Consolidated Financial Statements and Consolidating Financial Information

The Detroit Medical Center and Subsidiaries
Years Ended December 31, 2006 and 2005
With Report of Independent Auditors

0610-0779311

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Contents

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Report of Independent Auditors

The Board of Trustees
The Detroit Medical Center

We have audited the accompanying consolidated balance sheets of The Detroit Medical Center and subsidiaries (The DMC) as of December 31, 2006 and 2005, and the related consolidated statements of operations and changes in net assets (deficit), and cash flows for the years then ended. These financial statements are the responsibility of The DMC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of The DMC's 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 DMC'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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Detroit Medical Center and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and changes in net assets (deficit), and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

May 24, 2007

The Detroit Medical Center and Subsidiaries

Consolidated Balance Sheets

	December 31 2006	December 31 2005
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 23,791	$ 64,771
Net patient accounts receivable *(Note 3)*	98,806	85,248
Estimated third-party payor settlements *(Note 3)*	19,906	19,306
Other accounts receivable	28,349	35,200
Current portion of assets whose use is limited or restricted	8,009	4,609
Supplies	21,610	20,508
Prepaid expenses and other	30,336	28,755
Total current assets	230,807	258,397
Assets whose use is limited or restricted, less current portion *(Note 4)*:		
Board-designated funds for capital improvements	34,604	31,819
Board-designated funds for specific purposes	75,339	67,087
Professional liability funds	197,214	173,365
Funds held in trust under bond agreements *(Note 7)*	34,949	36,772
Endowment funds	59,183	59,555
Pledges receivable	16,338	14,265
Donor restricted funds	89,742	77,280
	507,369	460,143
Property and equipment, net *(Note 2)*	484,119	491,705
Other noncurrent assets *(Note 2)*	30,076	33,492
Total assets	$ 1,252,371	$ 1,243,737

	December 31	
	2006	2005
	(In Thousands)	
Liabilities and net assets (deficit)		
Current liabilities:		
Accounts payable and accrued expenses	**$ 179,254**	$ 183,852
Accrued compensation and related amounts	**51,726**	51,297
Estimated third-party payor settlements *(Note 3)*	**20,627**	19,732
Advance payment from third-party payor	**47,730**	25,658
Current portion of long-term debt *(Note 7)*	**23,018**	21,137
Current portion of accrued retirement liability *(Note 9)*	**33,831**	55,714
Current portion of accrued professional liability losses *(Note 8)*	**24,897**	20,901
Total current liabilities	**381,083**	378,291
Other liabilities:		
Long-term debt, less current portion *(Note 7)*	**553,076**	557,195
Other noncurrent liabilities, less current portion *(Notes 2, 8, 9, and 10)*	**260,669**	371,589
Total other liabilities	**813,745**	928,784
Total liabilities	**1,194,828**	1,307,075
Net assets (deficit):		
Unrestricted:		
Operations	**(40,186)**	(85,876)
Additional minimum pension liability	**(67,532)**	(128,573)
	(107,718)	(214,449)
Temporarily restricted	**100,511**	85,803
Permanently restricted	**64,750**	65,308
Total net assets (deficit)	**57,543**	(63,338)
Total liabilities and net assets (deficit)	**$ 1,252,371**	$ 1,243,737

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (Deficit)

	Year Ended December 31	
	2006	**2005**
	(In Thousands)	
Unrestricted revenue and other support		
Net patient service revenue *(Note 3)*	$ 1,688,752	$ 1,854,911
Revenue from services and facility agreements *(Note 14)*	68,292	6,676
Other revenue	75,015	55,643
Net assets released from restrictions for operations	11,492	10,697
Total unrestricted revenue and other support	1,843,551	1,927,927
Expenses		
Salaries, wages, and benefits	716,406	734,918
Services, supplies, and other *(Note 13)*	724,033	734,156
Provision for uncollectible accounts	243,293	291,576
Professional liability insurance *(Note 8)*	21,149	45,703
Interest	34,763	34,099
Depreciation and amortization	77,088	73,990
	1,816,732	1,914,442
Income from operations before impairment charge	26,819	13,485
Impairment charge	(3,998)	–
Income from operations	22,821	13,485
Other nonoperating income:		
Net gain on transfer of cancer services assets *(Note 14)*	–	2,086
Gain on sale of interest in joint venture	3,087	–
Investment income and other	8,364	529
Excess of revenue over expenses	34,272	16,100

Continued on next page.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (Deficit) (continued)

	Year Ended December 31 2006	2005
	(In Thousands)	
Unrestricted net assets		
Excess of revenue over expenses	$ 34,272	$ 16,100
Discontinued operations	–	106
Change in unrealized gain in fair value of investments	6,603	(2,980)
Net assets released from restrictions for long-lived assets	5,302	7,908
Change in additional minimum pension liability	61,041	21,713
Other changes	(487)	12
Increase in unrestricted net assets	106,731	42,859
Temporarily restricted net assets		
Contributions	14,811	13,475
Investment income	15,170	8,006
Change in unrealized gain in fair value of investments	2,359	178
Net assets released from restrictions for long-lived assets	(5,302)	(7,908)
Net assets released from restrictions for operations	(11,492)	(10,697)
Other changes	(838)	(856)
Increase in temporarily restricted net assets	14,708	2,198
Permanently restricted net assets		
Contributions	111	(788)
Other changes	(669)	(792)
Decrease in permanently restricted net assets	(558)	(1,580)
Increase in net assets	120,881	43,477
Net assets (deficit) at beginning of year	(63,338)	(106,815)
Net assets (deficit) at end of year	$ 57,543	$ (63,338)

See accompanying notes.

The Detroit Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2006	2005
	(In Thousands)	
Operating activities		
Increase in net assets	$ 120,881	$ 43,477
Adjustments to reconcile increase in net assets to cash provided by operating activities:		
Depreciation and amortization	77,088	73,990
Provision for uncollectible accounts	243,293	291,576
Gain on sale of assets	–	(2,086)
Gain on sale of joint venture interest	(3,089)	–
Additional minimum pension liability *(Note 9)*	(61,041)	(21,713)
Impairment charge	3,998	–
Change in net unrealized gain in fair value of investments	(8,962)	2,802
Changes in operating assets and liabilities:		
Patient accounts receivable	(256,851)	(265,638)
Estimated third party payor settlements	(600)	1,403
Other current assets	4,168	(12,480)
Accounts payable and accrued expenses	(4,598)	5,008
Other current liabilities	429	5,334
Due to third-party payors	895	(19,369)
Advance from third-party payor	22,072	805
Accrued retirement liability	(65,488)	(19,974)
Accrued unfunded professional liability losses	(19,367)	(5,750)
Other operating activities	(3,260)	(3,661)
Cash provided by operating activities	49,568	73,724
Investing activities		
Purchase of property and equipment	(49,840)	(59,610)
Proceeds from sale of assets	–	9,910
Proceeds from sale of joint venture interest	3,089	–
Increase in assets whose use is limited or restricted, excluding professional liability funds	(22,035)	(6,342)
Other investing activities	315	1,320
Cash used in investing activities	(68,471)	(54,722)
Financing activities		
Borrowings on line of credit	290,340	–
Repayments on line of credit	(290,340)	–
Repayment of long-term debt	(22,077)	(17,256)
Cash used in financing activities	(22,077)	(17,256)
(Decrease) increase in cash and cash equivalents	(40,980)	1,746
Cash and cash equivalents at beginning of year	64,771	63,025
Cash and cash equivalents at end of year	$ 23,791	$ 64,771

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

The Detroit Medical Center, a parent holding company, and its subsidiaries (jointly The DMC) are major providers of health care services to residents of the Detroit metropolitan area. The DMC constitutes the academic health center of Wayne State University, and works with the University to integrate clinical services, education, and research.

The consolidated financial statements of The DMC include The Detroit Medical Center and the corporations listed below, as well as their subsidiaries:

Associated Hospitals Processing Facility
Berry Center, LLC
Children's Hospital of Michigan [(A)]
Children's Choice of Michigan
DMC Insurance Co., Ltd. (see *Note 8*)
DMC Nursing Homes, Inc.
DMC Physician Group
Detroit Receiving Hospital and University Health Center (Detroit Receiving) [(A)]
Harper-Hutzel Hospital [(A)]
HealthSource
Huron Valley–Sinai Hospital, Inc. [(A)]
Radius Health Care System, Inc.
Rehabilitation Institute of Michigan [(A)]
Sinai-Grace Hospital [(A)]

[(A)] Members of The Detroit Medical Center Obligated Group (see *Note 7*).

These corporations consist of both membership and stock corporations, the sole member or majority stockholder of which is The Detroit Medical Center. Such corporations are referred to herein as the subsidiaries of The DMC. The consolidated financial statements include the accounts of The Detroit Medical Center and all majority-owned subsidiaries.

The DMC has an investment in and accounts for CareTech Corporation using the equity method of accounting. All significant intercompany account balances and transactions have been eliminated in consolidation.

1. Organization and Significant Accounting Policies (continued)

Mission

The DMC is committed to improving the health of the population served by providing the highest quality health care services in a caring and efficient manner without invidious discrimination, regardless of the person's religion, race, gender, ethnic identification, or economic status. Together with Wayne State University, The DMC strives to be the region's premier health care resource through a broad range of clinical services; the discovery and application of new knowledge; and the education of practitioners, teachers, and scientists.

As part of its public mission as the safety net health care provider in Southeast Michigan, The DMC writes off forgone charges associated with providing services to uninsured patients. This public mission support is determined by isolating the amount of bad debts originating from care to uninsured patients less any monies received by The DMC from third parties (Medicare, Medicaid, and Blue Cross) as a qualified disproportionate share hospital (DSH). The DMC also considers payments remitted to Wayne State University faculty physicians as recognition of care provided by such physicians to the uninsured population.

Cash and Cash Equivalents

The DMC considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments

Investments in equity securities with readily determined fair values and all investments in debt securities are classified as nontrading and are measured at fair value using quoted market prices. Realized gains and losses recorded using the average cost method, including losses considered to be other-than-temporary, are included in excess of revenue over expenses. Unrealized gains and losses determined to be temporary are recorded as an addition to or deduction from net assets.

The estimated fair value of certain limited partnerships, such as private equity investments and hedge funds are based on valuations provided by the investment managers at December 31, 2006 and 2005. The components of the individual investments within these funds are not readily marketable, their estimated value is subject to uncertainty and may differ from the value that would have been used had a ready market for such investments existed. Such a difference could be material. Alterntaive investments have liquidity restrictions. Amounts can be divtesed only at specified times based on terms in the partnership agreements.

1. Organization and Significant Accounting Policies (continued)

The DMC reviews investments for impairment conditions that indicate that an other-than-temporary decline in market value has occurred. In conducting this review, various factors are considered which, individually or in combination, indicate that a decline in investment value is other than temporary and that a reduction of the carrying value should be recorded in the statement of operations. These factors include specific information pertaining to an individual company or a particular industry and general market conditions.

Patient Service Revenue and Receivables

The majority of The DMC's services are reimbursed under fixed price provisions of third-party payment programs (primarily Medicare, Medicaid, and Blue Cross and Blue Shield of Michigan). Under these provisions, payment rates for patient care are determined prospectively on various bases and The DMC's revenues are limited to such amounts. Payments are also received from third parties for The DMC's capital and medical education costs, subject to certain limits. Additionally, The DMC has entered into agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined per diem rates, capitation agreements, and discounts from established charges.

Net patient service revenue is reported at the estimated net realizable amounts to be received from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period related services are rendered and adjusted in future periods as final settlements are determined. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes that adequate provision has been made in the consolidated financial statements for any adjustments that may result from final settlements.

The DMC receives payments from the state Medicaid program related to support of the DMC's indigent patient volume. The payments are recognized ratably as revenue over the period of support determined by the State.

1. Organization and Significant Accounting Policies (continued)

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 22% in 2006, respectively, and 23% and 21% in 2005, respectively, of net patient service revenues. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations is subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

In the normal course of business, The DMC has received requests for information from governmental agencies covering services provided. Management intends to fully cooperate with the governmental agencies in its request for information and believes that adequate provision has been made for any adjustments that may result from settlements.

The provision for bad debts is based upon management's assessment of expected net collections and considers business and economic conditions, trends in health care coverage and other collection indicators including historical write-off experience by payor category. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible receivables. After receipt of amounts due from insurance, The DMC follows established guidelines for placing certain past due patient balances with collection agencies.

Supplies

Supplies represent medical supplies which are stated at the lower of cost or market. Cost is determined based on the first-in, first out method.

Property and Equipment

Property and equipment, including amounts under capital leases, are stated at cost or estimated fair value at the date of donation, and are depreciated by the straight-line method over their estimated useful lives. The estimated useful lives for assets ranges from 3 years to 40 years.

1. Organization and Significant Accounting Policies (continued)

In 2006, the DMC evaluated its obligations in connection with FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), which clarifies the term "conditional asset retirement obligation' as used in FASB Statement 143, *Accounting for Asset Retirement Obligations* (FASB 143). FIN 47 states that the obligation to perform an asset retirement activity is unconditional if there is a legal obligation to perform the retirement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be estimated. Because there are no current plans requiring remediation giving rise to an asset retirement obligation and a settlement date has not been specified by others, management believes that sufficient information is not available to record an asset retirement obligation.

Other Noncurrent Assets

Other noncurrent assets include deferred debt issuance costs which are amortized ratably over the terms of the related debt issues using a method that approximates the interest method. Other intangible assets are amortized by the straight-line method over a ten-year period (see Note 2).

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific purpose, such as capital additions or research. When a donor restriction is satisfied, such as through expenditure for the restricted purpose, temporarily restricted net assets are reclassified as net assets released from restrictions for either operating purposes or for long-lived assets and are included in unrestricted revenues and other support, or as an other increase in unrestricted net assets, respectively. Pledges are recorded as increases in temporarily restricted net assets when the pledge is made.

Permanently restricted net assets have been restricted by the donors to be maintained by The DMC in perpetuity, the income therefrom to be used in accordance with any restrictions by the donor.

1. Organization and Significant Accounting Policies (continued)

Excess of Revenue Over Expenses

The statement of operations and changes in net assets includes the excess of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments (except those deemed to be other than temporary), additional minimum pension liability, results of discontinued operations, and net assets released from restrictions for the purchase of long-lived assets.

The excess of revenue over expenses for the year ended December 31, 2006, includes favorable changes in estimate related to prior periods of $22,325,000 related to the settlement of fiscal years 1997 to 2005 cost reports for the Medicare, Medicaid, and Blue Cross programs which were recognized during 2006. Cost report settlements are recognized as an increase in net patient service revenue.

The excess of revenue over expenses for the year ended December 31, 2005, includes net favorable changes in estimate related to prior periods of $9,654,000. This amount includes $47,812,000 of favorable changes in estimate related to the settlement of fiscal years 1997 to 2004 cost reports for the Medicare, Medicaid, and Blue Cross programs which were recognized during 2005. Cost report settlements are recognized as an increase in net patient service revenue. The DMC also recognized additional bad debt expense during 2005 of $31,306,000 related to services provided prior to January 1, 2005. In addition, the excess of revenue over expenses for the year ended December 31, 2005, includes changes in estimates for various operating expenses of approximately $6,852,000, which includes adjustments to the professional liability accruals and certain purchased services expenses.

Charity Care

The DMC provides health care services free of charge or at reduced rates to individuals who meet certain eligibility criteria, based on published Income Poverty Guidelines. Charity care may also be provided to other patients at the discretion of the management of the hospital providing the care.

1. Organization and Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

In accordance with the Financial Accounting Standards Board (FASB) Statement No. 144, *Accounting for the Impairment of Long-Lived Assets*, The DMC performs an evaluation of impairment losses on long-lived assets used in operations when events and circumstances indicate that long-lived assets might be impaired. If the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets, an impairment charge is recorded and the amount of the impairment is determined based on the fair market value of the asset.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

The Detroit Medical Center, each of its hospital subsidiaries and certain of its other subsidiaries are nonprofit corporations, exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Radius Health Care System, Inc. is a for-profit corporation, which has net operating loss carryforwards that are available to offset its future taxable income. The DMC uses the liability method of accounting for income taxes under which deferred taxes are determined based on the differences between financial statement and tax bases of assets and liabilities, using current tax rates. The DMC has recorded a valuation allowance equal to the deferred tax asset associated with the net operating loss carryforwards, as such amounts are not considered recoverable.

1. Organization and Significant Accounting Policies (continued)

New Pronouncements

On September 29, 2006 the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132-(R)* (Statement 158). The new standard applies to all plan sponsors who offer defined benefit postretirement benefit plans. Statement 158 requires an entity to recognize in its balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in changes in unrestricted net assets in the year in which the changes occur.

Statement 158 does not change the amount of net periodic benefit cost included in excess of revenue over expenses or address the various measurement issues associated with postretirement benefit plan accounting. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements are effective for the year ending December 31, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end balance sheet is effective for the year ending December 31, 2008.

Reclassification

Certain 2005 amounts have been reclassified to conform with the 2006 presentation.

2. Additional Balance Sheet Information

	December 31	
	2006	2005
	(In Thousands)	
Property and equipment:		
Land and land improvements	$ 9,646	$ 9,628
Buildings and improvements	800,694	786,264
Equipment	1,067,422	995,351
Construction in progress	11,885	32,422
	1,889,647	1,823,665
Accumulated depreciation	(1,405,528)	(1,331,960)
	$ 484,119	$ 491,705

2. Additional Balance Sheet Information (continued)

	December 31 2006	December 31 2005
	(In Thousands)	
Other noncurrent assets:		
Goodwill and other intangible assets	$ 11,441	$ 10,699
Accumulated amortization	(9,318)	(6,224)
	2,123	4,475
Deferred debt issuance costs, net of accumulated amortization	11,204	12,045
Investment held for deferred compensation	1,681	1,452
Investment in unconsolidated affiliates	7,675	5,892
Other	7,393	9,628
	$ 30,076	$ 33,492
Other noncurrent liabilities, less current portion:		
Accrued professional liability losses	$ 182,451	$ 186,185
Accrued retirement liability	31,747	136,393
Other postretirement liability	14,767	15,053
Deferred compensation liability	1,681	1,452
Minority interest in Berry Center, LLC	640	640
Other	29,383	31,866
	$ 260,669	$ 371,589

3. Net Patient Service Revenue and Accounts Receivable

Net patient service revenue consists of the following:

	Year Ended December 31 2006	2005
	(In Thousands)	
Gross revenue from services to patients	$ 3,625,588	$ 4,077,344
Contractual adjustments	(1,959,161)	(2,270,245)
Changes in estimate related to favorable prior year third-party payor settlements	22,325	47,812
Net patient service revenue	$ 1,688,752	$ 1,854,911

Net patient accounts receivable consists of the following:

	December 31 2006	2005
	(In Thousands)	
Gross patient accounts receivable	$ 488,387	$ 582,883
Allowances and advances under contractual arrangements	(334,113)	(403,298)
Allowance for uncollectible accounts	(55,468)	(94,337)
	$ 98,806	$ 85,248

The DMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Significant concentrations of accounts receivable at December 31, 2006 and 2005, include net amounts due from Medicare (19% and 18%), Medicaid (12% and 12%), Blue Cross (14% and 17%), and other payors, (55% and 53%), respectively.

4. Investments

Investments and cash and cash equivalents are summarized as follows:

	December 31 2006	December 31 2005
	(In Thousands)	
Cash and cash equivalents	$ 112,028	$ 161,236
United States government and Foreign obligations	106,943	113,123
Corporate bonds	67,839	55,466
Common stock	202,975	182,929
Limited partnerships	31,937	–
Other	1,109	2,504
	$ 522,831	$ 515,258

Over the past several years, the public equity markets have experienced changes which impacted the investment portfolio held by The DMC. Management continually reviews the investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are general market conditions, the issuer's financial condition and near-term prospect, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost. During the years ended December 31, 2006 and 2005, The DMC recorded a realized loss for other-than temporary declines in the fair value of investments of approximately $262,000 and $760,000, respectively, of which $262,000 and $366,000, respectively, is included in other non-operating income and $0 and $394,000, respectively, is included in investment income on temporarily restricted net assets in the accompanying statements of operations and changes in net assets.

The gross unrealized gains (losses) on investments were $41,483,000 and $(3,581,000) at December 31, 2006, and $33,244,000 and $(4,304,000) at December 31, 2005. The following tables summarize the fair value of investments that have gross unrealized gains (the amount by which fair value exceeds historical cost) and gross unrealized losses (the amount by which historical cost exceeds fair value) as of December 31, 2006 and 2005. The tables further segregate the securities that have been in a gross unrealized gain or loss position as of December 31, 2006 and 2005, for less than 12 months and those for 12 months or more. The gross unrealized losses of less than 12 months of $(2,302,000) at December 31, 2006, are a reflection of the normal fluctuation of the stock market and are therefore considered temporary. The gross unrealized losses of 12 months or longer of $(1,279,000) at December 31, 2006, represents an average 3.6% decline in fair value below cost. The decline in value is assessed by management to be temporary based on their assessment of projected recoveries in 2007.

4. Investments (continued)

The following tables summarize the unrealized gains and losses on investments held at December 31, 2006 and 2005:

	December 31, 2006					
	Less Than 12 Months		Greater Than 12 Months		Total	
Description of Securities	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)
	(In Thousands)					
Investments in loss position:						
Government obligations	$ 32,539	$ (293)	$ 25,160	$ (832)	$ 57,699	$ (1,125)
Corporate bonds	23,286	(122)	6,636	(152)	29,922	(274)
Subtotal, debt securities	55,825	(415)	31,796	(984)	87,621	(1,399)
Cash and equivalents	12,976	(473)	–	–	12,976	(473)
Common stock	15,582	(1,137)	1,901	(295)	17,483	(1,432)
Other investments	(280)	(277)	–	–	(280)	(277)
Total investments in loss position	84,103	(2,302)	33,697	(1,279)	117,800	(3,581)
Investments in gain position:						
Government obligations	23,332	373	25,912	1,476	49,244	1,849
Corporate bonds	24,095	565	13,822	1,216	37,917	1,781
Subtotal, debt securities	47,427	938	39,734	2,692	87,161	3,630
Cash and equivalents	86,301	380	12,751	384	99,052	764
Common stock	68,353	7,097	117,139	29,676	185,492	36,773
Limited partnerships	28,548	–	3,389	–	31,937	–
Other investments	134	251	1,255	65	1,389	316
Total investments in gain position	230,763	8,666	174,268	32,817	405,031	41,483
Totals	$ 314,866	$ 6,364	$ 207,965	$ 31,538	$ 522,831	$ 37,902

4. Investments (continued)

	December 31, 2005					
	Less Than 12 Months		Greater Than 12 Months		Total	
Description of Securities	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)	Fair Value	Unrealized Gains (Losses)
			(In Thousands)			
Investments in loss position:						
Government obligations	$ 48,733	$ (910)	$ 10,763	$ (601)	$ 59,496	$ (1,511)
Corporate bonds	21,988	(557)	3,160	(330)	25,148	(887)
Subtotal, debt securities	70,721	(1,467)	13,923	(931)	84,644	(2,398)
Cash and equivalents	152	(1)	–	–	152	(1)
Common stock	17,517	(1,739)	1,015	(166)	18,532	(1,905)
Other investments	–	–	–	–	–	–
Total investments in loss position	88,390	(3,207)	14,938	(1,097)	103,328	(4,304)
Investments in gain position:						
Government obligations	21,398	199	32,229	1,795	53,627	1,994
Corporate bonds	18,730	350	11,588	958	30,318	1,308
Subtotal, debt securities	40,128	549	43,817	2,753	83,945	3,302
Cash and equivalents	160,801	51	283	1	161,084	52
Common stock	48,998	4,859	115,399	24,899	164,397	29,758
Other investments	–	–	2,504	132	2,504	132
Total investments in gain position	249,927	5,459	162,003	27,785	411,930	33,244
Totals	$ 338,317	$ 2,252	$ 176,941	$ 26,688	$ 515,258	$ 28,940

Investment return is summarized as follows:

	Year Ended December 31	
	2006	2005
	(In Thousands)	
Interest and dividends	$ 4,197	$ 5,342
Net realized gains	29,342	11,931
Other than temporary loss on investments	(262)	(366)
Change in net unrealized gain	8,962	(2,802)
Total investment income	$ 42,239	$ 14,105
Included in other revenue	$ 14,034	$ 7,813
Included in other nonoperating income	4,073	1,088
Reported separately as change in unrealized gain	6,603	(2,980)
	24,710	5,921
Included in temporarily restricted investment income	15,170	8,006
Included in temporarily restricted unrealized gain	2,359	178
Total investment income	$ 42,239	$ 14,105

4. Investments (continued)

Investment return, excluding unrealized gains and losses, on board designated funds for capital improvements is included in other nonoperating income. All other investment return, excluding unrealized gains and losses in fair value of investments, which is not restricted by explicit donor stipulations, is included in other revenue. Investment return on limited partnerships is included in the realized gain/loss amount.

5. Fair Value of Financial Instruments

The following methods and assumptions were used in estimating fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts in the balance sheet for cash and cash equivalents approximate fair value.

Assets whose use is limited: The fair values for marketable debt and equity securities, including assets whose use is limited or restricted, are based on quoted market prices.

Long-term debt: The fair values for long-term debt are estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

The carrying amounts and fair values of cash and cash equivalents and assets whose use is limited or restricted are as follows:

	December 31	
	2006	**2005**
	(In Thousands)	
Cash and cash equivalents	$ 23,791	$ 64,771
Current portion of assets whose use is limited	8,009	4,609
Assets whose use is limited or restricted, less current portion	491,031	445,878

5. Fair Value of Financial Instruments (continued)

The carrying amount and fair value of long-term debt are as follows:

	December 31	
	2006	2005
	(In Thousands)	
Carrying amount	$ 534,480	$ 548,687
Fair value	549,260	583,608

6. Credit Agreement

Under the terms of the amended and restated credit agreement between The DMC and GE Capital, The DMC has liquidity available of up to $60,000,000 based on eligible accounts receivable which is determined based on net accounts receivable which are less than 120 days old reduced by third-party advances and allowances for uncollectible accounts. The credit agreement, which expires June 30, 2007, is secured by eligible accounts receivable. Under the terms of the credit agreement, The DMC is required to have days in accounts receivable less than 97 days, maintain liquidity of $50,000,000 on a monthly basis and average liquidity of $65,000,000 for the preceding three month period, and achieve defined cash flow ratios. Interest on borrowings is based on the current LIBOR plus 2.25% (7.6% at December 31, 2006). In addition, The DMC is charged an unused facility fee equal to 0.375% of the unused liquidity facility. At December 31, 2006 and 2005, The DMC had no outstanding balance under the credit agreement; the credit agreement was not utilized during the year ended 2005.

On May 7, 2007, the DMC and GE Capital executed an amended and restated credit agreement. Under the amended terms of the credit agreement, the DMC has liquidity available of up to $60,000,000 based on eligible accounts receivable which is determined based on net accounts receivable which are less than 120 days old reduced by third-party advances and allowances for doubtful accounts. The DMC has the ability to increase the available liquidity up to $80,000,000 based on eligible accounts receivable. The credit agreement, which expires June 30, 2010, is secured by eligible accounts receivable. Under the terms of the credit agreement, the DMC is required to have days in accounts receivable less than 97 days, maintain liquidity of $50,000,000 on a monthly basis and average liquidity of $65,000,000 for the preceding three month period, and maintain a fixed charge coverage ratio. Interest on borrowings can either be fixed or floating subject to monthly adjustments. In addition, the DMC is charged an unused facility fee equal to .25% of the unused liquidity facility.

7. Long-Term Debt and Leases

Long-term debt consists of the following:

	December 31	
	2006	**2005**
	(In Thousands)	
Michigan State Hospital Finance Authority (MSHFA) bonds:		
Series 1988A and 1988B, interest at 8.125%, due 2010	**$ 2,575**	$ 2,575
Series 1993A, interest at 6.25% to 6.5%, due 2018	**108,820**	108,820
Series 1993B, interest at 5.10% to 5.75%, due 2023	**110,785**	117,073
Series 1995, interest at 6.0% to 6.7%, due 2026	**35,635**	37,230
Series 1997A, interest at 5.0% to 5.5%, due 2027	**159,236**	162,890
Series 1998A, interest at 5.0% to 5.25%, due 2028	**108,650**	108,650
Obligations under capital leases	**41,614**	29,645
Notes payable and other obligations	**8,779**	11,449
	576,094	578,332
Less current portion	**23,018**	21,137
	$ 553,076	$ 557,195

The Detroit Medical Center and its hospital subsidiaries are members of The Detroit Medical Center Obligated Group, which was created under a Master Indenture and Security Agreement. In addition, The Detroit Medical Center and its hospital subsidiaries became part of Sinai Hospital Obligated Group, which was created under a separate Master Indenture, which also became known as The Detroit Medical Center Obligated Group subsequent to the 1997 acquisition of Sinai Hospital by The DMC. Collectively these Master Indentures are referred to as "Master Indentures." The Master Indentures provide that each member of the Obligated Group is jointly and severally liable for obligations issued thereunder. The Detroit Medical Center serves as Obligated Group Agent.

The MSHFA bonds are tax-exempt revenue bonds secured by obligations issued under the Master Indenture, which the Obligated Group must repay under loan agreements with MSHFA. The bonds mature in annual amounts through 2028, ranging in the aggregate from $12,185,000 in 2007 to $37,585,000 in 2028.

7. Long-Term Debt and Leases (continued)

On June 29 and June 30, 2004, The DMC entered into Forbearance Agreements with the trustees under the Master Indentures as a result of not achieving the required debt service coverage ratio for the year ended December 31, 2003. Under the terms of the Forbearance Agreements, the trustees have agreed to forbear their right to exercise any rights or remedies related to the failure to meet the debt service coverage ratio. The Forbearance Agreements require The DMC to maintain a debt service coverage ratio computed on an annualized basis of 1.2, maintain liquidity of $65,000,000 and 15 days cash on hand, and provide quarterly compliance certificates. The DMC is required to comply with such covenants until The DMC complies with the covenants for any consecutive three-year period, and no event of default occurs during such period, however these covenants do not extend beyond June 30, 2009. If The DMC is unable to meet the provisions of the Forbearance Agreements, The DMC will be required to retain a consultant, acceptable to the trustee within 60 days. If The DMC fails to comply with the material recommendations of the consultant, or if the debt service coverage ratio falls below 1.00, the trustees may, by written notice to The DMC, declare an immediate event of default under the Master Indentures.

Portions of the proceeds of the Series 1988A, 1988B, 1993A, 1993B, and 1995 Bonds, as well as the Series 1997A Bonds, were deposited into escrow funds to advance refund previously issued hospital revenue bonds. The principal outstanding under all of these previous issues, amounting to $8,945,000 at December 31, 2006, is considered to be extinguished for financial reporting purposes and will be paid from the escrow funds.

Interest paid was $33,720,000 in 2006 and $33,622,000 in 2005. In addition, The DMC capitalized interest of $281,000 in 2006.

The cost and accumulated depreciation for assets under capital lease were $49,063,000 and $17,419,000 at December 31, 2006, and $38,557,000 and $11,452,000 at December 31, 2005.

7. Long-Term Debt and Leases (continued)

Future maturities of long-term debt and future minimum payments under capital leases are summarized as follows:

	Bonds and Notes Payable	Capital Leases
	(In Thousands)	
2007	$ 14,037	$ 11,876
2008	14,474	11,860
2009	13,875	11,010
2010	14,678	7,215
2011	17,931	2,398
Thereafter	459,485	6,612
	$ 534,480	50,971
Less amounts representing interest		9,357
		$ 41,614

Rent expense incurred under operating noncancellable leases were $17,137,000 in 2006 and $16,894,000 in 2005. The DMC has noncancellable lease commitments at December 31, 2006, as follows:

	(In Thousands)
2007	$ 12,434
2008	11,623
2009	9,512
2010	8,849
2011	8,271

8. Professional and General Liability Claims

The Detroit Medical Center has established an offshore captive insurance company to provide professional and general liability coverage to The Detroit Medical Center, its hospital subsidiaries, certain medical staff members, and other affiliates. A portion of the risk of loss from professional liability claims is retained by some of the subsidiaries. Through March 31, 2004, The DMC acquired excess professional liability and general liability coverage from a captive insurance company in which it holds a minority interest. Effective April 1, 2004, The DMC purchased the excess coverage from the offshore captive owned by The DMC, which in turn reinsured the losses through commercial insurance companies.

The DMC and its affiliates have accrued their best estimate of the ultimate cost of losses payable by the captive insurance company and the retained portion of losses under other insurance arrangements. These estimates include an amount for claims incurred but not reported.

Accrued professional liability losses are recorded at their estimated present value based on discount rates, which average approximately 6.0% in 2006 and 2005. Professional liability expense was $21,149,000 in 2006 and $45,703,000 in 2005.

9. Retirement Benefits

Effective April 2004, The DMC maintains a defined contribution retirement plan for employees. The DMC contributes a fixed percentage of employee salaries to the plan and also matches contributions made by employees to the defined contribution plan during the year. Total expense under the plan was $11,537,000 in 2006 and $10,996,000 in 2005.

The DMC also has a noncontributory defined benefit retirement plan covering substantially all of the employees of The Detroit Medical Center and its subsidiaries hired prior to June 1, 2003. The benefits under the defined benefit plan are based in general on years of service and final average earnings.

In 2003, The DMC announced that benefits provided under the defined benefit retirement plan would be frozen effective June 1, 2003. Management elected to freeze the pension benefits to reduce the expected increase in pension expense subsequent to 2003. A curtailment gain was recognized in 2003 as a result of freezing the pension benefits. In 2005, The DMC recognized a curtailment gain of $11,505,000 related to a change in the amount of benefits for several collective bargaining units in 2005 resulting in a reduction of the projected benefit obligation at December 31, 2005.

9. Retirement Benefits (continued)

The DMC's funding policy for the defined benefit plan is, in general, to fund an amount based on the recommendation of consulting actuaries that is in compliance with the requirements of the Employee Retirement Income Security Act of 1974. On October 4, 2004, The DMC obtained a funding waiver from the Internal Revenue Service to defer the required funding of $10,241,000 for the 2003 plan year. The funding is amortized over a five year period in accordance with the agreement with the Pension Benefit Guaranty Corporation (PBGC). The DMC was required to provide collateral to the PBGC in the form of a $1.5 million Letter of Credit and mortgages on a professional office building and the former Hutzel Hospital building in connection with the funding waiver. The Letter of Credit expires on December 31, 2006, and is subject to annual renewals through 2009.

The following table provides a reconciliation of the changes in the defined benefit plan's benefit obligation and fair value of assets for the years ended December 31, 2006 and 2005, and a statement of the funded status as of December 31, 2006 and 2005.

	Year Ended December 31 2006	2005
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	$ 869,399	$ 886,027
Service cost	118	2,449
Interest cost	49,494	49,675
Actuarial gain	(20,772)	(30,046)
Benefits paid	(29,157)	(27,201)
Curtailment gain	–	(11,505)
Benefit obligation at end of year	869,082	869,399
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	677,276	640,918
Actual gain on plan assets	96,144	41,114
Employer contributions	59,241	22,445
Benefits paid	(29,157)	(27,201)
Fair value of plan assets at end of year	803,504	677,276
Funded status at December 31	(65,578)	(192,123)
Unrecognized net actuarial loss	69,692	131,036
Unrecognized prior service credit	(2,160)	(2,447)
Additional minimum pension liability	(67,532)	(128,573)
Accrued retirement liability	$ (65,578)	$ (192,107)

9. Retirement Benefits (continued)

The accumulated benefit obligation for the defined benefit plans was $869,082,000 and $869,399,000 at December 31, 2006 and 2005, respectively.

Amounts recognized in the statements of financial position consists of:

	December 31 2006	December 31 2005
	(In Thousands)	
Current portion of accrued retirement liability	$ (33,831)	$ (55,714)
Accrued retirement liability	(31,747)	(136,393)
Net accrued retirement liability	$ (65,578)	$ (192,107)

A summary of the components of net pension expense is as follows:

	Year Ended December 31 2006	Year Ended December 31 2005
	(In Thousands)	
Service cost-benefits earned during the period	$ 118	$ 2,449
Interest cost on projected benefit obligation	49,494	49,675
Expected return on assets	(59,183)	(53,295)
Amortization of prior service credit	(287)	(287)
Recognition of actuarial loss	3,611	3,930
Net retirement (credit) expense of defined benefit plan	(6,247)	2,472
Defined contribution plan expense	11,537	10,996
Total retirement expense	$ 5,290	$ 13,468

The assumptions used to determine benefit obligations are as follows:

	December 31 2006	December 31 2005
Discount rate	5.94%	5.88%
Rate of increase in compensations levels	Frozen at 2003 level	Frozen at 2003 level
Measurement date	December 31	December 31

9. Retirement Benefits (continued)

The assumptions used to determine the net periodic benefit cost are as follows:

	Year Ended December 31	
	2006	**2005**
Discount rate	**5.88%**	6.00%
Expected long-term rate of return on assets	**8.50%**	8.50%
Rate of increase in compensation levels	**4.50%**	4.50%

To develop the expected long-term rate of return on assets assumption, The DMC considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

The DMC's pension plan weighted average asset allocations by asset category are as follows:

	December 31	
	2006	**2005**
Asset category:		
Equity securities	**61%**	71%
Fixed income securities	**17%**	20%
Short term securities	**6%**	6%
Limited partnerships	**16%**	3%

The plan assets are invested in separately managed portfolios using investment management firms. The plans' objective is to maximize total return without assuming undue risk exposure. The plan maintains a well-diversified asset allocation that best meets these objectives. Plan assets are largely comprised of equity securities, which include companies with all market capitalization sizes in addition to international and convertible securities. Debt securities include both intermediate and international securities.

Investments in derivative securities are not permitted for the sole purpose of speculating on the direction of market interest rates. Included in this prohibition are leveraging, shorting, swaps, futures, options, forwards, and similar strategies.

9. Retirement Benefits (continued)

In each investment account, investment managers are responsible to monitor and react to economic indicators, such as GDP, CPI, and the Federal Monetary Policy, that may affect the performance of their account. The performance of all managers and the aggregate asset allocation are formally reviewed on a quarterly basis, with a rebalancing of the asset allocation occurring at least once a year. The current asset allocation objective is to maintain 60% of plan assets in equity securities, and 35% in fixed income securities, and 5% in alternative assets with each class allowing for a 10% deviation from the target.

Expected cash flows for the defined benefit retirement plan are as follows:

	Pension Benefits
	(In Thousands)
Expected employer contributions for the year ending December 31:	
2007	$ 33,831
Expected benefit payments for the year ending December 31:	
2007	$ 37,029
2008	39,183
2009	41,929
2010	44,725
2011	47,519
2012–2015	281,615

The expected employer contribution amounts above represent amounts to be paid to the trust and the benefit payment amounts above represent total benefits expected to be paid from the trust.

10. Other Postretirement Employee Benefits

Certain DMC hospitals sponsor defined benefit health care plans for retirees who meet eligibility requirements, and one hospital has committed to continue postretirement health care benefits to certain union employees meeting certain age and service requirements. Additionally, two hospitals provide postretirement life insurance benefits to eligible employees and retirees.

10. Other Postretirement Employee Benefits (continued)

On December 8, 2003, the Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to certain sponsors of postretirement health care benefit plans that provide a prescription drug benefit to their enrollees that is at least actuarially equivalent to Medicare Part D. The DMC's estimate of its postretirement obligation, net periodic postretirement benefit cost, and the corresponding disclosures reflect the effect of the plan.

The following table presents the amounts recognized for all the plans in the consolidated financial statements:

	Year Ended December 31	
	2006	**2005**
	(In Thousands)	
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of year	**$ 30,048**	$ 32,378
Service cost	**1**	1
Interest cost	**1,401**	1,768
Participant contributions	**282**	302
Actuarial gain	**(5,764)**	(1,830)
Benefits paid	**(2,296)**	(2,571)
Benefit obligation at end of year	**23,672**	30,048
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	**3,017**	2,999
Actual return on plan assets	**143**	53
Benefits paid from plan assets	**(37)**	(35)
Fair value of plan assets at end of year	**3,123**	3,017
Funded status at December 31	**(20,549)**	(27,031)
Unrecognized net actuarial loss	**5,523**	11,656
Unrecognized prior service cost	**259**	322
Accrued postretirement liability	**$ (14,767)**	$ (15,053)

10. Other Postretirement Employee Benefits (continued)

Net periodic postretirement benefit cost includes the following components:

	Year Ended December 31 2006	2005
	(In Thousands)	
Service cost	$ 1	$ 1
Interest cost	1,401	1,768
Expected return on assets	(160)	(160)
Amortization of prior service cost	63	63
Amortization of unrecognized net actuarial loss	386	734
Net periodic postretirement benefit cost	$ 1,691	$ 2,406

The weighted-average annual assumed rate of increase in the per capita cost of covered health care benefits (i.e., health care cost trend rate) is 12% for 2006 and is assumed to decrease 1% per year to 5% in 2013 and remain at that level thereafter. The weighted-average discount rate used in determining the accumulated postretirement obligation was 5.94% and 5.88% at December 31, 2006 and 2005, respectively. The weighted-average discount rate used in determining the net periodic postretirement benefit cost was 5.88% and 6.00% for the years ended December 31, 2006 and 2005, respectively. The DMC used a measurement date of December 31 in 2006 and 2005, to measure the obligations.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	One-Percentage Point Increase	One-Percentage Point Decrease
	(In Thousands)	
Effect on total of service and interest cost components	$ 100	$ (84)
Effect on postretirement benefit obligation	1,817	(1,471)

10. Other Postretirement Employee Benefits (continued)

Expected cash flows for the postretirement benefits are as follows (in thousands):

Expected benefit payments for the year ending December 31:	
2007	$ 2,763
2008	2,860
2009	2,924
2010	2,965
2011	2,971
2012–2016	13,373

The DMC funds the majority of the postretirement liability payments from operations.

11. Commitments and Contingencies

The DMC has entered into an information systems outsourcing arrangement with CareTech Corporation (an entity in which The DMC has a 30% equity interest). Under the agreement The DMC outsourced its entire information system operations for a 10-year period expiring December 31, 2011, with annual fees based on a budget approved annually. During the years ended December 31, 2006 and 2005, the expenses incurred under the outsourcing contract, excluding capital related items, were $54,916,000 and $53,446,000, respectively.

The DMC has an agreement with Provider HealthNet Services, Inc. (PHNS) to outsource medical record and transcription services of The DMC. The initial agreement was renegotiated in 2004, for a period of eight years ending May, 2012, with the option of five one-year renewal periods. The term of the medical records outsourcing agreement is eight years with contractually specified minimum annual payments over the term of the agreement. The contractual minimum payments aggregate $239,196,000 over the remaining term of the agreement. The DMC is contingently obligated should PHNS not achieve certain operating targets under The DMC agreement, which may require additional payments or extension of the contract. The DMC has the ability to terminate the agreement, subject to payment of certain penalty amounts. In connection with the initial outsourcing agreement, The DMC received a cash advance which was deferred and is being amortized over the term of the agreement and had a deferred balance of $4,101,000 and $5,420,000 at December 31, 2006 and 2005, respectively.

The DMC and its affiliates are parties to certain legal actions other than professional liability claims. Management believes the resolution of these matters will not materially affect the results of operations or the financial position of The DMC.

11. Commitments and Contingencies (continued)

At December 31, 2006, The DMC had commitments of $17,565,000 for the purchase of property and equipment.

12. Functional Expenses

The DMC fulfills the health care requirements of residents in the community it serves by providing, as its principal function, a complete array of necessary health care services. Expenses classified by function are as follows:

	Year Ended December 31 2006	2005
	(In Thousands)	
Health care services	$ 1,531,387	$ 1,582,930
Teaching	128,763	132,384
General and administrative	156,582	199,128
	$ 1,816,732	$ 1,914,442

13. Related-Party Transactions

The DMC purchases teaching and clinical professional services from Wayne State University. Purchases for these services amounted to $74,850,000 and $79,800,000 for the years ended December 31, 2006 and 2005, respectively. During 2006, the DMC and Wayne State University agreed to the terms and conditions related to a long term agreement. Under the agreement, Wayne State University will continue to provide services to the DMC for annual payments of approximately $76,000,000. In addition, the DMC may be requires to pay an additional $9,000,000 in performance and incentive payments.

The DMC has transactions with other affiliated entities, board members, and related parties that are not significant.

14. Sale and Lease of Assets, and Revenue From Service and Facility Agreements

In December, 2005, The DMC completed the sale and lease of assets associated with the cancer service line at Harper-Hutzel Hospital to the Barbara Ann Karmanos Cancer Institute (KCI). Under the terms of the Asset Acquisition and Lease Agreement and related agreements, The DMC agreed to lease certain assets to KCI related to providing inpatient and outpatient cancer services.

The DMC leases space to KCI in Harper-Hutzel Hospital through an operating lease with an initial term of 50 years. Under the terms of the lease agreement, upon the recording of the Master Deed for the condominium space, the lease will terminate and title to the space will be transferred to KCI. The lease was accounted for as a sales-type lease at December 31, 2005, and transfer of title was completed in May, 2006. The single payment associated with the lease was approximately $9,900,000 and The DMC recognized a nonoperating gain of approximately $4,341,000 in 2005 on the sale of the property.

In addition, The DMC leases an outpatient treatment center to KCI for a period of seven years, at which time ownership to the facility will be transferred to KCI. The lease requires annual payments of $824,000. KCI has the option to purchase the facility at the end of each lease year at predetermined amounts included in the lease. The lease has been accounted for as an operating lease at December 31, 2006 and 2005. As expected cash flows under the lease were less than the carrying value of the property and equipment at December 31, 2005, The DMC recognized an impairment charge of approximately $2,254,000 during the year ended December 31, 2005, related to the lease of the facility. The impairment charge has been included in the nonoperating gain in the 2005 statement of operations.

KCI also leases a radiation oncology center and equipment from The DMC. Under the terms of the ground lease with KCI, The DMC will receive payments of $720,000 annually for an initial term of five years and no payments will be received for the remaining 45 years of the initial lease term. The lease has been accounted for as an operating lease, and as such rental income is recognized ratably by The DMC over the lease term. In addition, The DMC leases radiation oncology equipment to KCI for a term of seven years. Payments under the lease are $824,000 annually. Under the terms of the agreement, title to the equipment transfers to KCI at the end of the lease term. The lease has been accounted for as a capital lease based on the transfer of ownership.

The DMC also leases space to KCI in a professional office building. The initial term is five years, and the annual rental is $750,000. KCI also leases space in a parking facility from The DMC for an annual rental of $510,000. The initial term under the lease is ten years.

14. Sale and Lease of Assets, and Revenue From Service and Facility Agreements (continued)

The DMC recognized rental income of $5,839,000 and $496,000 during the years ended December 31, 2006 and 2005, related to rental of the facilities to KCI.

The following is a summary of the rental payments which will be received by The DMC over the following five years (in thousands):

Year ending December 31:	
2007	$ 3,458
2008	3,573
2009	3,573
2010	3,573
2011	2,853

Under the terms of the agreements, The DMC will provide certain ancillary clinical services, management services, and information technology services to KCI. The initial agreement is for a period of five years subject to various renewal options. These services are generally based on costs incurred by The DMC. At December 31, 2006 and 2005, The DMC had a receivable of $8,270,000 and $11,929,000 from KCI for services provided during the years ended December 31, 2006 and 2005. The statement of operations includes $68,292,000 and $6,676,000 related to revenue from service and facility agreements provided to KCI for the year ended December 31, 2006 and 2005, respectively.

In connection with the sale of the cancer services to KCI during 2005 The DMC also transferred approximately $1,369,000 in restricted funds related to cancer services to KCI.

15. Impairment Charge

During the years ended December 31, 2006 and 2005, Michigan Orthopedic Specialty Hospital incurred operating losses of $6,652,000 and $1,996,000, respectively. As a result of the operating losses incurred and projected loss for 2007, management performed a recoverability analysis and concluded that Michigan Orthopedic Specialty Hospital was impaired as the carrying amount of the facility exceeded the projected undiscounted cash flows related to the facility. In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* The DMC recognized an impairment charge of $1,814,000 to reduce the carrying value of the facility to its fair value. The fair value of the facility was determined based on an independent appraisal obtained by management. In addition, management determined that the carrying value of the goodwill recorded at the time of the hospital's acquisition was impaired, and therefore, recorded a charge of $2,184,000 to reduce the carrying value of the recorded goodwill.

16. Operating Results, Performance Improvement Plans and Liquidity Matters

The DMC has a working capital deficiency of $150,276,000 and $119,894,000 at December 31, 2006 and 2005, respectively. The increase in the working capital deficiency is due to the additional funding of the pension plan in 2006. In addition, The DMC has a deficit in unrestricted net assets of $107,718,000 and $214,449,000 at December 31, 2006 and 2005, respectively. The financial position has resulted from insufficient payments for services rendered, historical declines in trends in patient volumes, continued provision of services to the uninsured, and the insolvency of certain managed care payors. However, based on current estimates of operating results, The DMC management believes that cash flow from operations, funds available from credit agreements, and funds designated for capital improvements and board designated funds will be sufficient to finance both ongoing operations and required capital commitments for fiscal 2007 and meet the additional requirements of the 2003 Forbearance Agreements (Note 7).

17. Subsequent Event

On March 29, 2007 The DMC's Harper-Hutzel Hospital (HUH) was notified by the Centers for Medicare & Medicaid Services (CMS) that HUH had been found to be out of compliance and violative of the Medicare Conditions of Participation by having failed to comply with certain requirements related to the maintenance of medical records, physical environment and infection control. The CMS correspondence further stated that as significant deficiencies exist, the Hospital's Medicare provider agreement will be terminated effective June 11, 2007.

However, the CMS notification allowed that the Medicare provider agreement would not be terminated should HUH submit an acceptable Plan of Correction within ten (10) days from the date of HUH's receipt of the preliminary notice. DMC management has filed its Plan of Correction with CMS and the Michigan Department of Community Health. Management has been informed that the DMC's Plan of Correction has been accepted by CMS and that a resurvey will occur to confirm that the Plan has been implemented. Management is of the firm opinion that CMS and the Michigan Department of Community Health will find the results of the resurvey satisfactory, and CMS will thereafter withdraw its Notice of Termination.

On May 24, 2007, CMS and the Michigan Department of Community Health completed the resurvey of the Hospital. Management was informed that based on the results of the survey that the hospital termination from the Medicare program would be withdrawn. Management expects to receive formal notification of the withdrawal in June 2007.

Consolidating Financial Information

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Report of Independent Auditors on Consolidating Financial Information

The Board of Trustees
The Detroit Medical Center

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating balance sheet and consolidating statement of operations and changes in unrestricted net assets (deficit) are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Ernst + Young LLP

May 24, 2007

The Detroit Medical Center

Consolidating Balance Sheet

December 31, 2006
(In Thousands)

	Consolidated Total	Consolidating Adjustments	Obligated Group	Nonobligated Group
Assets				
Current assets:				
Cash and cash equivalents	$ 23,791	$ –	$ 20,479	$ 3,312
Net patient accounts receivable	98,806	–	98,545	261
Estimated third-party payor settlements	19,906	–	19,906	–
Other accounts receivable	28,349	(402)	22,974	5,777
Current portion of assets whose use is limited or restricted	8,009	–	8,009	–
Supplies	21,610	–	21,032	578
Prepaid expenses and other	30,336	–	19,034	11,302
Total current assets	230,807	(402)	209,979	21,230
Assets whose use is limited or restricted, less current portion:				
Board-designated funds for capital improvements	34,604	–	33,705	899
Board-designated funds for specific purposes	75,339	–	72,090	3,249
Professional liability funds	197,214	–	–	197,214
Funds held in trust under bond agreements	34,949	–	34,923	26
Endowment funds	59,183	–	59,183	–
Pledges receivable	16,338	–	16,338	–
Donor restricted funds	89,742	–	89,742	–
	507,369	–	305,981	201,388
Property and equipment	484,119	–	478,293	5,826
Other noncurrent assets	30,076	(11,186)	29,114	12,148
Total assets	$ 1,252,371	$ (11,588)	$ 1,023,367	$ 240,592

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	Consolidated Total	Consolidating Adjustments	Obligated Group	Nonobligated Group
Liabilities and net assets (deficit)				
Current liabilities:				
Accounts payable and accrued expenses	$ 179,254	$ (1,578)	$ 172,273	$ 8,559
Accrued compensation and related amounts	51,726	–	51,311	415
Estimated third-party payor settlements	20,627	–	20,627	–
Advance from third-party payor	47,730	–	47,730	–
Current portion of long-term debt	23,018	–	22,198	820
Current portion of accrued pension liability	33,831	–	33,831	–
Current portion of accrued professional liability losses	24,897	–	24,557	340
Total current liabilities	381,083	(1,578)	372,527	10,134
Other liabilities				
Long-term debt, less current portion	553,076	–	540,200	12,876
Other noncurrent liabilities, less current portion	260,669	1,172	53,097	206,400
Total other liabilities	813,745	1,172	593,297	219,276
Total liabilities	1,194,828	(406)	965,824	229,410
Net assets (deficit):				
Unrestricted	(40,186)	(11,182)	(40,186)	11,182
Additional minimum pension liability	(67,532)	–	(67,532)	–
	(107,718)	(11,182)	(107,718)	11,182
Temporarily restricted	100,511	–	100,511	–
Permanently restricted	64,750	–	64,750	–
Total net assets (deficit)	57,543	(11,182)	57,543	11,182
Total liabilities and net assets (deficit)	$ 1,252,371	$ (11,588)	$ 1,023,367	$ 240,592

The Detroit Medical Center

Consolidating Statement of Operations and Changes in Unrestricted Net Assets (Deficit)

Year Ended December 31, 2006
(In Thousands)

	Consolidated Total	Consolidating Adjustments	Obligated Group	Nonobligated Group
Unrestricted revenue and other support				
Net patient service revenue	$ 1,688,752	$ (3,921)	$ 1,680,610	$ 12,063
Revenue from services and facility agreements	68,292	–	68,292	–
Other revenue	75,015	(49,614)	76,886	47,743
Net assets released from restrictions for operations	11,492	–	11,492	–
Total unrestricted revenue and other support	1,843,551	(53,535)	1,837,280	59,806
Expenses				
Salaries, wages, and benefits	716,406	–	711,300	5,106
Services, supplies, and other	724,033	(34,971)	722,912	36,092
Provision for uncollectible accounts	243,293	–	243,359	(66)
Professional liability insurance	21,149	(17,972)	20,271	18,850
Interest	34,763	(592)	34,411	944
Depreciation and amortization	77,088	–	75,386	1,702
Total expenses	1,816,732	(53,535)	1,807,639	62,628
Income (loss) from operations before impairment charge	26,819	–	29,641	(2,822)
Impairment charge	(3,998)	–	(3,998)	–
Income (loss) from operations	22,821	–	25,643	(2,822)
Other nonoperating income (expense):				
Gain on sale of interest in joint venture	3,087	–	3,087	–
Investment income and other	8,364	–	8,162	202
Equity (deficit) in net assets of subsidiaries	–	2,620	(2,620)	–
Excess of revenue over expenses	34,272	2,620	34,272	(2,620)
Other changes in unrestricted net assets:				
Change in unrealized loss in fair value of investments	6,603	–	2,203	4,400
Net assets released from restrictions for long-lived assets	5,302	–	5,302	–
Change in additional minimum pension liability	61,041	–	61,041	–
Other changes	(487)	(11,092)	3,913	6,692
Increase (decrease) in unrestricted net assets	$ 106,731	$ (8,472)	$ 106,731	$ 8,472