$ 37,592</u>



**Fletcher Allen Partners, Inc. and Subsidiaries**  
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The cost components of the net periodic benefit cost for the years ended September 30, 2012 are as follows:

<i>(in thousands)</i>	<b>CVMC Defined Benefit Plan</b>
Service cost	\$ 3,930
Interest cost	4,942
Expected return on plan assets	(4,460)
Amortization of unrecognized net loss	1,671
Amortization of prior service cost	107
Net periodic benefit cost	<u>\$ 6,190</u>

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

	<b>CVMC Defined Benefit Plan</b>
Weighted-average assumptions used to determine the benefit liability	
Discount rates	4.15 %
Rates of increase in future compensation levels	3.75
Weighted-average assumptions used to determine expense	
Discount rates	5.30
Rates of increase in future compensation levels	3.75
Expected long-term rate of return on plan assets	8.00

The expected long-term rate of return for the Plan's 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 4% and 6%. Based on historical experience, CVMC expects that the plan's asset managers will provide a modest (0.5% to 1.0% per annum) premium to their respective market benchmark indices.

**Plan Assets**

CVMC's pension plan weighted-average asset allocations as of September 30, 2012, by asset category, are as follows:

**Assets Category**

Bonds	40 %
Equities	39
Real estate	8
Mutual funds	13
	<u>100 %</u>

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The following table presents information as of September 30, 2012, about CVMC'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>
Bonds	\$ 17,502	\$ 11,770	\$ -	\$ 29,272
Equities	23,436	4,687	-	28,123
Real estate	5,750	-	-	5,750
Mutual funds	9,397	-	-	9,397
Total	<u>\$ 56,085</u>	<u>\$ 16,457</u>	<u>\$ -</u>	<u>\$ 72,542</u>

The investment strategy established by FAP'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, 2012.

**Cash Flows - Contributions**

CVMC expects to contribute \$5,200,000 to its pension plan in the year ending September 30, 2013.

**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**

2013	\$ 3,175
2014	3,575
2015	3,900
2016	4,475
2017	5,275
2018-2022	35,775

**Other FAP Retirement Plans**

The plans that follow are other retirement plans that are not defined benefit plans. These plans are described in the remainder of the footnote, followed by required disclosures of total retirement benefit costs.

**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 Partners, Inc. and Subsidiaries**

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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 Healthcare, 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.

#### **Central Vermont Medical Center Retirement Plan**

In accordance with ERISA guidelines, CVMC provided a new retirement plan effective January 1, 2012. CVMC maintains a tax sheltered annuity benefit plan for its employees. Employees who were not grandfathered into the Defined Benefit Plan, and who have met eligibility requirements, receive discretionary and nondiscretionary contributions based on a percentage of their salaries up to 6% of pay.

#### **Benefit Plan Costs**

FAP 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 \$37,992,000 for the year ended September 30, 2012.

### **15. Concentrations of Credit Risk**

FAP 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, 2012 is as follows:

Medicare	23 %
Medicaid	10
Blue cross	15
Other third-party payers	31
Patients	21
	<hr/>
	100 %

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**16. 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 \$20,235,000 in the year ended September 30, 2012. 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 \$4,837,000 in the year ended September 30, 2012. This payment increases to \$4,927,000 for the year ending September 30, 2013 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 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 \$4,624,000 in the year ended September 30, 2012. 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, 2012, approximately \$32,000 of the \$4,624,000 Dean's Tax was appropriated to research and education initiatives within FAHC.

# Fletcher Allen Partners, Inc. and Subsidiaries

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In addition to providing financial support of 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.

#### 17. Functional Expenses

FAP provides general health care services to residents within its geographic location. Expenses related to providing these services for the year ended September 30, 2012, are as follows:

*(in thousands)*

Education and research	\$ 1,788
Health care services	763,112
Management and general	<u>352,209</u>
Total functional expenses	1,117,109
Less: Nonoperating expenses	<u>1,626</u>
Total operating expenses	<u>\$ 1,115,483</u>

#### 18. 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).

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

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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 and Hedge Funds***

The estimated fair values of common collective trusts and hedge funds 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, 2012. FAP is able to redeem its investment in hedge funds on a calendar quarter basis after providing 90 days notice.

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

The estimated fair values of FAP'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 FAP's long-term debt is based on current traded value or a discounted cash flow private placement debt. Such amounts at September 30, 2012, are approximately \$355,212,000.

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The following table presents information as of September 30, 2012, about FAP's financial assets and liabilities 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>
Mutual funds	\$ 72,319	\$ 28,535	\$ -	\$ 100,854
Equities	1,247	-	-	1,247
Money market funds	22,006	-	-	22,006
Hedge funds	-	-	2,229	2,229
Bonds and notes	7,731	34,134	-	41,865
Common collective trusts	-	253,633	-	253,633
Beneficial interest in perpetual trusts	-	-	10,093	10,093
Real estate	-	300	-	300
	<u>\$ 103,303</u>	<u>\$ 316,602</u>	<u>\$ 12,322</u>	<u>\$ 432,227</u>
Interest rate swap agreements	<u>\$ -</u>	<u>\$ 14,342</u>	<u>\$ -</u>	<u>\$ 14,342</u>

A roll forward of Level 3 (defined above) for the year ended September 30, 2012, is as follows:

<i>(in thousands)</i>	<b>Beneficial Interest in Perpetual Trusts</b>	<b>Hedge Funds</b>	<b>Total Level 3 Assets</b>
<b>Beginning of year</b>	\$ 9,152	\$ -	\$ 9,152
Purchases	-	2,254	2,254
Sales	-	(111)	(111)
Unrealized gains	952	86	1,038
Unrealized losses	(11)	-	(11)
<b>End of the year</b>	<u>\$ 10,093</u>	<u>\$ 2,229</u>	<u>\$ 12,322</u>
Increase in fair value of Level 3 investments held at September 30, included in the statement of changes in net assets	<u>\$ 941</u>	<u>\$ 86</u>	<u>\$ 1,027</u>

**19. 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 \$940,000 as of September 30, 2012. Estimated cash flows due after one year are discounted using a risk adjusted rate for the year ended September 30, 2012.

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Pledges are expected to be collected as follows:

*(in thousands)*

**Amounts due**

Within one year	\$	986
In one to five years		342
In more than five years		648
		<u>1,976</u>
Less: Unamortized discount		359
		<u>1,617</u>
Less: Allowance for uncollectables		93
Net pledges receivables	\$	<u>1,524</u>

**20. Allowance for Doubtful Accounts**

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, FAP 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, FAP, 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, 2012:

*(in thousands)*

**Receivables**

Patients	\$	34,034
Third-party payers		125,477
	\$	<u>159,511</u>

The allowance for doubtful accounts is summarized as follows at September 30, 2012:

*(in thousands)*

**Allowance for doubtful accounts**

Patients	\$	9,749
Third-party payers		16,823
	\$	<u>26,572</u>



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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 statement of operations.

Net patient service revenue before the provision for bad debts for the years ended September 30, 2012, is summarized as follows:

*(in thousands)*

**Net patient service revenue**

Patients	\$ 38,817
Third-party payers	998,442
	<u>\$ 1,037,259</u>

**21. Subsequent Events**

FAP has evaluated subsequent events through December 21, 2012, 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.

On July 1, 2012, FAP approved an affiliation agreement between FAP and Community Providers, Inc. ("CPI"). Under the terms of this agreement, FAP will become the sole corporate member of CPI, continuing to serve its purpose of establishing an integrated regional health care system. This agreement was subject to due diligence and regulatory approval which was completed in the quarter ending December 31, 2012. CPI is the parent organization of Champlain Valley Physicians Hospital Medical Center (CVPH) in Plattsburgh, NY and Elizabethtown Community Hospital (ECH) in Elizabethtown, NY. With approval pending from the New York State Department of Health, the anticipated effective date of affiliation is January 1, 2013.

## **Supplemental Schedules**

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Balance Sheet**  
**September 30, 2012**

<i>(in thousands)</i>	<b>FAHC Consolidated</b>	<b>CVMC</b>	<b>Fletcher Allen Partners</b>	<b>Eliminations</b>	<b>Total After Eliminations FAP</b>
<b>Assets</b>					
Current assets					
Cash and cash equivalents	\$ 164,520	\$ 9,345	\$ -	\$ -	\$ 173,865
Patient accounts receivable, net	117,439	15,500	-	-	132,939
Due from related parties	-	560	-	(560)	-
Short-term investments	1,932	-	-	-	1,932
Inventory (at lower of cost or market)	20,913	2,948	-	-	23,861
Current portion of restricted assets	13,132	-	-	-	13,132
Estimated receivables from third party payors	5,344	796	-	-	6,140
Prepays and other current assets	20,839	4,317	-	-	25,156
Total current assets	<u>344,119</u>	<u>33,466</u>	<u>-</u>	<u>(560)</u>	<u>377,025</u>
Assets whose use is limited or restricted					
Board designated assets	259,725	34,375	-	-	294,100
Funds held by trustee	31,228	-	-	-	31,228
Restricted assets	37,319	-	-	-	37,319
Donor restricted assets for specific purposes	19,326	6,025	-	-	25,351
Donor restricted assets for permanent endowment	26,064	3,101	-	-	29,165
Total assets whose use is limited or restricted	<u>373,662</u>	<u>43,501</u>	<u>-</u>	<u>-</u>	<u>417,163</u>
Property and equipment, net	<u>398,376</u>	<u>72,688</u>	<u>-</u>	<u>-</u>	<u>471,064</u>
Other assets					
Intangible assets	13,150	-	-	-	13,150
Long-term investments	-	-	-	-	-
Notes and other receivables	8,796	1,277	-	-	10,073
Investment in affiliated companies	5,131	-	-	-	5,131
Pledges receivable (net)	537	47	-	-	584
Total other assets	<u>27,614</u>	<u>1,324</u>	<u>-</u>	<u>-</u>	<u>28,938</u>
Total assets	<u>\$ 1,143,771</u>	<u>\$ 150,979</u>	<u>\$ -</u>	<u>\$ (560)</u>	<u>\$ 1,294,190</u>

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Balance Sheet**  
**September 30, 2012**

<i>(in thousands)</i>	<b>FAHC Consolidated</b>	<b>CVMC</b>	<b>Fletcher Allen Partners</b>	<b>Eliminations</b>	<b>Total After Eliminations FAP</b>
<b>Liabilities and net assets</b>					
Current liabilities					
Current installment of long-term debt	\$ 8,885	\$ 4,604	\$ -	\$ -	\$ 13,489
Accounts payable	24,093	1,578	-	-	25,671
Accrued expenses	49,301	2,066	-	(560)	50,807
Accrued payroll and related benefits	64,457	7,796	-	-	72,253
Estimated third party payor settlements	13,916	3,000	-	-	16,916
Estimated incurred but unreported medical claims	23,283	1,348	-	-	24,631
Total current liabilities	183,935	20,392	-	(560)	203,767
Long-term debt, excluding current installments	377,163	24,670	-	-	401,833
Reserve for outstanding losses on malpractice claims	28,982				28,982
Pension and other postretirement benefit obligations	35,921	45,661	-	-	81,582
Other long-term liabilities	20,469	779	-	-	21,248
Total liabilities	646,470	91,502	-	(560)	737,412
Commitments and contingent liabilities					
Net assets					
Unrestricted	450,052	50,322	-	-	500,374
Temporarily restricted	21,185	6,054	-	-	27,239
Permanently restricted	26,064	3,101	-	-	29,165
Retained earnings	-	-	-	-	-
Total net assets	497,301	59,477	-	-	556,778
Total liabilities and net assets	\$ 1,143,771	\$ 150,979	\$ -	\$ (560)	\$ 1,294,190

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Statement of Operations**  
**Year Ended September 30, 2012**

<i>(in thousands)</i>	<b>FAHC Consolidated</b>	<b>CVMC</b>	<b>Fletcher Allen Partners</b>	<b>Eliminations</b>	<b>Total After Eliminations FAP</b>
<b>Unrestricted revenue and other support</b>					
Net patient service revenue	\$ 889,829	\$ 147,430	\$ -	\$ -	\$ 1,037,259
Less: Provision for bad debt	(29,973)	(5,883)	-	-	(35,856)
Net patient service revenue after provision for bad debts	859,856	141,547	-	-	1,001,403
Premium revenue and payer incentives	104,029	2,875	-	-	106,904
Other revenue	29,681	6,561	-	-	36,242
Total unrestricted revenue and other	993,566	150,983	-	-	1,144,549
<b>Expenses</b>					
Salary, payroll taxes and fringes	568,094	97,610	-	-	665,704
Supplies and other	233,950	30,853	-	-	264,803
Purchased services	38,590	7,070	-	-	45,660
Depreciation	48,158	8,946	-	-	57,104
Interest expense	18,394	1,557	-	-	19,951
Claims expenses	62,261	-	-	-	62,261
Total expenses	969,447	146,036	-	-	1,115,483
Net income from operations	24,119	4,947	-	-	29,066
<b>Nonoperating revenue (expenses)</b>					
Investment income and losses on investment	20,806	862	-	-	21,668
Unreal gain in interest rate swap contract	(1,266)	-	-	-	(1,266)
Other	5,066	819	-	-	5,885
Loss on extinguishment of debt	(2,305)	(529)	-	-	(2,834)
Contribution revenue from acquisition	-	-	52,453	-	52,453
Total nonoperating revenue	22,301	1,152	52,453	-	75,906
Excess of revenues over expenses	46,420	6,099	52,453	-	104,972
Net unrealized gain on investments	29,157	1,788	-	-	30,945
Assets released from restrictions - capital	144	190	-	-	334
Adjustment minimum pension liability	(8,135)	(10,208)	-	-	(18,343)
Transfer of net assets	-	52,453	(52,453)	-	-
Increase in unrestricted net assets	\$ 67,586	\$ 50,322	\$ -	\$ -	\$ 117,908

# Fletcher Allen Partners, Inc. and Subsidiaries

## Consolidating Balance Sheet - FAHC Consolidated

### September 30, 2012

<i>(in thousands)</i>	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, LLC	Fletcher Allen Skilled Nursing, LLC	Vermont Managed Care Indemnity Company.Ltd.	Fletcher Allen Executive Services	Fletcher Allen Coordinated Transport	Eliminations	Total September 30, 2012
<b>Assets</b>									
Current assets									
Cash and cash equivalents	\$ 149,463	\$ 14,127	\$ 80	\$ -	\$ 21	\$ 100	\$ 729	\$ -	\$ 164,520
Patient accounts receivable, net	116,106	1,123	66	-	-	-	144	-	117,439
Due from related parties	-	-	-	-	(117)	-	-	117	-
Short-term investments	1,932	-	-	-	-	-	-	-	1,932
Inventory (at lower of cost or market)	20,913	-	-	-	-	-	-	-	20,913
Current portion of restricted assets	-	-	-	-	13,132	-	-	-	13,132
Estimated receivables from third party payors	5,344	-	-	-	-	-	-	-	5,344
Prepays and other current assets	10,022	7,092	197	-	3,528	-	-	-	20,839
Total current assets	303,780	22,342	343	-	16,564	100	873	117	344,119
Assets whose use is limited or restricted									
Board designated assets	259,725	-	-	-	-	-	-	-	259,725
Funds held by trustee	31,228	-	-	-	-	-	-	-	31,228
Restricted assets	615	-	-	-	36,704	-	-	-	37,319
Donor restricted assets for specific purposes	19,326	-	-	-	-	-	-	-	19,326
Donor restricted assets for permanent endowment	26,064	-	-	-	-	-	-	-	26,064
Total assets whose use is limited or restricted	336,958	-	-	-	36,704	-	-	-	373,662
Property and equipment, net	397,781	159	-	-	-	-	436	-	398,376
Other assets									
Intangible assets	13,150	-	-	-	-	-	-	-	13,150
Notes and other receivables	8,546	250	-	-	-	-	-	-	8,796
Investment in affiliated companies	25,355	-	-	4,914	-	-	-	(25,138)	5,131
Pledges receivable (net)	537	-	-	-	-	-	-	-	537
Total other assets	47,588	250	-	4,914	-	-	-	(25,138)	27,614
Total assets	\$ 1,086,107	\$ 22,751	\$ 343	\$ 4,914	\$ 53,268	\$ 100	\$ 1,309	\$ (25,021)	\$ 1,143,771

# Fletcher Allen Partners, Inc. and Subsidiaries

## Consolidating Balance Sheet - FAHC Consolidated

### September 30, 2012

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, LLC	Fletcher Allen Skilled Nursing, LLC	Vermont Managed Care Indemnity Company Ltd.	Fletcher Allen Executive Services	Fletcher Allen Coordinated Transport	Eliminations	Total September 30, 2012
<i>(in thousands)</i>									
<b>Liabilities and Net Assets</b>									
<b>Current liabilities</b>									
Current installment of long-term debt	\$ 8,885	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,885
Accounts payable	24,004	7	5	-	70	-	7	-	24,093
Accrued expenses	30,144	6,385	43	-	-	-	13	12,716	49,301
Accrued payroll and related benefits	64,395	202	30	-	-	-	-	(170)	64,457
Estimated third party payor settlements	13,916	-	-	-	-	-	-	-	13,916
Due to related parties	2,396	9,563	260	-	-	210	-	(12,429)	-
Estimated incurred but unreported medical claims	11,702	6,429	-	-	5,152	-	-	-	23,283
Total current liabilities	155,442	22,586	338	-	5,222	210	20	117	183,935
Long-term debt, excluding current installments	377,163	-	-	-	-	-	-	-	377,163
Reserve for outstanding losses on malpractice claims	-	-	-	-	28,982	-	-	-	28,982
Pension and other postretirement benefit obligations	35,921	-	-	-	-	-	-	-	35,921
Other long-term liabilities	20,219	250	-	-	-	-	-	-	20,469
Total liabilities	588,745	22,836	338	-	34,204	210	20	117	646,470
<b>Commitments and contingent liabilities</b>									
<b>Net assets</b>									
Unrestricted	450,113	-	5	4,914	-	(110)	1,289	(6,159)	450,052
Temporarily restricted	21,185	-	-	-	-	-	-	-	21,185
Permanently restricted	26,064	-	-	-	-	-	-	-	26,064
Retained earnings	-	(85)	-	-	19,064	-	-	(18,979)	-
Total net assets	497,362	(85)	5	4,914	19,064	(110)	1,289	(25,138)	497,301
Total liabilities and net assets	\$ 1,086,107	\$ 22,751	\$ 343	\$ 4,914	\$ 53,268	\$ 100	\$ 1,309	\$ (25,021)	\$ 1,143,771

# Fletcher Allen Partners, Inc. and Subsidiaries

## Consolidating Statement of Operations - FAHC Consolidated

### Year Ended September 30, 2012

	Fletcher Allen Health Care, Inc.	Fletcher Allen Health Ventures, Inc.	Fletcher Allen Medical Group, LLC	Fletcher Allen Skilled Nursing, LLC	Vermont Managed Care Indemnity Company, Ltd.	Fletcher Allen Executive Services	Fletcher Allen Coordinated Transport	Eliminations	Total September 30, 2012
<b>Unrestricted revenue and other support</b>									
Net patient service revenue	\$ 930,622	\$ -	\$ 639	\$ -	\$ -	\$ -	\$ 1,378	\$ (42,810)	\$ 889,829
Less: Provision for bad debt	(29,834)	-	(58)	-	-	-	(81)	-	(29,973)
Net patient service revenue after provision for bad debts	900,788	-	581	-	-	-	1,297	(42,810)	859,856
Premium revenue and payer incentives	9,646	97,598	1	-	-	-	-	(3,216)	104,029
Other revenue	27,517	-	1,203	-	8,038	235	2	(7,314)	29,681
Total unrestricted revenue and other	937,951	97,598	1,785	-	8,038	235	1,299	(53,340)	993,566
<b>Expenses</b>									
Salary, payroll taxes and fringes	562,235	4,724	1,372	-	-	338	2,418	(2,993)	568,094
Supplies and other	240,764	944	112	-	81	3	345	(8,299)	233,950
Purchased services	34,907	1,491	301	-	876	-	131	884	38,590
Depreciation	48,015	40	-	-	-	-	103	-	48,158
Interest expense	18,394	-	-	-	-	-	-	-	18,394
Claims expenses	-	90,542	-	-	14,652	-	-	(42,933)	62,261
Total expenses	904,315	97,741	1,785	-	15,609	341	2,997	(53,341)	969,447
Net income (loss) from operations	33,636	(143)	-	-	(7,571)	(106)	(1,698)	1	24,119
<b>Nonoperating revenue (expenses)</b>									
Investment income and losses on investment	18,310	33	1	-	2,462	-	-	-	20,806
Unreal gain in interest rate swap contract	(1,266)	-	-	-	-	-	-	-	(1,266)
Loss on extinguishment of debt	(2,305)	-	-	-	-	-	-	-	(2,305)
Other	(1,896)	(32)	-	701	-	-	-	6,293	5,066
Total nonoperating revenue (expense)	12,843	1	1	701	2,462	-	-	6,293	22,301
Excess (deficiency) of revenues over expenses	46,479	(142)	1	701	(5,109)	(106)	(1,698)	6,294	46,420
Net unrealized gain (loss) on investments	29,157	-	-	-	1,521	-	-	(1,521)	29,157
Assets released from restrictions - capital	144	-	-	-	-	-	-	-	144
Adjustment minimum pension liability	(8,135)	-	-	-	-	-	-	-	(8,135)
Transfer of net assets	-	-	-	(500)	-	-	1,812	(1,312)	-
Increase (decrease) in unrestricted net assets	\$ 67,645	\$ (142)	\$ 1	\$ 201	\$ (3,588)	\$ (106)	\$ 114	\$ 3,461	\$ 67,586



**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Balance Sheet - CVMC**  
**Year Ended September 30, 2012**

*(in thousands)*

**Assets**

Current assets

Cash and cash equivalents

\$ 7,660 \$ 1,685 \$ 9,345

Patient and other trade accounts receivable-net

14,205 1,295 15,500

Due from (due to) related parties

12,208 (11,648) 560

Short-term investments

- - -

Inventories

2,948 - 2,948

Current portion of restricted assets

- - -

Estimated receivable from third - party payers

796 - 796

Prepaid and other current assets

4,317 - 4,317

Total current assets

42,134 (8,668) 33,466

Assets whose use is limited or restricted

Board-designated assets

28,778 5,597 34,375

Assets held by trustee under bond indenture agreements

- - -

Restricted assets

- - -

Donor restricted assets for specific purposes

6,025 - 6,025

Donor restricted assets for permanent endowment

3,101 - 3,101

Total assets whose use is limited or restricted

37,904 5,597 43,501

Property and equipment-net

68,977 3,711 72,688

Other assets

Deferred financing costs-net

- - -

Notes receivable and other assets

1,277 - 1,277

Investment in affiliated companies

- - -

Pledges receivable

47 - 47

Total other assets

1,324 - 1,324

\$ 150,339 \$ 640 \$ 150,979

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Balance Sheet - CVMC**  
**Year Ended September 30, 2012**

*(in thousands)*

**Liabilities and Net Assets**

Current liabilities

Current installments of long-term debt	\$ 4,101	\$ 503	\$ 4,604
Accounts payable	1,566	12	1,578
Accrued expenses and other liabilities	2,068	(2)	2,066
Accrued payroll and related benefits	7,176	620	7,796
Estimated third-party payer settlements	3,000	-	3,000
Estimated amounts for incurred but not reported claims	903	445	1,348
Total current liabilities	<u>18,814</u>	<u>1,578</u>	<u>20,392</u>

Long-term liabilities

Long-term debt-excluding current installments	20,392	4,278	24,670
Reserve for outstanding losses on malpractice and workers' compensation claims	-	-	-
Pension and other postretirement benefit obligations	45,661	-	45,661
Other long-term liabilities	779	-	779
Total long-term liabilities	<u>66,832</u>	<u>4,278</u>	<u>71,110</u>
Total liabilities	<u>85,646</u>	<u>5,856</u>	<u>91,502</u>

Net assets

Unrestricted	55,538	(5,216)	50,322
Temporarily restricted	6,054	-	6,054
Permanently restricted	3,101	-	3,101
Retained earnings	-	-	-
Total net assets	<u>64,693</u>	<u>(5,216)</u>	<u>59,477</u>
	<u>\$ 150,339</u>	<u>\$ 640</u>	<u>\$ 150,979</u>

**Fletcher Allen Partners, Inc. and Subsidiaries**  
**Consolidating Statement of Operations - CVMC**  
**Year Ended September 30, 2012**

(in thousands)

**Unrestricted revenue and other support**

Net patient service revenue	\$ 133,921	\$ 13,509	\$ 147,430
Less: Provision for bad debts	(5,799)	(84)	(5,883)
Net patient service revenue after provision for bad debt	128,122	13,425	141,547
Premium revenue	2,875	-	2,875
Other revenue	6,411	150	6,561
Total unrestricted revenue and other support	137,408	13,575	150,983

**Expenses**

Salary, payroll taxes and fringe benefits	87,231	10,379	97,610
Supplies and other	27,870	2,983	30,853
Purchased services	6,611	459	7,070
Depreciation and amortization	8,315	631	8,946
Interest expense	1,347	210	1,557
Total expenses	131,374	14,662	146,036
Income (loss) from operations	6,034	(1,087)	4,947

**Nonoperating gains (losses)**

Investment income	778	84	862
Loss on extinguishment of debt	(529)	-	(529)
Other	763	56	819
Total nonoperating gains	1,012	140	1,152
Excess (deficiency) of revenue over expenses	7,046	(947)	6,099
Net change in unrealized gain (losses) on investments	1,695	93	1,788
Assets released from restrictions for capital purchases	190	-	190
Pension related adjustments	(10,208)	-	(10,208)
Transfer of net assets	52,453	-	52,453
Increase (decrease) in unrestricted net assets	\$ 51,176	\$ (854)	\$ 50,322

# Fletcher Allen Obligated Group

## Obligated Group Balance Sheet

### September 30, 2012

(in thousands)

#### Assets

##### Current assets

Cash and cash equivalents	\$ 158,808
Patient and other trade accounts receivable-net	131,606
Due from related parties	560
Short-term investments	1,932
Inventories	23,861
Estimated receivable from third - party payers	6,140
Prepaid and other current assets	14,339
Total current assets	337,246

##### Assets whose use is limited or restricted

Board-designated assets	294,100
Assets held by trustee under bond indenture agreements	31,228
Restricted assets	615
Donor restricted assets for specific purposes	25,351
Donor restricted assets for permanent endowment	29,165
Total assets whose use is limited or restricted	380,459

##### Property and equipment-net

470,469

##### Other assets

Deferred financing costs-net	13,150
Notes receivable and other assets	9,823
Investment in affiliated companies	25,355
Pledges receivable	584
Total other assets	48,912

\$ 1,237,086

#### Liabilities and net assets

##### Current liabilities

Current installments of long-term debt	\$ 13,489
Accounts payable	25,582
Accrued expenses and other liabilities	32,210
Accrued payroll and related benefits	72,191
Estimated third-party payer settlements	16,916
Due to related parties	2,396
Estimated amounts for incurred but not reported claims	13,050
Total current liabilities	175,834

##### Long-term liabilities

Long-term debt-excluding current installments	401,833
Pension and other postretirement benefit obligations	81,582
Other long-term liabilities	20,998
Total long-term liabilities	504,413
Total liabilities	680,247

##### Commitments and contingent liabilities

##### Net assets

Unrestricted	500,435
Temporarily restricted	27,239
Permanently restricted	29,165
Total net assets	556,839
Total liabilities and net assets	\$ 1,237,086

**Fletcher Allen Obligated Group**  
**Obligated Group Statement of Operations**  
**Year Ended September 30, 2012**

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*(in thousands)*

**Unrestricted revenue and other support**

Net patient service revenue	\$ 1,078,052
Less: Provision for bad debts	<u>(35,717)</u>
Net Patient service revenue after provision for bad debt	1,042,335
Premium revenue	12,521
Other revenue	<u>34,078</u>
Total unrestricted revenue and other support	<u>1,088,934</u>

**Expenses**

Salaries, payroll taxes, and fringe benefits	659,845
Supplies and other	271,617
Purchased services	41,977
Depreciation and amortization	56,961
Interest expense	<u>19,951</u>
Total expenses	<u>1,050,351</u>
Income from operations	<u>38,583</u>

**Nonoperating gains (losses)**

Investment income	19,172
Loss on interest rate swap contracts	(1,266)
Loss on extinguishment of debt	(2,834)
Other	<u>(1,077)</u>
Total nonoperating gains	<u>13,995</u>

Excess of revenue over expenses	52,578
Net change in unrealized losses on investments	30,945
Assets released from restrictions for capital purchases	334
Pension related adjustments	(18,343)
Transfer of net assets	<u>52,453</u>
Increase in unrestricted net assets	<u>\$ 117,967</u>

**Fletcher Allen Obligated Group**  
**Obligated Group Statement of Changes in Net Assets**  
**Year Ended September 30, 2012**

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*(in thousands)*

**Unrestricted net assets**

Excess of revenues over expenses	\$ 52,578
Net change in unrealized losses on investments	30,945
Assets released from restrictions for capital purchases	334
Pension-related adjustments	(18,343)
Transfer of net assets	52,453
	<hr/>
Increase in unrestricted net assets	117,967

**Temporarily restricted net assets**

Gifts, grants, and bequests	2,908
Investment income	180
Net unrealized gains (losses) on investments	3,099
Net realized gains on investments	617
Net assets released from restrictions used in operations	(1,522)
Net assets released from restrictions used for nonoperating purposes	(306)
Net assets released from restrictions used for capital purchases	(334)
Transfer of net assets	(64)
Acquisition of temporarily restricted net assets	6,035
	<hr/>
Increase in temporarily restricted net assets	10,613

**Permanently restricted net assets**

Gifts, grants, and bequests	67
Change in beneficial interest in perpetual trusts	941
Transfer of net assets	64
Acquisition of permanently restricted net assets	3,101
	<hr/>
Increase (decrease) in permanently restricted net assets	4,173
	<hr/>
Increase in net assets	132,753

**Net assets**

Beginning of year	424,086
	<hr/>
End of year	\$ 556,839

**Fletcher Allen Obligated Group**  
**Obligated Group Balance Sheet**  
**September 30, 2012**

*(in thousands)*

**Assets**

Current assets

Cash and cash equivalents	\$ 149,463	\$ 9,345	\$ 158,808
Patient accounts receivable, net	116,106	15,500	131,606
Due from related parties	-	560	560
Short-term investments	1,932	-	1,932
Inventory (at lower of cost or market)	20,913	2,948	23,861
Estimated receivables from third party payors	5,344	796	6,140
Prepays and other current assets	10,022	4,317	14,339
Total current assets	<u>303,780</u>	<u>33,466</u>	<u>337,246</u>

Assets whose use is limited or restricted

Board designated assets	259,725	34,375	294,100
Funds held by trustee	31,228	-	31,228
Restricted assets	615	-	615
Donor restricted assets for specific purposes	19,326	6,025	25,351
Donor restricted assets for permanent endowment	26,064	3,101	29,165
Total assets whose use is limited or restricted	<u>336,958</u>	<u>43,501</u>	<u>380,459</u>

Property and equipment, net

	<u>397,781</u>	<u>72,688</u>	<u>470,469</u>
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Other assets

Intangible assets	13,150	-	13,150
Long-term investments	-	-	-
Notes and other receivables	8,546	1,277	9,823
Investment in affiliated companies	25,355	-	25,355
Pledges receivable (net)	537	47	584
Total other assets	<u>47,588</u>	<u>1,324</u>	<u>48,912</u>

	<u>\$ 1,086,107</u>	<u>\$ 150,979</u>	<u>\$ 1,237,086</u>
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**Fletcher Allen Obligated Group**  
**Obligated Group Balance Sheet**  
**September 30, 2012**

*(in thousands)*

**Liabilities and net assets**

Current liabilities

	FAHC (Hospital)	CVMC	Total
Current installment of long-term debt	\$ 8,885	\$ 4,604	\$ 13,489
Accounts payable	24,004	1,578	25,582
Accrued expenses	30,144	2,066	32,210
Accrued payroll and related benefits	64,395	7,796	72,191
Estimated third party payor settlements	13,916	3,000	16,916
Due to related parties	2,396	-	2,396
Estimated incurred but unreported medical claims	11,702	1,348	13,050
Total current liabilities	155,442	20,392	175,834
Long-term debt, excluding current installments	377,163	24,670	401,833
Pension and other postretirement benefit obligations	35,921	45,661	81,582
Other long-term liabilities	20,219	779	20,998
Total liabilities	588,745	91,502	680,247

Commitments and contingent liabilities

Net assets

Unrestricted	450,113	50,322	500,435
Temporarily restricted	21,185	6,054	27,239
Permanently restricted	26,064	3,101	29,165
Retained earnings	-	-	-
Total net assets	497,362	59,477	556,839
Total liabilities and net assets	\$ 1,086,107	\$ 150,979	\$ 1,237,086



**Fletcher Allen Obligated Group**  
**Obligated Group Statement of Operations**  
**Year Ended September 30, 2012**

(in thousands)

	<b>FAHC (Hospital)</b>	<b>CVMC</b>	<b>Total</b>
<b>Unrestricted revenue and other support</b>			
Net patient service revenue	\$ 930,622	\$ 147,430	\$ 1,078,052
Less: Provision for bad debt	(29,834)	(5,883)	(35,717)
Net patient service revenue after provision for bad debts	900,788	141,547	1,042,335
Premium revenue and payer incentives	9,646	2,875	12,521
Other revenue	27,517	6,561	34,078
Total unrestricted revenue and other	937,951	150,983	1,088,934
<b>Expenses</b>			
Salary, payroll taxes and fringes	562,235	97,610	659,845
Supplies and other	240,764	30,853	271,617
Purchased services	34,907	7,070	41,977
Depreciation	48,015	8,946	56,961
Interest expense	18,394	1,557	19,951
Total expenses	904,315	146,036	1,050,351
Net income from operations	33,636	4,947	38,583
<b>Nonoperating revenue (expenses)</b>			
Investment income and losses on investment	18,310	862	19,172
Unreal gain in interest rate swap contract	(1,266)	-	(1,266)
Other	(1,896)	819	(1,077)
Loss on extinguishment of debt	(2,305)	(529)	(2,834)
Contribution revenue from acquisition	-	-	-
Total nonoperating revenue	12,843	1,152	13,995
Excess of revenues over expenses	46,479	6,099	52,578
Net unrealized gain on investments	29,157	1,788	30,945
Assets released from restrictions - capital	144	190	334
Adjustment asset retirement obligation	-	-	-
Adjustment minimum pension liability	(8,135)	(10,208)	(18,343)
Transfer of net assets	-	52,453	52,453
Increase in unrestricted net assets	\$ 67,645	\$ 50,322	\$ 117,967