

Evercare of Arizona, Inc.

*Financial Statements as of and for the
Years Ended December 31, 2008 and 2007,
Supplemental Schedules as of and
for the Year Ended December 31, 2008,
Independent Auditors' Report, and
Internal Control Letter*

EVERCARE OF ARIZONA, INC.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Evercare of Arizona, Inc.:

We have audited the accompanying balance sheets of Evercare of Arizona, Inc. (the "Plan") (an Arizona corporation and a wholly owned subsidiary of Ovations, Inc.) as of December 31, 2008 and 2007, and the related statements of operations, changes in stockholder's equity and other comprehensive (loss) income, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit over its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Plan as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The supplemental 2008 combining information beginning on page 20 is not a required part of the basic financial statements, but is supplementary information required by the Arizona Health Care Cost Containment System (AHCCCS). This supplementary information is the responsibility of the Plan's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

April 30, 2009

EVERCARE OF ARIZONA, INC.

BALANCE SHEETS

AS OF DECEMBER 31, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 21,712,032	\$ 21,035,454
Short-term investments	1,059,040	2,397,509
Receivables — net of allowance of \$2,977,176 and \$2,935,225 in 2008 and 2007, respectively	2,384,235	3,846,458
Related-party receivable — net		172,518
Deferred income taxes	1,316,051	1,367,933
Other	22,373	33,184
Total current assets	26,493,731	28,853,056
LONG-TERM DEFERRED INCOME TAXES	108,479	
LONG-TERM INVESTMENTS	24,524,755	30,526,882
TOTAL	<u>\$ 51,126,965</u>	<u>\$ 59,379,938</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Medical services payable	\$ 22,052,801	\$ 28,962,564
Payable to Arizona Health Care Cost Containment System (AHCCCS)	481,753	2,888,583
Related-party payable — net	1,343,480	
Deferred income taxes		30,186
Other	481,066	447,439
Total current liabilities	24,359,100	32,328,772
CONTINGENCIES		
STOCKHOLDER'S EQUITY:		
Common stock, \$1 par value — authorized, 2,000,000 shares; 1 share issued and outstanding	1	1
Additional paid-in capital	10,999,115	10,999,115
Retained earnings	15,932,452	15,852,253
Accumulated other comprehensive (loss) income	(163,703)	199,797
Total stockholder's equity	26,767,865	27,051,166
TOTAL	<u>\$ 51,126,965</u>	<u>\$ 59,379,938</u>

See notes to financial statements.

EVERCARE OF ARIZONA, INC.

STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
CAPITATION REVENUE	<u>\$ 156,671,081</u>	<u>\$ 183,160,032</u>
MEDICAL SERVICES EXPENSES:		
Institutional care	77,762,692	87,868,423
Home- and community-based services	39,998,288	44,384,612
Acute care	<u>18,729,411</u>	<u>21,457,409</u>
Total medical services expenses	<u>136,490,391</u>	<u>153,710,444</u>
INCOME BEFORE MANAGEMENT FEES AND OPERATING EXPENSES	20,180,690	29,449,588
MANAGEMENT FEES	18,017,173	20,556,361
OPERATING EXPENSES	<u>4,444,524</u>	<u>4,904,823</u>
(LOSS) INCOME BEFORE NET INTEREST INCOME	(2,281,007)	3,988,404
NET INTEREST INCOME	<u>2,048,619</u>	<u>3,292,600</u>
(LOSS) INCOME BEFORE INCOME TAXES	(232,388)	7,281,004
FEDERAL AND STATE INCOME TAX (BENEFIT) PROVISION	<u>(312,586)</u>	<u>2,821,802</u>
NET INCOME	<u>\$ 80,198</u>	<u>\$ 4,459,202</u>

See notes to financial statements.

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STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY AND OTHER COMPREHENSIVE (LOSS) INCOME FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>Common Stock</u> Shares	<u>Amount</u>	<u>Additional</u> <u>Paid-In</u> <u>Capital</u>	<u>Retained</u> <u>Earnings</u>	<u>Accumulated</u> <u>Other</u> <u>Comprehensive</u> <u>(Loss) Income</u>	<u>Total</u>
BALANCE — December 31, 2006	1	\$ 1	\$ 10,999,115	\$ 21,393,052	\$ (126,626)	\$ 32,265,542
Comprehensive income:						
Net income				4,459,202		4,459,202
Dividend distribution				(10,000,000)		(10,000,000)
Change in net unrealized gains and losses on investments available-for-sale					326,422	326,422
Total comprehensive loss						(5,214,376)
BALANCE — December 31, 2007	1	\$ 1	\$ 10,999,115	\$ 15,852,254	\$ 199,796	\$ 27,051,166
Comprehensive income:						
Net income				80,198		80,198
Change in net unrealized gains and losses on investments available-for-sale					(363,499)	(363,499)
Total comprehensive loss						(283,301)
BALANCE — December 31, 2008	1	\$ 1	\$ 10,999,115	\$ 15,932,452	\$ (163,703)	\$ 26,767,865

See notes to financial statements.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — Evercare of Arizona, Inc. (the “Plan”) is a prepaid health plan that derives substantially all of its revenue through a contract with the Arizona Health Care Cost Containment System (AHCCCS) to provide specified long-term health care services to qualified members. The Plan contracts for fixed monthly premiums, based on negotiated per-capita enrollee rates. The Plan subcontracts with hospitals, physicians, and other medical providers within Arizona and surrounding states to care for AHCCCS members in various counties.

The Plan is a wholly owned subsidiary of Ovations, Inc. The Plan was previously a wholly owned subsidiary of Lifemark Corporation (“Lifemark”). In May 2008, Lifemark merged into Ovations, Inc., which is a wholly owned subsidiary of United HealthCare Services, Inc. (UHS), which is a wholly owned subsidiary of UnitedHealth Group Incorporated (“UnitedHealth Group”).

Basis of Presentation — The financial statements reflect the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Use of Estimates — These financial statements include some amounts that are based on estimates and judgments. The most significant estimates relate to medical services expenses, medical services payable, and estimates regarding members’ share of costs and home- and community-based services, which affect the Plan’s ultimate capitated revenue. The Plan adjusts these estimates as more current information becomes available, and any adjustment could have a significant impact on operating results. The impact of any changes in estimates is included in the determination of income in the period in which the change in estimate is identified.

Cash and Cash Equivalents — Cash and cash equivalents investments represent cash held by the Plan in disbursement accounts and money market instruments with a maturity of three months or less at the time of purchase. Claims and other payments are made from the disbursement accounts daily. Cash and cash equivalents are reported at cost, which approximates market value.

Cash and cash equivalents also consist of the Plan’s share in an investment pool, sponsored and administered by UHS for the benefit of the UHS-owned health plans. The investment pool consists principally of investments with original maturities of less than one year with the average life of the individual investments being less than 60 days. The Plan’s share of the pool represents an undivided ownership interest in the pool and is immediately convertible to cash at no cost or penalty. The pool is primarily invested in governmental obligations, commercial paper, certificates of deposit, and short-term agency notes, and is recorded at cost, which approximates market value. Interest income from the pool accrues daily to participating members based upon ownership percentage.

Investments — Investments that mature within one year are classified as short term. Investments with maturities greater than one year are classified as long term. Investments consist of government obligations, mortgage-backed securities, and corporate bonds.

The Plan follows the provisions of Financial Accounting Standards Board (FASB) Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and has classified all investments as available-for-sale, whereby investments are reported at fair value, with unrealized gains and losses

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

reported as accumulated other comprehensive (loss) income, net of income taxes, in the statements of changes in shareholder's equity and other comprehensive income. Fair value is based on quoted market prices.

The Plan continually monitors the difference between the cost and estimated fair value of its investments. If any of the Plan's investments experience a decline in value that the Plan believes is other than temporary, the Plan records a realized loss in net interest income in the statements of operations. No such losses were incurred and recorded as of December 31, 2008 and 2007.

The Plan's investment policy limits investments in other residential mortgage-backed securities, including home equity and subprime mortgages, to 10% of total investments, and total investments in mortgage-backed securities to 30% of total investments.

Minimum Net Worth — Under the laws of the State of Arizona, AHCCCS requires the Plan to maintain a minimum net worth of \$2,000 per member. As of December 31, 2008, the Plan had \$6,825 of equity per member, meeting this requirement. As of December 31, 2007, the Plan had \$5,824 of equity per member, meeting this requirement.

Revenue Recognition — Long-term care capitation premiums and prior period coverage (PPC) capitation premiums are both recognized as revenue in the month that the Plan receives notification from AHCCCS that members are entitled to long-term health care services. Prior period capitation premiums pertain to service dates prior to notification. AHCCCS reconciles PPC capitation and refunds the Plan all costs in excess of 110% of the premium. AHCCCS may also recoup from the Plan any PPC profit amounts in excess of 10%.

Medical Services Expenses and Payables — Medical services expenses include claims paid, claims processed but not yet paid, estimates for claims received but not yet processed, estimates for the costs of health care services that members have received, but for which claims have not yet been submitted, and loss adjustment expenses.

The Plan contracts for nursing home services at negotiated per-diem rates. Hospital services are generally contracted at per-diem rates or adjusted total charges, as defined by AHCCCS, less any applicable discounts. Home- and community-based services, physicians' services, and other medical services are contracted on a capitated or fee-for-service basis.

The estimates for incurred but not reported claims are developed using actuarial methods based upon historical submission and payment data, cost trends, customer and product mix, seasonality, utilization of health care services, contracted service rates, and other relevant factors. The estimates may change as actuarial methods change or as underlying facts upon which estimates are based change. The Plan did not change actuarial methods during the years ended December 31, 2008 and 2007. Management believes the amount of medical services payable is adequate to cover the Plan's liability for unpaid claims as of December 31, 2008; however, actual claim payments may differ from those established estimates. Adjustments to medical services payable estimates are reflected in operating results in the period in which the change in estimate is identified.

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NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Reinsurance Ceded — In the normal course of business, the Plan seeks to limit its exposure to loss on any single insured and to recover a portion of benefits paid by ceding risk to AHCCCS, which provides the reinsurance by program contract. Reinsurance recoveries received of \$8,123,403 and \$9,304,252 during 2008 and 2007, respectively, are included as a reduction to medical services expenses in the accompanying statements of operations. Reinsurance recoveries are stated at actual and estimated amounts due to the Plan pursuant to the AHCCCS contract. These recoveries are recognized as a percentage of reinsurance eligible expenses in which medical costs exceed the stated deductible per member for the contract year.

Income Taxes — The Plan follows the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, under which deferred income tax assets and liabilities are recognized for the differences between financial and income tax reporting bases of assets and liabilities based on enacted tax rates and laws. Deferred income taxes have been provided for all significant temporary differences. These temporary differences arise primarily from accrued medical claims and allowances for doubtful accounts.

Economic Dependence — The Plan's only source of revenue is its contract with AHCCCS, which provides the Plan the right to offer services in Apache, Coconino, Mohave, and Navajo counties. The Plan's contract with AHCCCS serving members in all contracted counties expires in September 2009.

The Plan's contract in Maricopa County was not renewed after September 2006. Through an agreement with AHCCCS, the Plan was allowed to retain its membership in Maricopa County, but is unable to enroll or market to new members in that county. Although the Plan's operations have negative impact from the loss of the contract in Maricopa County, this decision by AHCCCS has allowed management time to develop strategies to evaluate and minimize disruptions to ongoing operations.

At December 31, 2008, Maricopa County capitation revenue of \$111,751,336 accounted for 71.3% of the total capitation revenue of \$156,671,081 presented on the statements of operations in the audited financial statements. At December 31, 2007, Maricopa County capitation revenue of \$141,951,171 accounted for 77.5% of the total capitation revenue of \$183,160,032 presented on the statements of operations in the audited financial statements.

Concentration of Credit Risk — Concentration of credit risk with respect to receivables is limited due to the fact that AHCCCS, the Plan's sole customer, is a governmental agency. As of December 31, 2008 and 2007, the Plan had cash and cash equivalents on deposit with a major financial institution that were in excess of Federal Deposit Insurance Corporation insured limits.

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NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Recently Adopted Accounting Standards — In February 2007, the FASB issued Statement of Financial Accounting Standards (FAS) No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*” (FAS 159). FAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under FAS 159, a company may elect to use fair value to measure various assets and liabilities including accounts receivables, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, and issued debt. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. The Plan adopted FAS 159 as of January 1, 2008. The impact of adoption of FAS 159 was not material to the Plan.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements* (FAS 157). FAS 157 establishes a framework for measuring fair value. It does not require any new fair value measurements, but does require expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. FAS 157 is effective for financial assets and liabilities measured at fair value in the Plan’s financial statements. The Plan adopted FAS 157 as of January 1, 2008. The impact of adoption of FAS 157 was not material to the Plan. See Note 2 for additional discussion.

2. INVESTMENTS

For purposes of calculating gross realized gains and losses on sales of investments, the amortized cost of the specific investment sold is used. The gross realized losses on sales of investments totaled \$63,241 and \$0 for the years ended December 31, 2008 and 2007, respectively. The gross realized gain on sales of investments totaled \$185,304 and \$77,659 for the years ended December 31, 2008 and 2007, respectively.

As of December 31, 2008 and 2007, the amortized costs, fair value, and gross unrealized holding gains and losses of the Plan’s short- and long-term investments, excluding cash and cash equivalents of \$21,712,032 and \$21,035,454, respectively, are as follows (in thousands):

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
U.S. government and agency	\$ -	\$ -	\$ -	\$ -
State and state agency	5,294	97	(117)	5,274
Political subdivisions	6,948	112	(84)	6,976
Corporate bonds	6,902	103	(147)	6,858
Mortgage-backed securities	6,710	157	(392)	6,475
Total	\$ 25,854	\$ 469	\$ (740)	\$ 25,583
Years to maturity:				
Less than one year	1,055	10	(6)	1,059
One to five years	11,476	170	(206)	11,440
Five to ten years	5,804	130	(120)	5,814
Over ten years	809	2	(16)	795
Mortgage-backed securities	6,710	157	(392)	6,475
Total	\$ 25,854	\$ 469	\$ (740)	\$ 25,583
	2007			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
U.S. government and agency	\$ 982	\$ 57	\$ -	\$ 1,039
State and state agency	8,531	49	(26)	8,554
Political subdivisions	9,969	55	(11)	10,013
Corporate bonds	6,001	60	(15)	6,046
Mortgage-backed securities	7,241	49	(18)	7,272
Total	\$ 32,724	\$ 270	\$ (70)	\$ 32,924
Years to maturity:				
Less than one year	\$ 2,404	\$ 1	\$ (7)	\$ 2,398
One to five years	12,804	139	(29)	12,914
Five to ten years	8,529	76	(9)	8,596
Over ten years	1,746	5	(7)	1,744
Mortgage-backed securities	7,241	49	(18)	7,272
Total	\$ 32,724	\$ 270	\$ (70)	\$ 32,924

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Included in the table above are mortgage-backed securities, which do not have a single maturity date, which are disclosed separately.

The gross unrealized losses and fair value of investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment type and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2008, are as follows:

	As of December 31, 2008					
	Less Than 12 Months		12 Months or Greater		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. government and agency	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political subdivisions	1,854	(61)	147	(23)	2,001	(84)
State and state agency	1,911	(74)	257	(43)	2,168	(117)
Corporate bonds	3,687	(143)	194	(4)	3,881	(147)
Mortgage-backed securities	975	(197)	684	(195)	1,659	(392)
Total temporarily impaired securities	<u>\$ 8,427</u>	<u>\$ (475)</u>	<u>\$ 1,282</u>	<u>\$ (265)</u>	<u>\$ 9,709</u>	<u>\$ (740)</u>

	As of December 31, 2007					
	Less Than 12 Months		12 Months or Greater		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. government and agency	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political subdivision	556	-	1,433	(11)	1,989	(11)
State and state agency	1,251	(9)	2,201	(17)	3,452	(26)
Corporate bonds	666	(13)	578	(2)	1,244	(15)
Mortgage-backed securities	1,833	(15)	314	(3)	2,147	(18)
Total temporarily impaired securities	<u>\$ 4,306</u>	<u>\$ (37)</u>	<u>\$ 4,526</u>	<u>\$ (33)</u>	<u>\$ 8,832</u>	<u>\$ (70)</u>

The unrealized losses on investments in political subdivisions, state and state agency obligations, corporate obligations, and mortgage-backed securities at December 31, 2008, were mainly caused by interest rate increases and not due to unfavorable changes in the credit ratings associated with these securities. The Plan evaluates impairment at each reporting period for each of the securities whereby the fair value of the investment is less than the amortized cost. The Plan evaluated the credit ratings of the state and state agency obligations, political subdivision obligations, and corporate obligations, noting neither a significant deterioration since purchase nor other factors that may indicate an other-than-temporary impairment, such as the length of time and extent to which market value has been less than cost, the financial condition and near-term prospects of the issuer, as well as specific events or circumstances that may influence the operations of the issuer, and our intent and ability to hold the investments for a sufficient time in order to enable recovery of our cost.

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NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

The Company adopted FAS 157 as of January 1, 2008. This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The fair value hierarchy is as follows:

Level 1 — Quoted (unadjusted) prices for identical assets in active markets.

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 non-active markets (few transactions, limited information, non-current prices, high variability over time, etc.);
- Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates, etc.); and
- Inputs that are derived principally from or corroborated by other observable market data.

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

Fair values of available-for-sale debt and equity securities are based on quoted market prices, where available. The Company obtains one price for each security primarily from a third party pricing service (pricing service), which generally uses Level 1 or Level 2 inputs for the determination of fair value in accordance with FAS 157. The pricing service normally derives the security prices through recently reported trades for identical or similar securities, making adjustments through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, non-binding broker quotes, benchmark yields, credit spreads, default rates and prepayment speeds. As the Company is responsible for the determination of fair value, it performs quarterly analyses on the prices received from the pricing service to determine whether the prices are reasonable estimates of fair value. As a result of these reviews, the Company has not historically adjusted the prices obtained from the pricing service.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

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NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

The following table presents information about the fair value of the Company's financial assets at December 31, 2008, according to the valuation techniques the Company used to determine their fair values (in thousands):

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Cash and cash equivalents	\$ 21,712	\$ -	\$ -	\$ 21,712
Debt securities — available-for-sale:				
U.S. government and agency obligations	-	-	-	-
State and state agency	-	5,274	-	5,274
Municipalities and local agency	-	6,976	-	6,976
Corporate bonds	-	6,858	-	6,858
Mortgage-backed securities (a)	-	6,475	-	6,475
Total debt securities — available-for-sale	-	25,583	-	25,583
Total cash, cash equivalents and investments at fair value	<u>\$ 21,712</u>	<u>\$ 25,583</u>	<u>\$ -</u>	<u>\$ 47,295</u>

^(a) Includes agency-backed mortgage pass-through securities.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Cash Equivalents — The carrying value of cash and cash equivalents approximates fair value as maturities are less than three months.

Debt Securities — The estimated fair values of debt securities held as available-for-sale are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices. Fair values of debt securities that do not trade on a regular basis in active markets are classified as Level 2. At December 31, 2008, all debt securities were classified as Level 2.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

3. RECEIVABLES

Receivables from third parties at December 31, 2008 and 2007, consist of the following:

	2008	2007
AHCCCS receivables:		
Capitation	\$ 374,063	\$ 30,000
Reinsurance — net of allowance of \$2,805,882 and \$2,935,225 at December 31, 2008 and 2007, respectively	1,739,338	3,463,618
Home- and community-based services	<u>-</u>	<u>40,311</u>
Total AHCCCS receivables	2,113,401	3,533,929
Due from providers — net of allowance of \$171,294 and \$0 at December 31, 2008 and 2007, respectively	29,992	-
Interest	<u>240,842</u>	<u>312,529</u>
Total	<u>\$2,384,235</u>	<u>\$3,846,458</u>

4. ASSETS SECURING PERFORMANCE BOND

Pursuant to the contracts with AHCCCS, the Plan is required to provide either a performance bond or a designated substitute security to guarantee performance of the Plan's obligations under the contracts. In May 2002, the Plan (with AHCCCS approval) entered into an agreement to purchase a surety bond to fulfill its contractual obligation with AHCCCS. At December 31, 2008 and 2007, the value of the surety bond was \$17,500,000 and requires no Plan assets to secure this obligation.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

5. CHANGE IN INCURRED CLAIMS

Changes in estimates related to prior years' incurred claims are included in medical services expenses in the current year in the accompanying statements of operations. The following tables disclose paid claims, incurred claims, and the balance in the unpaid claim reserve for the years ended December 31, 2008 and 2007 (in thousands):

	Current Year's Incurred Claims	Prior Years' Incurred Claims	Total
2008			
Beginning-of-year claim reserve	\$ -	\$ (28,963)	\$ (28,963)
Paid claims	130,252	19,547	149,799
End-of-year claim reserve	<u>21,517</u>	<u>536</u>	<u>22,053</u>
Incurred claims	<u>\$ 151,769</u>	<u>\$ (8,880)</u>	<u>\$ 142,889</u>
	Current Year's Incurred Claims	Prior Years' Incurred Claims	Total
2007			
Beginning-of-year claim reserve	\$ -	\$ (30,582)	\$ (30,582)
Paid claims	141,975	21,664	163,639
End-of-year claim reserve	<u>28,111</u>	<u>852</u>	<u>28,963</u>
Incurred claims	<u>\$ 170,086</u>	<u>\$ (8,066)</u>	<u>\$ 162,020</u>

The Plan recognized reinsurance recoveries, net of allowance, of approximately \$6,399,246 in 2008 and \$8,309,000 in 2007 that are not included in the table above. These recoveries represent those claims costs the Plan was reimbursed for by AHCCCS and are presented as a reduction to medical services expense in the accompanying statements of operations.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

6. INCOME TAXES

The components of the provision for income taxes for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Current portion:		
Federal	\$ (329,790)	\$ 2,790,123
State	<u>(3,025)</u>	<u>607,386</u>
Total current portion	<u>(332,815)</u>	<u>3,397,509</u>
Deferred portion:		
Federal	23,362	(476,882)
State	<u>(3,133)</u>	<u>(98,825)</u>
Total deferred portion	<u>20,229</u>	<u>(575,707)</u>
Total income tax (benefit) provision	<u>\$ (312,586)</u>	<u>\$ 2,821,802</u>

The reconciliation of the tax provision at the U.S. federal statutory rate to the provision for income taxes for the years ended December 31, 2008 and 2007, is as follows:

	2008	2007
Income tax at the federal statutory rate of 35%	\$ (81,335)	\$ 2,551,962
State income taxes — net of federal tax benefit	(4,003)	341,203
Tax-exempt interest	(192,920)	(178,407)
Other — net	5,722	107,044
Provision to return adjustment	<u>(40,050)</u>	<u>-</u>
Total income tax (benefit) provision	<u>\$ (312,586)</u>	<u>\$ 2,821,802</u>

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

As of December 31, 2008 and 2007, the components of deferred income tax assets and liabilities are as follows:

	2008	2007
Deferred income tax assets:		
Allowance for bad debt	\$ 1,176,854	\$ 1,160,272
Book over tax capital gain	2,207	2,421
Loss reserve discounting	162,321	205,240
Unrealized loss	<u>108,479</u>	<u>-</u>
Total deferred tax assets	<u>1,449,861</u>	<u>1,367,933</u>
Deferred income tax liabilities:		
Bond discount accrual	(5,263)	(6,670)
Other items	(18,599)	(23,516)
Unrealized gain	<u>(1,469)</u>	<u>-</u>
Total deferred tax liabilities	<u>(25,331)</u>	<u>(30,186)</u>
Net deferred income tax assets	<u>\$ 1,424,530</u>	<u>\$ 1,337,747</u>

The Plan's operations are included in the consolidated federal income tax return of UnitedHealth Group. Federal income taxes are paid to or refunded by UnitedHealth Group pursuant to the terms of a tax-sharing agreement, approved by the Board of Directors, under which taxes approximate the amount that would have been computed on a separate company basis. Income taxes incurred in the current and prior years will be available for recoupment by the Plan only in the event of future net losses of consolidated UnitedHealth Group. The Plan receives a benefit at the federal rate in the current year for net losses incurred in that year to the extent losses can be utilized in the consolidated federal income tax return of UnitedHealth Group. UnitedHealth Group currently files income tax returns in the United States federal jurisdiction, various states, and foreign jurisdictions. The U.S. Internal Revenue Service (IRS) has completed exams on UnitedHealth Group's consolidated income tax returns for fiscal years 2007 and prior. UnitedHealth Group's 2008 tax return is under advance review by the IRS under its Compliance Assurance Program. With the exception of a few states, UnitedHealth Group is no longer subject to income tax examinations prior to 2002 in major state and foreign jurisdictions. The Plan does not believe any adjustments that may result from these examinations will be material to the Plan.

The Plan accounts for uncertain income tax positions in accordance with the provisions of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*. Under the guidance of FIN No. 48, the Plan may recognize the tax benefit from an uncertain tax position only if it is more likely than not to be sustained upon examination, based on the technical merits of the position. The Plan has not included a reconciliation of the beginning and ending amount of unrecognized tax benefits as it does not have any uncertain tax positions as of December 31, 2008.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Federal income taxes recoverable of \$515,306 and \$3,028,141 as of December 31, 2008 and 2007, respectively, are included in the related-party receivable account. State income taxes receivable of \$48,869 as of December 31, 2008 and payable of \$539,769 as of December 31, 2007, are included in the related-party receivable account.

Federal and state income taxes received, net of payments, in 2008 was \$2,257,011 and federal and state income taxes paid, net of refunds, in 2007 was \$4,571,558.

7. RELATED-PARTY TRANSACTIONS

Balances with related parties at and for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
UnitedHealth Group Incorporated:		
Tax receivables - federal and state	\$ 564,175	\$ 2,488,372
Lifemark (now part of Ovations, Inc.):		
Management fees payable	-	(1,701,729)
Other payables	-	(611,675)
United HealthCare Services, Inc.:		
Management fees payable	(1,461,126)	-
Other payables	(505,291)	(2,450)
Other receivables	226,992	-
UnitedHealth Insurance Company :		
Medical expense payable	<u>(168,230)</u>	<u>-</u>
Net related-party (payable) receivable	<u>\$ (1,343,480)</u>	<u>\$ 172,518</u>

The Plan has a management agreement with UHS to perform substantially all of the administration of the Plan. Prior to 2008, this agreement was with Lifemark. UHS is responsible for all equipment, furniture, and computer hardware and software expenses associated with the administration of the Plan. The Plan is responsible for its own legal, actuarial, and audit fees; fees for consultants (marketing) not authorized by UHS in connection with its management of the Plan; premiums for insurance coverage for professional liability, life, directors and officers, and errors and omissions liability; board of directors fees; and any other expenses such as banking or investment fees that are clearly related to the business of the Plan as an independent corporate entity. Operations of the Plan may not be indicative of those that would have occurred if it had operated as an independent company.

The Plan has an agreement with Evercare Hospice, Inc., a corporation under common control, to provide hospice services to qualified members for those services it is registered with AHCCCS to provide and bills the Plan on a monthly basis.

EVERCARE OF ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

The Plan has an agreement with UHS to provide administrative services related to pharmacy management and claims processing for its enrollees. Additionally, UHS collects rebates on certain pharmaceutical products and remits the rebates to the Plan based on the Plan's member utilization. Management fees related to this agreement are collected through the UHS arrangement.

8. DIVIDENDS AND CAPITAL CONTRIBUTIONS

The Plan had no dividend distribution or capital contributions for the year ending December 31, 2008. On October 30, 2007, the Plan paid an ordinary dividend in the amount of \$10,000,000 to Lifemark (now Ovations, Inc.).

9. CONTINGENCIES

Because of the nature of its business, the Plan is routinely made party to a variety of legal actions related to the design and management of our service offerings. The Plan records liabilities for estimates of probable costs resulting from these matters. These matters include, but are not limited to, claims relating to health care benefits coverage, medical malpractice actions, contract disputes, and claims related to disclosure of certain business practices. Although the outcomes of any such legal actions cannot be predicted, in the opinion of management, the resolution of any currently pending or threatened actions will not have a material adverse effect upon the Plan's financial position or results of operations.

10. SUBSEQUENT EVENTS

There are no events subsequent to December 31, 2008, that require disclosure.

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