Group Health Cooperative and Subsidiaries

Consolidated Financial Statements as of and for the Years Ended December 31, 2006 and 2005, and Independent Auditors' Report

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

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Deloitte.

Deloitte & Touche LLP
Suite 3300
925 Fourth Avenue
Seattle, WA 98104-1126
USA

Tel: +1 206 716 7000
Fax: +1 206 965 7000
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Trustees
Group Health Cooperative and Subsidiaries
Seattle, Washington

We have audited the accompanying consolidated balance sheets of Group Health Cooperative ("GHC"), GHC's subsidiaries and controlled affiliates, Group Health Options, Inc. ("GHO"), KPS Health Plans ("KPS"), Group Health Community Foundation (the "Foundation"), Auxiliary of Group Health Cooperative of Puget Sound ("Auxiliary"), and KPS's wholly owned subsidiary, Northwest Credentials Verification Service ("NCVS") (collectively, the "Group") as of December 31, 2006 and 2005, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006 and 2005, 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.

As discussed in Note 2 to the consolidated financial statements, the Group adopted 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)*, which changed its method of accounting for pension and postretirement benefits as of December 31, 2006.

Deloitte & Touche LLP

March 28, 2007

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 AND 2005
(In thousands)

ASSETS	2006	2005
CURRENT ASSETS:		
Cash and cash equivalents	$ 461,805	$ 104,625
Restricted cash	227	-
Short-term marketable securities	63,254	372,085
Accounts receivable—net	83,533	83,914
Inventories	24,276	24,953
Funds held by trustee—current portion	830	363
Other	24,340	23,797
Total current assets	658,265	609,737
LONG-TERM MARKETABLE SECURITIES	437,616	165,255
FUNDS HELD BY TRUSTEE—Net of current portion	81,544	-
LAND, BUILDINGS, AND EQUIPMENT:		
Land	18,399	21,675
Buildings and improvements	374,986	398,417
Equipment	348,801	335,191
Total land, buildings, and equipment	742,186	755,283
Less accumulated depreciation	(513,797)	(485,354)
Construction in progress	86,326	53,838
Land, buildings, and equipment—net	314,715	323,767
PREPAID PENSION ASSET	-	45,444
OTHER ASSETS	37,466	24,034
TOTAL	$ 1,529,606	$ 1,168,237

See notes to consolidated financial statements.

LIABILITIES AND NET ASSETS	2006	2005
CURRENT LIABILITIES:		
Accounts payable	$ 125,530	$ 72,162
External delivery services payable	133,427	149,078
Accrued employee compensation	35,693	39,498
Accrued taxes and interest	13,765	14,517
Unearned dues and deposits	17,253	13,978
Current portion of reserve for self-insurance	18,727	17,707
Current portion of retiree medical benefits	5,238	-
Current portion of long-term debt	6,082	5,524
Total current liabilities	355,715	312,464
NONCURRENT LIABILITIES:		
Long-term debt	205,340	110,353
Self-insurance	64,605	57,291
Retiree medical benefits	93,235	65,409
Other	35,826	15,079
Total noncurrent liabilities	399,006	248,132
Total liabilities	754,721	560,596
COMMITMENTS AND CONTINGENCIES (Note 6)		
NET ASSETS:		
Unrestricted	761,941	596,410
Temporarily restricted	5,634	4,148
Permanently restricted	7,310	7,083
Total net assets	774,885	607,641
TOTAL	$ 1,529,606	$ 1,168,237

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In thousands)

	2006	2005
REVENUES:		
Premium revenue:		
Group dues	$ 1,588,053	$ 1,411,486
Medicare	637,370	579,400
Medicaid	33,263	33,941
Individual and family	68,135	60,199
Nonpremium revenue:		
Clinical services	162,522	148,837
Investment earnings	40,121	20,830
Other	54,280	65,015
Total revenues	2,583,744	2,319,708
EXPENSES:		
Employee compensation	512,143	496,292
Group Health Permanente expense	224,721	204,777
External delivery services	1,071,217	1,009,222
Purchased services	79,969	77,515
Medical and operating supplies	224,953	214,677
Depreciation	46,422	41,822
Other	181,916	163,294
Total expenses	2,341,341	2,207,599
INCOME BEFORE INCOME TAX EXPENSE	242,403	112,109
INCOME TAX EXPENSE (BENEFIT)	4,355	(94)
NET INCOME	238,048	112,203
CHANGE IN NET UNREALIZED INVESTMENT GAINS AND LOSSES—Net of tax	7,117	(2,572)
SFAS No. 158 TRANSITION AMOUNT—Net of tax	(79,478)	-
NET MEMBERSHIP ACTIVITY	(156)	(135)
CHANGE IN UNRESTRICTED NET ASSETS	165,531	109,496
CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	1,486	603
CHANGE IN PERMANENTLY RESTRICTED NET ASSETS	227	466
CHANGE IN NET ASSETS	167,244	110,565
NET ASSETS:		
Beginning of year	607,641	497,076
End of year	$ 774,885	$ 607,641

See notes to consolidated financial statements.

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 167,244	$ 110,565
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	46,422	41,822
Provision for self-insurance	17,163	18,163
Self-insurance claims paid	(8,829)	(9,991)
Change in net unrealized investment gains and losses—net of tax	(7,117)	2,572
Other	(1,075)	554
Cash provided by (used in) operating assets and liabilities:		
Accounts receivable—net	381	(19,660)
Inventories	677	(1,742)
Other current assets	(543)	(13,263)
Other assets	47,119	(12,011)
Accounts payable	53,141	30,235
External delivery services payable	(15,651)	5,505
Accrued employee compensation	(3,805)	(2,710)
Accrued taxes and interest	(752)	1,428
Unearned dues and deposits	4,359	236
Other noncurrent liabilities	55,228	10,916
Net cash provided by operating activities	353,962	162,619
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for land, buildings, and equipment	(85,492)	(54,717)
Proceeds from disposal of land, buildings, and equipment	48,288	164
Proceeds from sale of marketable securities	1,378,363	2,906,449
Purchases of marketable securities	(1,334,717)	(2,988,953)
Purchases of other equity investments—net	(10,475)	(3,549)
Funds held by trustee	(82,011)	4,130
Net cash used in investing activities	(86,044)	(136,476)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long-term borrowings	99,996	2,536
Repayment of debt	(5,483)	(2,907)
Payments for deferred financing cost	(5,095)	-
Net membership activity	(156)	(135)
Net cash provided by (used in) financing activities	89,262	(506)
NET INCREASE IN CASH AND CASH EQUIVALENTS	357,180	25,637
CASH AND CASH EQUIVALENTS:		
Beginning of year	104,625	78,988
End of year	$ 461,805	$ 104,625

(Continued)

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In thousands)

	2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 5,561	$ 5,062
Income taxes	$ 3,859	$ 850

See notes to consolidated financial statements. (Concluded)

1. ORGANIZATION

The accompanying consolidated financial statements include the accounts of Group Health Cooperative (the "Cooperative" or "GHC"), GHC's wholly owned subsidiary, Group Health Options, Inc. ("GHO"), and controlled affiliates, KPS Health Plans ("KPS"), Group Health Community Foundation (the "Foundation"), Auxiliary of Group Health Cooperative of Puget Sound ("Auxiliary"), and KPS's wholly owned subsidiary, Northwest Credentials Verification Service ("NCVS") (collectively, the "Group"). All significant intercompany transactions have been eliminated.

The Cooperative is a Washington nonprofit corporation registered as a health maintenance organization headquartered in Seattle, Washington. The Cooperative offers comprehensive, coordinated health care to an enrolled membership for a fixed prepaid fee through its owned and leased facilities, employed providers, and contracted providers, in addition to providing certain health care services on a fee-for-service basis.

GHO is a Washington for-profit corporation registered and operating as a health care services contractor that provides health care coverage products that feature increased customer choice, including a point of service plan benefit.

KPS is a Washington taxable nonprofit corporation registered and operating as a health care services contractor headquartered in Bremerton, Washington. KPS provides health care services through contracts with participating physicians and hospitals. Effective October 1, 2005, GHC acquired control of KPS (see Note 10).

The Foundation is a Washington nonprofit corporation. It is organized exclusively to benefit, perform the functions of, and carry out the purposes of the Cooperative and other affiliated tax-exempt organizations. It supports research, health careers, training, health education, GHC programs, and other projects that promote high quality health care. Grants are awarded to qualified health-related community organizations, extending the internal resources of the Cooperative to the community. The Foundation's operations are largely a function of the level of grants and donations it receives.

The Auxiliary is an unincorporated association. It is organized for the purpose of promoting and advancing the welfare of GHC through fundraising in order to provide services and gifts to the hospitals, medical centers, specialty centers, and health-related programs of the Cooperative and its patients.

NCVS, a Washington limited liability company, performs primary source credentials verification of health care providers requesting new or continued participation with KPS and contracts nationally with health plans, hospitals, and other organizations to provide credentials verification services.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant estimates and assumptions are used in the recording of external delivery services payable, asset valuation, allowances for uncollectible accounts, self-insurance reserves, and the evaluation of contingencies and litigation. Changes in these estimates and assumptions may have a material impact on the financial statements.

Cash and Cash Equivalents—Cash and cash equivalents consist of liquid investments with original maturities of three months or less and are carried at cost, which approximates fair value.

Marketable Securities—Marketable securities are readily convertible to cash and are carried at fair value in accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Maturities for short-term marketable securities are more than 3 and less than 12 months and consist primarily of government securities and commercial paper. All investments are classified as available-for-sale securities and reported at fair value. The change in unrealized gains and losses is recorded as a separate component of net assets for GHC, GHO, KPS, and NCVS. The Foundation records the change in unrealized gains and losses to income during the periods in which they occur. The Group records realized gains and losses on disposal of specific investments, which are included within investment earnings. Realized gains and losses were not significant in 2006 and 2005. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity or, in the case of mortgage-backed securities, over the estimated life of the security. The discount or premium is amortized using the effective yield method. Such amortization and accretion is included in investment earnings.

Marketable securities as of December 31, 2006 and 2005, consist of the following (in thousands):

	2006				2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt:								
U.S. government securities	$270,296	$ 384	$(1,740)	$268,940	$133,393	$ 294	$ (945)	$132,742
Commercial paper	9,893	-	(3)	9,890	221,949	18	(20)	221,947
Corporate debt securities	76,665	89	(257)	76,497	117,212	595	(574)	117,233
Collateralized mortgage obligations	18,070	57	(122)	18,005	42,653	25	(220)	42,458
Mutual funds:								
Fixed income	7,180	108	(112)	7,176	10,045	3	(134)	9,914
Equity	110,723	9,630	-	120,353	11,821	1,346	(130)	13,037
Other	9	-	-	9	9	-	-	9
Total	$492,836	$10,268	$(2,234)	$500,870	$537,082	$ 2,281	$(2,023)	$537,340

The following table shows the gross unrealized losses and fair value of the Group's investments with unrealized losses that are deemed to be temporarily impaired aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Debt:						
U.S. government securities	$183,681	$(1,335)	$12,906	$(405)	$196,587	$(1,740)
Commercial paper	4,436	(3)	-	-	4,436	(3)
Corporate debt securities	56,523	(92)	4,666	(165)	61,189	(257)
Collateralized mortgage obligations	7,954	(57)	2,066	(65)	10,020	(122)
Mutual funds—fixed income	132	(1)	4,413	(111)	4,545	(112)
Total	$252,726	$(1,488)	$24,051	$(746)	$276,777	$(2,234)

The unrealized losses on the Group's investments were caused by changes in interest rates. The Group has the ability and intent to hold these investments until a recovery of market value, which may be maturity, and considers these investments to be temporarily impaired. Market conditions may change such that it might not be considered advantageous to hold until a market recovery, or a security may experience a credit downgrade. If these conditions are experienced, the Group may not continue to hold the investment in order to lower its risk.

Accounts Receivable—Accounts receivable are primarily comprised of enrollee dues, receivables for noncovered health care services, and receivables for services provided to nonenrollees. The Group records a reduction in the related dues revenues for an estimate of amounts related to retroactive enrollment changes. Provisions for contractual adjustments are recorded on an accrual basis and are deducted from gross revenues. Bad debts related to services provided to nonenrollees or noncovered services provided to enrollees are recorded as expenses in the consolidated statements of operations and changes in net assets. The allowance for uncollectible accounts was $9,772,000 and $8,070,000 as of December 31, 2006 and 2005, respectively.

Inventories—Inventories consist of pharmaceuticals, medical, and operating supplies and are stated at the lower of weighted-average cost or market.

Funds Held by Trustee—Funds held by trustee are primarily for amounts required by the terms and conditions of the revenue bonds (see Note 3). The Series 2006 revenue bonds require that certain reserves be established and held by the bond trustee. A bond fund reserve in the amount of $8,848,000 was established for the benefit of the bond owners and shall be maintained as long as any Series 2006 bonds remain outstanding. A project fund reserve was established with a December 31, 2006, balance of $72,696,000. This reserve, which holds the majority of the bond proceeds, will be maintained until all issuance and project costs have been incurred related to the construction of a medical specialty center located in Bellevue, Washington. The Cooperative will request reimbursement from the bond trustee as costs are incurred. The bond fund reserve and the project fund reserve are included within the long-term portion of funds held by trustee on the consolidated balance sheets as of December 31, 2006.

Charitable Gift Annuities—As of December 31, 2006 and 2005, the Foundation had a charitable gift annuities liability of $943,000 and $743,000, respectively, which includes a 10% reserve as required by state law and is recorded as a component of other noncurrent liabilities in the accompanying consolidated balance sheets.

Land, Buildings, and Equipment—Land, buildings and improvements, and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or, for leasehold improvements, over the term of the related lease, including first extension, whichever is shorter. When assets are sold or retired, their cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in operations. The estimated useful lives of buildings, improvements, and leasehold improvements are 5 to 40 years, and the estimated useful life of equipment is 2 to 20 years.

Construction in Progress—Construction in progress ("CIP") projects include costs incurred while preparing assets for their intended use. CIP projects typically consist of major computer system installations, the construction or remodel of buildings, or the installation of major equipment or systems.

Long-Lived Assets—In accounting for its long-lived assets, the Group makes estimates about the expected useful lives of the assets, the expected residual values of the assets, and the potential for impairment based on the fair value of the assets and the cash flows they generate. Factors indicating potential impairment include, but are not limited to, significant decreases in the market value of the long-lived assets, a significant change in the long-lived assets condition, and operating cash flow losses associated with the use of the long-lived asset.

There is inherent risk in estimating the future cash flows used in the impairment test. If cash flows do not materialize as estimated, there is a risk the impairment charges recognized to date may be inaccurate, or further impairment charges may be necessary in the future.

In 2003, the Cooperative announced its intention to cease operations of its Eastside Campus located in Bellevue, Washington, in 2008 and to consider the sale of the Campus at that time. As a result, management periodically performs an evaluation of the recoverability of the book value of the Eastside Campus assets. No impairment loss was incurred in 2006 or 2005.

Advertising—Advertising costs are expensed as incurred and are recorded within purchased services in the statement of operations and changes in net assets. The Group recorded advertising expense of $7,710,000 and $7,253,000 for the years ended December 31, 2006 and 2005, respectively.

Income Taxes—GHO, KPS, and NCVS are subject to federal income taxes. These companies file separate federal tax returns and are not subject to any state income tax filing requirements. GHC is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code (the "Code") as a charitable organization under Section 501(c)(3) of the Code, except for unrelated business income tax. The Foundation has received a determination letter from the Internal Revenue Service ("IRS") that it is a tax-exempt public foundation in accordance with Sections 501(c)(3) and 509(a)(3) of the Code. The Auxiliary has received a determination letter from the IRS that it is a tax-exempt organization in accordance with Sections 501(c)(3) and 509(a)(2) of the Code.

GHO, KPS, and NCVS recognize deferred income taxes for the tax consequences in future years of the differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. No valuation allowance has been recorded as of December 31, 2006 and 2005.

Self-Insurance—The Group is partially self-insured for professional liability and industrial accident claims and fully self-insured for unemployment benefits. The provision for estimated self-insurance claims was $17,163,000 and $18,163,000 for the years ended December 31, 2006 and 2005, respectively. Professional liability and industrial accident claims liabilities are determined using case-based estimates for reported claims and actuarial estimates for incurred but not reported claims. These estimates are based on historical information along with certain assumptions about future events. Changes in assumptions related to expected claims development as well as changes in actual experience could cause these estimates to change. The provision for estimated self-insurance payments includes an estimate for professional liability claims and loss adjustment expense of $14,879,000 and $10,922,000 for the years ended December 31, 2006 and 2005, respectively.

Reinsurance—The Group limits certain exposure to claims loss by ceding reinsurance to other insurance companies. GHC maintains reinsurance coverage for professional liability and industrial accident claims. Insurance coverage for professional liability claims is on a claims-made basis. Retention levels are $10,000,000 per claim with a $50,000,000 annual aggregate in 2006 and 2005. KPS purchases reinsurance to limit its exposure on all of its insured contracts except the Federal Employees Health Benefit Plan. A retention level of $500,000 per claim with a coinsurance level of 10% was held in 2006 and 2005 by KPS.

Reinsurance contracts do not relieve the Group from its obligations to plaintiffs. Failure of reinsurers to honor their obligations could result in losses to the Group. The Group had recorded prepaid reinsurance premiums of $1,557,000 and $1,542,000 as of December 31, 2006 and 2005, respectively.

Derivatives and Hedging Activities—In certain instances, the Group enters into derivative contracts to hedge specific assets and liabilities. Prior to entering into a derivative contract designated as a hedge, the relationship between the hedging instruments and the hedged items, as well as its risk management objective and strategy, are formally documented. On the date the Group enters into a derivative contract utilized as a hedge, the derivative instrument is designated as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (known as a "fair value" hedge) or a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a forecasted transaction (known as a "cash flow" hedge).

In a cash flow hedge, the effective portion of the changes in the fair value of the hedging derivative is recorded in net assets and is subsequently reclassified into earnings during the same period in which the hedged item affects earnings. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

To qualify for hedge accounting treatment, the derivatives and related hedged items must be designated as a hedge. Both at the inception of the hedge and on an ongoing basis, the Group assesses whether the hedging relationship is expected to be highly effective in offsetting changes in fair value or cash flows of hedged items. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting treatment is discontinued.

Revenues—Revenues are derived principally from prepaid health care dues and fee-for-service billings. Dues received in advance of the coverage period are deferred, and revenues are recognized in the period in which services are covered. Fee-for-service revenues are generated through the provision of certain medical services not fully covered under existing benefit policies, from services provided to nonenrollees who receive care at GHC's facilities, and from optical and pharmacy sales. Group contracts cover employee groups and are entered into with employers or union trusts.

The Cooperative has a contract with the Centers for Medicare and Medicaid Services ("CMS") to provide health care services to enrollees eligible for Medicare coverage. Under this arrangement, premiums from CMS are paid prospectively and are equal to a regional average per-capita cost adjusted for the health risk of enrollees. Supplemental dues are paid by individual enrollees or employer groups for benefits not covered under CMS premiums.

Included in other revenues are unconditional promises to donate cash and other assets to the Foundation, reported at fair value at the date the promise is received. The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets.

Net Assets—Unrestricted net assets result from operations and unrestricted contributions received. Temporarily and permanently restricted net assets are accounted for within the Cooperative and the Foundation. Temporarily restricted net assets account for funds restricted by donors for specific purposes and are available to support the Cooperative and the Foundation in carrying out their missions. Permanently restricted net assets are contributions restricted by the donor to be invested in perpetuity. A portion of the income earned from permanently restricted net assets is disbursed to support the Foundation in carrying out its mission.

Functional Expense—The Group's expenses are primarily related to health care delivery services, which are activities that result in goods and services being provided to consumers.

Group Health Permanente Expense—Group Health Permanente P.C., is an independent medical group with an exclusive contract to provide medical services at Group Health facilities providing primary, specialty, and inpatient care.

External Delivery Services—External delivery services represent health care expenses incurred by the Cooperative, GHO, and KPS for care provided by contracted and non-contracted health care facilities and practitioners. The liability reflected on the consolidated balance sheets is determined using actuarial estimates. These estimates are based on historical information along with certain assumptions about future events. Changes in assumptions, as well as changes in actual experience, could materially impact these estimates.

Net Membership Activity—Net membership activity consists of changes in capital dues and donated capital resulting from the change in membership.

Statutory Accounting Practices—The accompanying consolidated financial statements have been prepared in accordance with GAAP, which differ from the accounting principles and practices prescribed or permitted by the Insurance Commissioner of the State of Washington that are used in the preparation of the statutory financial statements filed by the Cooperative, GHO, and KPS. The primary difference is that certain assets (principally non-government receivables for which a portion is more than 90 days outstanding, prepaid expenses, administrative leasehold improvements, EDP software, EDP hardware greater than 3% of statutory surplus, deferred tax assets not to be realized within one year, and administrative furniture and equipment) are designated as nonadmitted assets for statutory purposes and are excluded from the balance sheet. In addition, the pension liability and postretirement medical benefit for nonvested employees is excluded from the statutory balance sheet. The National Association of Insurance Commissioners ("NAIC") developed the codification of statutory accounting practices (the "Codification"), which became effective for health-related organizations on January 1, 2001. The state of Washington adopted the Codification; however, state law supersedes the Codification should differences exist between the two.

Risk-based capital ("RBC") requirements promulgated by the NAIC and adopted by the state of Washington establish that certain required amounts of statutory basis capital and surplus be maintained. As of December 31, 2006, the statutory capital surplus of the Cooperative, GHO, and KPS exceeded that required by the RBC formula.

Accounting Changes—In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R),* which requires companies to record a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. Employers without publicly traded equity securities are required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. Earlier application of the recognition is encouraged; consequently, the Group adopted the recognition provisions of this statement at the end of its fiscal year, December 31, 2006.

In recognizing the provisions of this statement, a pension transition amount of $51,393,000 was recorded, resulting in a pension liability for previously unrecognized losses in the amount of $501,000, as of December 31, 2006. An additional retiree medical liability was recorded in the amount of $28,085,000, and consisted of previously unrecognized gains, prior service cost, and transition obligation. Both required an offsetting adjustment against unrestricted net assets in the amount of $79,478,000, net of tax.

New Accounting Pronouncements—In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*, which permits a choice to measure many financial instruments and certain other items at fair value. This standard is effective for the 2008 fiscal year. The Group is evaluating the impact the adoption of this standard will have on its future financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which establishes a framework to measure fair value assets and liabilities and expands disclosures about fair value measurements. This standard is effective for the 2008 fiscal year. The Group is evaluating the impact the adoption of this standard will have on its future financial position and results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This standard is effective for the Group's 2007 fiscal year. The Group has not completed the process of evaluating the impact that will result from adopting this standard and, therefore, is unable to disclose the impact that adopting this standard will have on its future financial position and results of operations.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements Nos. 133 and 140*, which requires an evaluation of interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. This standard is effective for the Group's 2007 fiscal year. Management does not believe this standard will have a material impact on the Group's 2007 financial statements.

3. BORROWING ARRANGEMENTS

The Cooperative has a revolving line of credit that enables it to draw up to $50,000,000. Rates under this agreement vary with short-term interest rates. The line of credit expires in November 2007, at which time the Cooperative has the option of converting any outstanding balance to a four-year term loan. The terms of this agreement require the Cooperative to comply with certain restrictive covenants. The Cooperative was in compliance with the covenants at December 31, 2006 and 2005. There were no borrowings under the line of credit during 2006 and 2005.

Revenue Bonds—In 2006, the Cooperative issued new debt to finance the acquisition, construction, and equipping of a medical specialty center located in Bellevue, Washington, to be owned and operated by the Cooperative. The Series 2006 revenue bonds were issued with the principal amount of $97,965,000, plus net original issue premium in the sum of $2,031,000. The monies received from the issuance will be trusteed assets until construction costs are incurred and are included within funds held by trustee on the consolidated balance sheet as of December 31, 2006. Approximately $5,078,000 of deferred financing costs in connection with the Series 2006 revenue bonds are included within other assets on the consolidated balance sheet as of December 31, 2006.

The Series 2006 bonds, as well as the previously outstanding revenue bonds, were issued through the Washington Health Care Facilities Authority (the "Authority"). As security for the repayment of the bonds, the Cooperative has granted the Authority a security interest in its gross receivables and bond funds and liens against certain facilities and equipment. The loan agreements for the revenue bonds require, among other restrictions, that the Cooperative achieve certain minimum debt service coverage ratios. The Cooperative was in compliance with all debt covenants at December 31, 2006 and 2005.

In 2002, the Cooperative entered into two total return swaps, which provide for the payment of a floating rate of interest by the Cooperative in exchange for a fixed payment matching the interest requirement on the Series 1988A and 1991 bonds (see Note 8). The Series 1988A bonds fully matured in 2005 and the associated total return swap expired.

Long-term debt at December 31, 2006 and 2005, consists of the following (in thousands):

	Years of Maturity	2006	2005
Revenue bonds:			
Series 2006, 4-1/2% to 5.0%, plus bond premium of $2,024 in 2006	2022–2036	$ 99,989	$ -
Series 2001, 3-1/4% to 5-3/8%, plus bond premium of $1,712 and $1,964 in 2006 and 2005, respectively	2006–2019	66,432	68,168
Series 1991, 6-3/5% to 7.0%, net of bond discount of $1,356 and $1,492 in 2006 and 2005, respectively	2006–2021	43,904	45,143
Other	2005–2008	1,097	2,566
Subtotal		211,422	115,877
Less current portion		(6,082)	(5,524)
Total long-term debt		$ 205,340	$ 110,353

Future annual principal payments on long-term debt for each of the next five years and thereafter at December 31, 2006, are as follows (in thousands):

Years Ending December 31	
2007	$ 5,890
2008	5,423
2009	5,675
2010	5,985
2011	6,050
Thereafter	180,019
Subtotal	209,042
Add unamortized premium and discount—net	2,380
Total	$ 211,422

Interest paid during 2006 and 2005 was $5,561,000 and $5,062,000, respectively. Total interest cost incurred was $5,942,000 and $5,028,000 during 2006 and 2005, respectively, and the amount thereof capitalized was $762,000 and $832,000 in 2006 and 2005, respectively.

Surplus Notes—KPS holds surplus notes issued to providers who were creditors pursuant to the need to rehabilitate the company in 2000. GHC acquired control of KPS pursuant to a Transfer Agreement ("Agreement"), effective October 1, 2005, between the Washington State Office of Insurance Commissioner ("OIC") and GHC. At the time of acquisition, the fair value of the surplus notes was $5,082,000. The Agreement provided for KPS to pay tendered surplus notes at 50% of face value and to issue a new participating surplus note for the remaining 50% balance. Any surplus note not tendered by June 15, 2006, was cancelled. The new participating surplus notes are non-interest bearing and are exempt from registration. The repayment of any principal is pursuant to a payment formula based on KPS's future earnings. If certain earnings thresholds are not met by 2007, the notes shall be cancelled. The surplus notes balance is $1,081,000 and $2,536,000 as of December 31, 2006 and 2005, respectively, and is recorded as a component of current portion of long-term debt in the consolidated balance sheets.

4. PENSION PLANS

The Group contributes to two defined benefit plans (the "Plans"), a defined contribution plan, 401(k) plan, and several union-negotiated plans that collectively cover substantially all of its employees. The Group's policy is to fund pension costs for the Plans based on actuarially determined funding requirements, thereby accumulating funds adequate to provide for all accrued benefits. Contributions for the defined contribution plan are based on a percentage of covered employees' salaries. Matching contributions to the 401(k) plan are based on a percentage of participants' contributions as set forth in the plan agreement. The total expense for these plans was $29,857,000 and $25,036,000 in 2006 and 2005, respectively.

The actuarial cost method used in determining the net periodic pension cost is the projected unit credit cost method. At December 31, 2006 and 2005, net periodic pension expense related to the Group's participation in the Plans for 2006 and 2005 included the following components (in thousands):

	2006	2005
Service cost	$ 21,703	$ 19,621
Interest cost on projected benefits	20,731	18,646
Expected return on Plan assets	(29,213)	(26,082)
Actuarial loss	5,704	3,090
Net periodic pension cost	$ 18,925	$ 15,275
Discount rate (preretirement)	5.50%–5.75 %	5.50%–6.00 %
Discount rate (postretirement)	5.00–5.75	5.00–6.00
Rate of increase in compensation levels	4.39–5.00	4.50–5.00
Expected return on plan assets	8.00–8.50	8.00–8.50

Assumptions used for the net periodic postretirement cost are based on the beginning of the year.

The Plans' funded status as of December 31, 2006 and 2005, is as follows (in thousands):

	2006	2005
Projected benefit obligation—end of year	$ 402,830	$ 380,931
Change in Plan assets:		
Fair value of Plan assets—beginning of year	$ 349,382	$ 303,799
Actual return on Plan assets	41,497	21,683
Acquisition	-	14,178
Employer contributions	25,718	25,292
Employee contributions	65	58
Benefits paid	(14,333)	(15,629)
Fair value of Plan assets—end of year	$ 402,329	$ 349,381
Plan assets less than projected benefit obligations	$ (501)	$ (31,550)
Unrecognized net loss	-	74,877
Net amount recognized	$ (501)	$ 43,327
Accumulated benefit obligation—end of year	$ 356,112	$ 334,116
Discount rate (preretirement)	5.80%–6.00 %	5.50%–5.75 %
Discount rate (postretirement)	5.00–6.00	5.00–5.75
Rate of increase in compensation levels	4.39–5.00	4.50–5.00

Assumptions used for the accumulated benefit obligation are based on the end of the year.

The benefit obligation is the actuarial present value of all vested and nonvested benefits for employee service before December 31, 2006 and 2005.

Certain of the Group's employees are covered by union-sponsored, collectively bargained, multiemployer defined benefit plans. Contributions are determined in accordance with the provisions of negotiated labor contracts.

Investment Policies and Strategies—GHC has adopted an investment policy for the Retirement Income Credit Plan that incorporates a strategic, long-term asset allocation mix designed to best meet its long-term pension obligations. Plan fiduciaries set the investment policies and strategies for the pension trust. This includes the following:

- Selecting investment managers
- Setting long-term and short-term target asset allocations
- Periodic review of the target asset allocations, and, if necessary, to make adjustments based on changing economic and market conditions
- Monitoring the actual asset allocations, and, when necessary, rebalancing to the current target allocation.

As of December 31, 2006 and 2005, the following table summarizes the target and actual allocations of plan assets:

	2006		2005	
	Target Allocation	**Actual Allocation**	**Target Allocation**	**Actual Allocation**
Equity securities	60%–70%	64 %	60%–70%	65 %
Debt securities	25–40	33	20–40	34
Cash equivalents	0–5	3	0–5	1
Other investments	0–5	-	0–5	-
Total		100 %		100 %

The investment policy emphasizes the following key objectives:

- Maintain a diversified portfolio among various asset classes and investment managers
- Invest in a prudent manner for the exclusive benefit of plan participants
- Preserve the funded status of the plan
- Balance between acceptable level of risk and maximizing returns
- Maintain adequate control over administrative costs
- Maintain adequate liquidity to meet expected benefit payments.

Expected Long-Term Rate of Return on Assets—The Group uses an approach which analyzes historical long-term rates of return for various investment categories, as measured by appropriate indexes. The rates of return on these indexes are then weighted based upon the percentage of plan assets in each applicable category to determine a composite expected return. The Group reviews its expected rate of return assumption annually. However, this is considered to be a long-term assumption and hence not anticipated to change annually, unless there are significant changes in economic and market conditions.

The prepaid benefit cost at December 31, 2005, was $43,328,000. This amount is reflected on the consolidated balance sheets as a prepaid pension asset of $45,444,000 and a liability, included in other noncurrent liabilities, of $2,116,000. As a result of the Group adopting the provisions of SFAS No. 158 at December 31, 2006, the prepaid pension asset was adjusted against unrestricted net assets resulting in a pension liability. The change to the net pension asset was $51,393,000 and is a component of the SFAS No. 158 transition amount in the statements of operations and changes in net assets.

There are no required employer contributions expected to be made to the Plans in 2007.

Expected amounts to be recognized as components of 2007 net periodic pension cost are (in thousands):

Service cost	$ 22,550
Interest cost on projected benefits	22,783
Expected return on Plan assets	(33,223)
Actuarial loss	1,728
Net periodic pension cost	$ 13,838

The benefits expected to be paid in each of the next five years, and in the aggregate for the five fiscal years thereafter, as of December 31, 2006, are as follows (in thousands):

Years Ending December 31	
2007	$ 20,967
2008	23,879
2009	26,809
2010	28,879
2011	31,262
2012–2016	185,533
Total	$ 317,329

5. RETIREE MEDICAL PLANS

The Cooperative provides certain medical benefits for eligible retired employees. Employees become eligible for these benefits upon retirement and attainment of a specified age and upon completion of a certain number of years of service.

At December 31, 2006 and 2005, net periodic postretirement benefit cost comprises the following components (in thousands):

	2006	**2005**
Service cost	$ 1,634	$ 1,754
Interest cost on accumulated benefit obligation	5,342	5,276
Amortization of loss from earlier periods	1,314	879
Amortization of unrecognized prior service cost	(544)	(327)
Amortization of unrecognized transition obligation over 20 years	2,000	2,000
Net periodic postretirement benefit cost	$ 9,746	$ 9,582

The Cooperative's accumulated postretirement benefit obligation ("APBO") is unfunded. The APBO at December 31, 2006 and 2005, comprises the following (in thousands):

	2006	2005
Accumulated postretirement benefit obligation—end of year	$ 98,473	$ 96,506
Change in Plan assets:		
Employer contributions	$ 4,767	$ 4,783
Benefits paid	(4,767)	(4,783)
Fair value of Plan assets—end of year	$ -	$ -
Funded status	$ (98,473)	$ (96,506)
Unrecognized actuarial loss	-	20,078
Unrecognized prior service cost	-	(3,281)
Unrecognized transition obligation	-	14,300
Accrued postretirement benefit obligation	$ (98,473)	$ (65,409)

Future benefit costs were estimated assuming medical costs would increase at a 7.0% annual rate. A 1.0% increase in this annual trend rate would have increased the APBO at December 31, 2006, by $11,522,000 and the sum of service cost and interest cost for 2006 by $976,000. A 1.0% decrease in this annual trend rate would have decreased the APBO at December 31, 2006, by $9,848,000 and the sum of service cost and interest cost for 2006 by $804,000.

The weighted-average discount rate used in determining the APBO was 5.80% in 2006 and 5.50% in 2005. The assumptions used to determine the APBO are measured at year-end. The weighted average discount rate used in determining the net periodic postretirement benefit cost was 5.80% in 2006 and 5.75% in 2005, and is based on beginning of year assumptions.

Expected amounts to be recognized as components of 2007 net periodic postretirement benefit cost are (in thousands):

Service cost	$ 1,661
Interest cost on projected benefits	5,560
Actuarial loss	867
Amortization of prior service cost	(544)
Reallocation of cost	2,000
Net periodic pension cost	$ 9,544

The Cooperative funds the plan as benefit payments are required. The expected benefit payments to be paid and contributions to be made in each of the next five years, and in the aggregate for the five fiscal years thereafter, as of December 31, 2006, are as follows (in thousands):

Years Ending December 31	
2007	$ 5,238
2008	5,706
2009	6,159
2010	6,606
2011	6,982
2012–2016	38,453
Total	$ 69,144

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was enacted. The Act introduced a drug benefit under Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide an equivalent benefit. As of December 31, 2006, the Cooperative's retiree medical plan provides prescription drug coverage for eligible retirees.

As a result of the Cooperative adopting the provisions of SFAS No. 158 at December 31, 2006, an additional retiree medical liability was recorded which consisted of previously unrecognized gains, prior service cost, and transition obligations. The change in retiree medical liability was $28,085,000 and is recorded as a component of the SFAS No. 158 transition amount in the statements of operations and changes in net assets.

6. COMMITMENTS AND CONTINGENCIES

Leases—The Group has various operating leases for land, buildings, and equipment. Total rent expense was $16,859,000 and $17,644,000 on these leases in 2006 and 2005, respectively. Total sublease rental revenue was $1,553,000 and $1,030,000 in 2006 and 2005, respectively. Future minimum rental payments and future minimum sublease rental receipts under noncancelable operating lease and sublease agreements as of December 31, 2006, are as follows (in thousands):

Years Ending December 31	Minimum Sublease Rental Receipts	Minimum Rental Payments
2007	$ 1,518	$ 17,342
2008	1,376	18,045
2009	1,300	16,792
2010	1,109	15,962
2011	882	13,649
Thereafter	115	62,368
Total	$ 6,300	$ 144,158

In July 2006, the Cooperative entered into a sale-leaseback transaction involving the sale of its administrative main building located in Tukwila, Washington, and then entered into a 10-year operating lease with the purchaser. The gain on sale of $26,026,000 was deferred, and will be amortized over 120 months and recognized as a component of other expense in the consolidated statements of operations and changes in net assets. The sale price was contingent upon certain conditional use permits being obtained from the City of Tukwila. If the permits were issued, then the purchaser would increase the selling price by $3,000,000, which would increase the recorded gain on sale by the same amount. The permitting process completed in March 2007. The funds are held in escrow and are expected to be released in April 2007.

Labor—Approximately 60% of the Cooperative's employees are covered under collective bargaining agreements. These employees provide nursing and other technical services to the Cooperative. Bargaining disputes could adversely affect the Cooperative.

Litigation—The Group is involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates accruals, if any, that are necessary related to these matters. Management believes the recorded amounts are adequate and the ultimate outcome of the matters will not have a material adverse effect on the Group's financial position or results of operations.

7. DISCLOSURE ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents—The carrying amounts, at cost, approximate fair value due to the short maturity of those instruments.

Marketable Securities—The fair values of investments, which agree with the carrying values, are estimated based on quoted market prices for these or similar investments.

Funds Held by Trustee—The carrying amount, at cost, of funds held by trustee approximates fair value due to the short maturity of those instruments.

Long-Term Debt—The fair value of the Group's long-term debt is estimated based on the future cash flows at the discounted current rates available to the Group for debt of similar type and maturity. Any call provisions that apply are taken into account when valuing the debt. The fair value of the long-term debt was $226,274,000 and $126,328,000 as of December 31, 2006 and 2005, respectively.

8. DERIVATIVE FINANCIAL INSTRUMENTS

The Cooperative is exposed to the effects of changing interest rates. This exposure is managed, in part, with the use of derivatives. The following is a summary of the Cooperative's risk management strategies and the effects of these strategies on the consolidated financial statements.

As of December 31, 2006, the Cooperative has a total return swap considered to be a derivative financial instrument. The total return swap entitles the Cooperative to receive payments equal to the coupon rates on the 1991 series debt and pay a variable rate that is based on the Bond Market Association Municipal Swap Index. The Cooperative has elected to account for the total return swap as a free-standing derivative; therefore, changes in the fair value are recorded in earnings. The notional amount of this derivative was $45,260,000 as of December 31, 2006. As of December 31, 2005, the notional amount of $46,635,000 also included a total return swap on the 1988A series debt that matured in December 2005. For the years ended December 31, 2006 and 2005, the amount included in earnings was not material.

The effect of the total return swap has been to reduce the interest rate paid by the Cooperative from the stated rates to a lower variable rate; however, this also created exposure to increasing interest rates. In February 2003, to hedge the interest rate variability, the Cooperative entered into a new pay-fixed, receive-variable interest rate swap on $25 million of the series 1991 bonds through March 2008. In December 2006, this swap was terminated in order to rebalance the mix of variable and fixed rate interest exposure following the issuance of the series 2006 revenue bonds. While management expected this derivative to be highly effective in achieving its stated economic goal, it did not qualify for hedge accounting treatment. Therefore, this swap has been accounted for as a free-standing derivative with changes in the fair value recorded in earnings. For the year ended December 31, 2006, the amount included in earnings was not material.

In January 2007, the Cooperative entered into an interest rate swap on the 2006 series debt as part of the effort to rebalance the mix of variable and fixed rate exposure. The swap entitles GHC to receive payments based on a fixed rate and pay a variable rate based on the Bond Market Association Municipal Swap Index. The terms include a provision to cap the market value of the swap at $22,500,000, and a par termination option with a term to match the call provision of the 2006 series bonds. The Cooperative has elected to account for the swap as a free-standing derivative; therefore, changes in the fair value will be recorded in earnings. The notional amount of this derivative is $75,000,000.

9. FEDERAL INCOME TAXES

The components of income tax expense for GHC, GHO, KPS, and NCVS related to continuing operations and comprehensive income for the years ended December 31, 2006 and 2005, are summarized as follows (in thousands):

	2006	2005
Federal income tax expense (benefit) on operations	$ 4,355	$ (94)
Federal income tax expense (benefit) included in comprehensive loss/income	(1,150)	175

Federal income tax expense (benefit) included in comprehensive loss/income is recognized as a component of changes in unrealized investment gains and losses and comprehensive loss/income in the consolidated statements of operations and changes in net assets.

The deferred tax asset is recorded within other current assets and the deferred tax liability is recorded as a component of accounts payable in the accompanying consolidated balance sheets of the following amounts (in thousands):

	2006	2005
Deferred tax asset	$ 5,010	$ 5,977
Deferred tax liability	(88)	(93)
Net deferred tax asset	$ 4,922	$ 5,884

The deferred tax asset results from tax credit carryforwards and temporary differences in unearned premiums, discounted reserves, vacation expense, fixed asset valuation, and allowance for doubtful accounts that are not deductible for tax purposes in the current year. The deferred tax liability results from unrealized investment gains, accrued dividends, the use of deferred compensation, and the effect of an IRS Section 481 adjustment due to a change in accounting method for unearned premiums. No valuation allowance has been provided for the net deferred tax asset as management believes it is more likely than not that the entire amount will be realized.

At December 31, 2006, KPS had available net operating loss carryforwards of approximately $9,210,000, expiring between 2018 and 2024, subject to the IRS 382 limitation rule, if not used by KPS to reduce income taxes payable in future periods. The effective tax rates for the taxable entities differ from the federal statutory rate of 34% of income before taxes primarily due to the effect of net operating loss carryforwards.

10. KPS HEALTH PLANS ACQUISITION

Effective October 1, 2005, GHC acquired control of KPS. KPS was subject to receivership by the OIC since 1999 as a result of financial problems. Pursuant to a Transfer Agreement between the OIC and GHC, the OIC transferred control of KPS to GHC for a zero purchase price. The acquisition was accounted for under the purchase method, which resulted in negative goodwill of $1,774,000, which is being amortized over 48 months and is recognized as a component of other revenue in the consolidated statements of operations and changes in net assets. In 2006, additional consideration was conveyed through KPS incurring amounts due to its surplus note holders. Negative goodwill was reduced resulting in an adjusted negative goodwill balance of $187,000 at December 31, 2006. The accompanying consolidated financial statements include the accounts of KPS beginning October 1, 2005.

Supplemental pro-forma information representing the results of operations as though the companies had combined at the beginning of the year for 2005 is shown as follows (in thousands):

Revenues	$ 2,430,492
Net income	115,707

11. JOINT VENTURE AND NEW ADMINISTRATIVE BUILDING

In December 2005, GHC signed a joint venture agreement with City Investors V LLC, a real estate development company controlled by the Vulcan Corporation, to form Westlake Terry LLC. GHC has a 49.5 percent interest in Westlake Terry LLC in the amount of $13,423,000 as of December 31, 2006. Under the agreement, the joint venture plans to develop two adjacent buildings totaling 319,000 square feet located in Seattle, Washington, with GHC becoming a major tenant of the new facility with a 10-year operating lease agreement. GHC plans to move its administrative headquarters to this site once construction is completed in 2007.

In May 2006, GHC and City Investors V LLC entered into loan guaranties with Westlake Terry LLC's lenders relating to its construction and long-term financing.

The Westlake Terry LLC is currently in the construction phase. During the construction phase, GHC has provided a guaranty of $40,250,000 which will remain in effect until Westlake Terry LLC meets certain conditions. Once Westlake Terry LLC has met these conditions, GHC's guaranty to the lender is reduced to a maximum liability of $22,000,000 and will remain in effect until certain additional operating conditions have been met.

Management believes the likelihood of performance on these guarantees to be remote and, therefore, has not recorded a related liability.

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