

APRIA HEALTHCARE GROUP INC

Form 10-K/A

September 11, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

**FORM 10-K/A
AMENDMENT NO. 1**

(Mark one)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

**For the transition period from _____ to _____
Commission file number 1-14316
APRIA HEALTHCARE GROUP INC.
(Exact name of registrant as specified in its charter)**

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

33-0488566
(I.R.S. Employer
Identification Number)

26220 Enterprise Court, Lake Forest, CA
(Address of Principal Executive Offices)

92630
(Zip Code)

**Registrant's telephone number: (949) 639-2000
Securities registered pursuant to Section 12(b) of the Act:**

Common Stock, \$0.001 par value per share
(Title of each class)

New York Stock Exchange
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the
Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the
Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was
required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained
herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements
incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,
or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting
company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer Accelerated filer Non-Accelerated filer Smaller Reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of June 30, 2008 the aggregate market value of the shares of common stock held by non-affiliates of the Registrant, computed based on the closing sale price of \$18.90 per share as reported by the New York Stock Exchange, was approximately \$588,499,412.

As of September 9, 2008, there were outstanding 43,949,271 shares of the Registrant's common stock, par value \$.001 per share, which is the only class of common stock of the Registrant (not including 17,112,574 shares held in treasury).

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Explanatory Note

Apria Healthcare Group Inc. (Apria, the Company , we or our) is filing this Amendment No. 1 (Amendment No. 1) to its Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the Original Form 10-K), which was filed with the Securities and Exchange Commission (the SEC) on February 29, 2008, to amend Part II, Item 9A: Controls and Procedures, to revise our conclusions regarding the effectiveness of the Company s internal control over financial reporting and disclosure controls and procedures. In addition, the cover page and portions of Part IV, Item 15: Exhibits and Financial Statement Schedules, have been updated and amended.

Subsequent to the evaluation of the effectiveness of our internal control over financial reporting and disclosure controls and procedures made in connection with the Original Form 10-K, we reevaluated our internal control over financial reporting relating to the calculation of accounts receivable reserves and concluded that the Company did not effectively design and perform certain control activities to prevent or detect material misstatements that might exist in our reserve for uncollectible accounts receivable and, therefore, a material weakness existed in the Company s internal control over financial reporting. Due to the identification of this material weakness our management, including our Chief Executive Officer and Chief Financial Officer, reevaluated the effectiveness of our disclosure controls and procedures as of December 31, 2007 and concluded that they were not effective as of that date. Notwithstanding the material weakness, based upon the work performed by the Company during August and September of 2008, we have concluded that there were no material adjustments required to the previously reported accounts receivable reserve amounts, and that our consolidated financial statements for the periods covered by and included in our Original Form 10-K are fairly stated in all material respects in accordance with accounting principles generally accepted in the United States of America.

In addition, as required under Rule 12b-15 promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), the Company s principal executive officer and principal financial officer are providing new certifications in connection with this Amendment No. 1. For purposes of this Amendment No. 1 and in accordance with Rule 12b-15 under the Exchange Act, Item 9A of the Original Form 10-K has been amended and restated in its entirety. Except for the amendments described above, this Amendment No. 1 does not modify or update the disclosures in, or the exhibits to, the Original Form 10-K. Among other things, forward-looking statements made in the Original Form 10-K have not been revised to reflect events that occurred or facts that became known to us after the filing of the Original Form 10-K, and such forward looking statements should be read in their historical context.

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PART II

Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

In connection with the Original Form 10-K, with the participation of our Chief Executive Officer and Chief Financial Officer, our management had evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2007. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer had concluded that, as of the end of the period covered by the Original Form 10-K, our disclosure controls and procedures were effective.

Subsequent to the evaluation made in connection with our Original Form 10-K, we reevaluated our internal control over financial reporting relating to the calculation of accounts receivable reserves and concluded that the Company did not effectively design and perform control activities to prevent or detect material misstatements that might exist in our reserve for uncollectible accounts receivable and, therefore, a material weakness existed. Specifically, we did not perform an analysis with a sufficient level of detail to support management's estimate of the reserve for uncollectible accounts receivable. Due to the identification of the material weakness in internal control over financial reporting, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, reevaluated the effectiveness of our disclosure controls and procedures and have concluded that they were not effective as of December 31, 2007.

Notwithstanding the material weakness, based upon the work performed by the Company during August and September of 2008, including a review of accounts receivable reserves as of December 31, 2007, we have concluded that there were no material adjustments required to the previously reported accounts receivable reserve amounts and that our consolidated financial statements for the periods covered by and included in our Original Form 10-K are fairly stated in all material respects in accordance with accounting principles generally accepted in the United States of America.

Future Remediation Plan for Material Weakness

During September 2008, we completed the design and implementation of control activities that we believe will prevent or detect material misstatements that might exist in our reserve for uncollectible accounts receivable. Specifically, we have developed a process to assess our historical cash receipts experience and consider other relevant factors to support management's estimate for uncollectible accounts receivable. While management believes that these steps are appropriate to remediate the material weakness in our internal control over financial reporting, management cannot conclude that remediation is complete until such controls operate for a sufficient period of time and are tested further. Following testing of our operational effectiveness, we believe our remediation will be complete in the fourth quarter of 2008.

Changes in Internal Control Over Financial Reporting

During the fourth quarter of the period covered by the Original Form 10-K, there were changes to our internal control over financial reporting. These changes were made in connection with analyzing deferred revenues and deferred expenses during the fourth quarter of 2007, where management identified that certain corrections to the amounts reported for these items were necessary. As a result of this, management has improved internal control over financial reporting by hiring additional qualified resources into the financial accounting group.

Management's Report On Internal Control Over Financial Reporting (As Revised)

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance that material misstatements will be prevented or detected on a timely basis. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, the Company has conducted an evaluation of the effectiveness of its internal control over financial reporting as of December 31, 2007. In making this assessment, our management used the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. Based upon our evaluation, we identified a material weakness in our internal control over financial reporting, which is described below. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. Because of the following material weakness, management has concluded that the Company's internal control over financial reporting was not effective as of December 31, 2007.

Management's estimate of the reserve for uncollectible accounts receivable. We did not effectively design and perform control activities to prevent or detect material misstatements that might exist in our reserve for uncollectible accounts receivable. Specifically, we did not perform an analysis with a sufficient level of detail to support management's estimate of the reserve for uncollectible accounts receivable.

Our management has not yet conducted an assessment of the internal control over financial reporting of Coram. We completed the acquisition of Coram on December 3, 2007, and it was not possible, given the timing of the acquisition, to conduct an assessment of Coram's internal control over financial reporting in the period between the completion of the acquisition and the date of our management's assessment of our internal control over financial reporting. Accordingly, our conclusion in this Amendment No. 1 regarding the effectiveness of our internal control over financial reporting as of December 31, 2007 does not include the internal control over financial reporting of Coram. Included in our consolidated financial statements was 28 days of operations which amounted to approximately \$42.0 million, or 2.6% of net revenues and \$0.7 million of net income. Additionally, Coram's total assets as of December 31, 2007 were approximately \$444 million, or 28% of consolidated total assets. We intend to undertake an evaluation of Coram's internal control over financial reporting during 2008.

The Company's independent registered public accounting firm has audited the Company's internal control over financial reporting as of December 31, 2007, as stated in the Report of Independent Registered Accounting Firm, appearing under Item 15, which expresses an adverse opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2007.

September 11, 2008

/s/ LAWRENCE M. HIGBY

Lawrence M. Higby
Chief Executive Officer

/s/ CHRIS A. KARKENNY

Chris A. Karkenny Executive Vice
President and Chief Financial Officer

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PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) 1. The financial statements described in the Index to Consolidated Financial Statements and Financial Statement Schedule are included in this Amendment No. 1 starting at page F-1.
2. The financial statement schedule is included on page S-1.

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

3. Exhibits included or incorporated by reference herein:

See Exhibit Index.

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AND FINANCIAL STATEMENT SCHEDULE**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Apria Healthcare Group Inc.
Lake Forest, California

We have audited the accompanying consolidated balance sheets of Apria Healthcare Group Inc. and subsidiaries (the Company) as of December 31, 2007 and 2006, and the consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedules listed in the Index at Item 15. We also have audited the Company's internal control over financial reporting as of and for the year ended December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management's Report on Internal Control Over Financial Reporting, management excluded from its assessment the internal control over financial reporting at Coram, Inc., which was acquired on December 3, 2007 and whose financial statements constitute 28% of total assets, 2.6% of net revenues, and 0.8% of net income of the consolidated financial statement amounts as of December 31, 2007. Accordingly, our audit did not include the internal control over financial reporting at Coram, Inc. The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting based on our audits. Our responsibility is to express an opinion on these financial statements and financial statement schedules and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment:

Management's estimate of the reserve for uncollectible accounts receivable.

The Company did not effectively design and perform certain control activities to prevent or detect material misstatements that might exist in its reserve for uncollectible accounts receivable.

This material weakness was considered in assessing the nature, timing, and extent of audit tests applied in our audit of the financial statements and financial statement schedules of the Company and this material weakness does not affect our opinion on such financial statements and financial statement schedules.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Apria Healthcare Group Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein. Also, in our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Note 8 to the consolidated financial statements, the Company changed its method of accounting for Share-Based Payment and prospectively adjusted the 2006 consolidated financial statements for the change. Also, as discussed in Note 3 to the consolidated financial statements, on January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*.

DELOITTE & TOUCHE LLP

Costa Mesa, CA

February 29, 2008

(September 11, 2008 as to the material weakness described above)

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CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)	December 31,	
	2007	2006
		(As Restated See Note 2)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 28,451	\$ 14,657
Accounts receivable, less allowance for doubtful accounts of \$47,823 and \$27,324 at December 31, 2007 and 2006, respectively	284,141	211,097
Inventories, net	52,079	40,681
Deferred income taxes	66,198	42,480
Deferred expenses	3,102	3,020
Prepaid expenses and other current assets	23,364	19,142
TOTAL CURRENT ASSETS	457,335	331,077
PATIENT SERVICE EQUIPMENT, less accumulated depreciation of \$453,324 and \$445,608 at December 31, 2007 and 2006, respectively	200,180	212,068
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	102,827	52,975
GOODWILL	715,235	539,187
INTANGIBLE ASSETS, NET	107,757	6,551
DEFERRED DEBT ISSUANCE COSTS, NET	2,834	4,612
OTHER ASSETS	11,634	8,166
	\$ 1,597,802	\$ 1,154,636
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 120,360	\$ 66,969
Accrued payroll and related taxes and benefits	66,625	46,532
Income taxes payable	3,076	10,793
Other accrued liabilities	73,835	44,804
Deferred revenue	29,704	29,158
Current portion of long-term debt	254,252	2,145
TOTAL CURRENT LIABILITIES	547,852	200,401
LONG-TERM DEBT, net of current portion	433,031	485,000
DEFERRED INCOME TAXES	62,290	60,815
INCOME TAXES PAYABLE AND OTHER NON-CURRENT LIABILITIES	42,604	8,727
TOTAL LIABILITIES	1,085,777	754,943
COMMITMENTS AND CONTINGENCIES (Notes 11 and 13)		
STOCKHOLDERS EQUITY		
Preferred stock, \$.001 par value: 10,000,000 shares authorized; none issued		
Common stock, \$.001 par value:		

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150,000,000 shares authorized; 60,844,901 and 59,762,307 shares issued at December 31, 2007 and 2006, respectively; 43,794,492 and 42,789,450 outstanding at December 31, 2007 and 2006, respectively	61	60
Additional paid-in capital	514,848	482,123
Treasury stock, at cost; 17,050,409 and 16,972,857 shares at December 31, 2007 and 2006, respectively	(431,651)	(429,573)
Retained earnings	428,538	346,732
Accumulated other comprehensive income	229	351
TOTAL STOCKHOLDERS EQUITY	512,025	399,693
	\$ 1,597,802	\$ 1,154,636

See notes to consolidated financial statements.

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**APRIA HEALTHCARE GROUP INC.
CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share data)	Year Ended December 31,		
	2007	2006 (As Restated See Note 2)	2005 (As Restated See Note 2)
Net revenues:			
Fee for service arrangements	\$ 1,465,303	\$ 1,355,202	\$ 1,329,346
Capitation	166,498	161,489	146,324
TOTAL NET REVENUES	1,631,801	1,516,691	1,475,670
Costs and expenses:			
Cost of net revenues:			
Product and supply costs	386,496	345,693	309,338
Patient service equipment depreciation	110,775	113,177	111,759
Home respiratory therapy services	38,886	38,501	34,669
Nursing services	11,353	8,825	9,078
Other	17,482	15,384	14,369
TOTAL COST OF NET REVENUES	564,992	521,580	479,213
Provision for doubtful accounts	43,138	38,723	46,948
Selling, distribution and administrative	862,062	804,285	792,031
<i>Qui tam</i> settlement and related costs (Note 13)			19,258
Amortization of intangible assets	3,079	5,080	6,941
TOTAL COSTS AND EXPENSES	1,473,271	1,369,668	1,344,391
OPERATING INCOME	158,530	147,023	131,279
Interest expense	22,447	31,205	22,972
Interest income and other	(1,954)	(1,742)	(853)
INCOME BEFORE TAXES	138,037	117,560	109,160
Income tax expense	51,998	43,297	40,677
NET INCOME	\$ 86,039	\$ 74,263	\$ 68,483
Basic net income per common share	\$ 1.98	\$ 1.75	\$ 1.42
Diluted net income per common share	\$ 1.95	\$ 1.73	\$ 1.40

See notes to consolidated financial statements.

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APRIA HEALTHCARE GROUP INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)	Common Stock Shares	Par Value	Additional Paid-In Capital	Treasury Stock Shares	Cost	Retained Earnings (As Restated See Note 2)	Accumulated Other Comprehensive (Loss)Income	Total Stockholders Equity (As Restated See Note 2)
Balance at January 1, 2005, as previously reported	58,236	\$ 58	\$ 439,544	9,628	\$ (254,432)	\$ 221,041	\$ (26)	\$ 406,185
Restatement adjustments						(17,055)		(17,055)
Balance at January 1, 2005, as restated	58,236	58	439,544	9,628	(254,432)	203,986	(26)	389,130
Exercise of stock options	937	1	21,179					21,180
Tax benefits related to stock options			4,117					4,117
Compensatory stock options and awards	43		3,259					3,259
Repurchases of common stock				7,337	(175,000)			(175,000)
Unrealized gain on interest rate swap agreements, net of taxes							482	482
Net income						68,483		66,483
Total comprehensive income						68,483	482	68,965
Balance at December 31, 2005, as restated	59,216	59	468,099	16,965	(429,432)	272,469	456	311,651
Exercise of stock options	508	1	8,244					8,245
Tax benefits related to stock options			403					403
Tax shortfalls on share-based			(386)					(386)

compensation									
Compensatory stock options and awards	38		5,763						5,763
Restricted stock retained in treasury upon vesting				8	(141)				(141)
Unrealized loss on interest rate swap agreements, net of taxes								(105)	(105)
Net income						74,263			74,263
Total comprehensive income						74,263		(105)	74,158
Balance at December 31, 2006, as restated	59,762	60	482,123	16,973	(429,573)	346,732		351	399,693
Cumulative effect adjustment pursuant to adoption of FIN 48						(4,233)			(4,233)
Exercise of stock options	887	1	17,617						17,618
Tax benefits related to stock options			4,057						4,057
Tax shortfalls on share-based compensation			(99)						(99)
Compensatory stock options and awards	196		11,150						11,150
Restricted stock retained in treasury upon vesting				77	(2,078)				(2,078)
Unrealized loss on interest rate swap agreements, net of taxes								(122)	(122)
Net income						86,039			86,039
Total comprehensive income						86,039		(122)	85,917
Balance at December 31, 2007	60,845	\$ 61	\$ 514,848	17,050	\$ (431,651)	\$ 428,538	\$	229	\$ 512,025

See notes to consolidated financial statements.

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APRIA HEALTHCARE GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Year Ended December 31,		
	2007	2006 (As Restated See Note 2)	2005 (As Restated See Note 2)
OPERATING ACTIVITIES			
Net income	\$ 86,039	\$ 74,263	\$ 68,483
Items included in net income not requiring cash:			
Provision for doubtful accounts	43,138	38,723	46,948
Depreciation	131,645	133,563	133,677
Amortization of intangible assets	3,079	5,080	6,941
Amortization of deferred debt issuance costs	1,778	1,755	1,729
Deferred income taxes	4,605	24,712	(4,962)
Share-based compensation	11,150	5,763	3,259
Excess tax benefits from shared-based compensation	(4,057)	(403)	
Gain on disposition of assets and other	(536)	(81)	
Changes in operating assets and liabilities, exclusive of effects of acquisitions:			
Accounts receivable	(33,724)	(23,342)	(54,198)
Inventories, net	2,589	2,025	(561)
Prepaid expenses and other assets	(48)	7,094	3,452
Accounts payable, exclusive of book cash overdraft	7,043	7,717	2,907
Accrued payroll and related taxes and benefits	477	(4,775)	3,547
Income taxes payable	20,380	2,145	(6,427)
Deferred revenue, net of deferred expenses	289	1,238	(1,790)
Accrued expenses	20,159	5,437	3,294
NET CASH PROVIDED BY OPERATING ACTIVITIES	294,006	280,914	206,299
INVESTING ACTIVITIES			
Purchases of patient service equipment and property, equipment and improvements, exclusive of effects of acquisitions	(128,759)	(125,628)	(118,867)
Proceeds from disposition of assets	102	778	767
Cash paid for acquisitions	(354,578)	(8,082)	(105,471)
NET CASH USED IN INVESTING ACTIVITIES	(483,235)	(132,932)	(223,571)
FINANCING ACTIVITIES			
Proceeds from revolving credit facilities	359,000	29,800	216,250
Payments on revolving credit facilities	(170,000)	(184,800)	(51,000)
Payments on other long-term debt	(3,264)	(7,030)	(7,854)
Change in book cash overdraft included in accounts payable	(4,291)	(2,128)	(2,384)
Capitalized debt issuance costs		(1,119)	(15)
Repurchases of common stock			(175,000)
Excess tax benefits from shared-based compensation	4,057	403	
Issuances of common stock	17,521	8,245	21,180

NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	203,023	(156,629)	1,177
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,794	(8,647)	(16,095)
Cash and cash equivalents at beginning of year	14,657	23,304	39,399
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 28,451	\$ 14,657	\$ 23,304

SUPPLEMENTAL DISCLOSURES See Note 7 Long-term Debt and Note 9 Income Taxes for cash paid for interest and income taxes, respectively.

NON-CASH TRANSACTIONS See Statements of Stockholders Equity, Note 5 Business Combinations and Note 11 Leases for tax benefit from stock option exercises, non-cash treasury stock transactions, liabilities assumed in acquisitions and purchase of property and equipment under capital leases, respectively.

Purchases of patient service equipment and property, equipment and improvements exclude purchases that remain unpaid at the end of the respective year. Such amounts are then included in the following year's purchases. Unpaid purchases were \$10,994, \$8,152 and \$10,754 at December 31, 2007, 2006 and 2005, respectively.

See notes to consolidated financial statements.

Table of Contents**APRIA HEALTHCARE GROUP INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation: The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These statements include the accounts of Apria Healthcare Group Inc. (Apria or the Company) and its subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation. The 2006 and prior years financial statements have been restated. See Note 2 to these Consolidated Financial Statements.

Company Background: Apria operates in the home healthcare segment of the healthcare industry, providing a variety of clinical services and related products and supplies as prescribed by a physician or authorized by a case manager as part of a care plan. Essentially all products and services offered by the Company are provided through the Company's network of approximately 550 branch facilities, which are located throughout the United States. Our home respiratory therapy and home medical equipment service lines are currently organized into three geographic divisions. The recently acquired Coram home infusion business is organized in a single division. The Company's chief operating decision maker evaluates operating results on a divisional basis and, therefore, each division is designated an operating segment. All divisions provide the same products and services, including home respiratory therapy, home infusion therapy and home medical equipment and supplies, except for the recently acquired Coram business which provides home infusion therapy services only. For financial reporting purposes, all of the Company's operating segments are aggregated into one reportable segment in accordance with the aggregation criteria of Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

Use of Accounting Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition and Concentration of Credit Risk: Revenues are recognized under fee for service arrangements through equipment we rent to patients, sales of equipment, supplies, pharmaceuticals and other items we sell to patients and lastly, through capitation payments received from third party payors for services and equipment we provide to the patients of these payors. Revenue generated from equipment that we rent to patients is recognized over the rental period, typically one month, and commences on delivery of the equipment to the patients. Revenue related to sales of equipment, supplies and pharmaceuticals is recognized on the date of delivery to the patients. Revenues derived from capitation arrangements were approximately 10%, 11% and 11% of total net revenues for 2007, 2006 and 2005, respectively. Capitation revenue is earned as a result of entering into a contract with a third party to provide its members certain services without regard to the actual services provided, therefore revenue is recognized in the period that the beneficiaries are entitled to health care services. All revenues are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including private insurers, prepaid health plans, Medicare and Medicaid. For the years 2007, 2006 and 2005, revenues reimbursed under arrangements with Medicare and Medicaid were approximately 35%, 36% and 39%, respectively, as a percentage of total revenues. In all three years presented, no other third-party payor group represented more than 9% of the Company's revenues. In fee for service arrangement revenue, rental and sale revenues comprise approximately \$730,492,000 or 49.9% and \$734,811,000 or 50.1%; \$701,224,000 or 51.7% and \$653,978,000 or 48.3%; and \$704,607,000 or 53.0% and \$624,739,000 or 47.0% in 2007, 2006 and 2005, respectively.

Emerging Issues Task Force (EITF) Topic 00-21, *Revenue Arrangements with Multiple Deliverables*, addresses the accounting for revenues in which multiple products and/or services are delivered at different times under one arrangement with a customer, and provides guidance in determining whether multiple deliverables should be considered as separate units of accounting. In our business, we have multiple products that are delivered to patients. These arrangements involve equipment that is rented and related supplies that may be sold that cannot be returned. In our revenue recognition policy regarding arrangements with multiple deliverables, revenue is recognized when each deliverable is provided to the patient. For example, revenues from equipment rental supplies sales are recognized upon delivery of the products, as the supplies sold are considered a separate unit of accounting.

Deferred Revenue and Deferred Expense: Rental of equipment to patients is accounted for under SFAS No. 13, *Accounting for Leases*. Under SFAS No. 13, a lessor is required to recognize rental income over the lease term. Rental of patient equipment is billed on a monthly basis beginning on the date the equipment is delivered. Since deliveries can occur on any day during a month, the amount of billings that apply to the next month are deferred.

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The accounting for the deferral of expenses by lessors is addressed by SFAS No. 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. Only the direct costs associated with the initial rental period are deferred in accordance with SFAS No. 91.

Cash and Cash Equivalents: Cash is maintained with various financial institutions. These financial institutions are located throughout the United States and the Company's cash management practices limit exposure to any one institution. Book cash overdrafts, which are reported as a component of accounts payable, were \$14,228,000 and \$18,519,000 at December 31, 2007 and 2006, respectively. Management considers all highly liquid instruments purchased with a maturity of less than three months to be cash equivalents.

Accounts Receivable: Included in accounts receivable are earned but unbilled receivables of \$48,262,000 and \$30,036,000 at December 31, 2007 and 2006, respectively. Delays ranging from a day up to several weeks between the date of service and billing can occur due to delays in obtaining certain required payor-specific documentation from internal and external sources. Earned but unbilled receivables are aged from date of service and are considered in the analysis of historical performance and collectibility.

Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenues and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review.

Management performs periodic analyses to evaluate accounts receivable balances to ensure that recorded amounts reflect estimated net realizable value. Specifically, management considers historical realization data, accounts receivable aging trends, other operating trends, the extent of contracted business and business combinations. Also considered are relevant business conditions such as governmental and managed care payor claims processing procedures and system changes. Additionally, focused reviews of certain large and/or problematic payors are performed. Due to continuing changes in the healthcare industry and third-party reimbursement, it is possible that management's estimates could change in the near term, which could have an impact on operations and cash flows.

Accounts receivable are reduced by an allowance for doubtful accounts which provides for those accounts from which payment is not expected to be received, although services were provided and revenue was earned. Upon determination that an account is uncollectible, it is written-off and charged to the allowance.

Inventories: Inventories are stated at the lower of cost (first-in, first-out method) or market and consist primarily of pharmaceuticals and items used in conjunction with patient service equipment. Inventories are reduced by a reserve for slow moving or obsolete inventory.

Patient Service Equipment: Patient service equipment is stated at cost and consists of medical equipment rented to patients on a month-to-month basis. Depreciation is provided using the straight-line method over the estimated useful lives of the equipment, which range from one to ten years.

Property, Equipment and Improvements: Property, equipment and improvements are stated at cost. Included in property and equipment are assets under capitalized leases which consist of information systems hardware and software. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives for each of the categories presented in Note 4 are as follows: leasehold improvements – the shorter of the remaining lease term or seven years; equipment and furnishings – three to fifteen years; and information systems – three to six years.

Capitalized Software: Included in property, equipment and improvements are costs related to internally developed and purchased software that are capitalized and amortized over periods that the assets are expected to provide benefit and are accounted for under Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized costs include direct costs of materials and services incurred in developing or obtaining internal-use software and payroll and benefit costs for employees directly involved in the development of internal-use software.

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Long-Lived Assets: The recoverability of long-lived assets, including property and equipment and certain identifiable intangible assets, is evaluated in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires a review for impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Factors considered important which could trigger an impairment review include but are not limited to:

significant underperformance relative to historical or projected future operating results;

significant changes in the manner of use of the assets or the strategy for our overall business;

significant decrease in the market value of the assets; and

significant negative industry or economic trends.

When it is determined that the carrying amount of long-lived assets may not be recoverable based upon the existence of one or more of the above indicators, management assesses the assets for impairment based on the estimated future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment loss is recorded for the excess of the asset's carrying amount over its fair value. Fair value is generally determined based on the estimated future discounted cash flows over the remaining useful life of the asset using a discount rate determined by management to be commensurate with the risk inherent in its business model. The assumptions supporting the cash flows, including the discount rates, are determined using management's best estimates as of the date of the impairment review. If these estimates or their related assumptions change in the future, impairment charges may be required for these assets, and future results of operations could be adversely affected.

Goodwill: Goodwill arising from business combinations represents the excess of the purchase price over the estimated fair value of the net assets of the businesses acquired. In accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is tested annually for impairment or more frequently if circumstances indicate the possibility of impairment. The Company has selected December 31 to perform its annual impairment test. Management does not believe any impairment of its goodwill existed at December 31, 2007. The goodwill amounts for the December 3, 2007 acquisition of Coram are based upon preliminary estimates that are subject to change in 2008 upon completion of the final valuation analysis. Final determination of these estimates could result in an adjustment to the purchase price allocation with an offsetting adjustment to goodwill.

Intangible Assets: Intangible assets consist of covenants not to compete, trade names, patient referral sources and customer lists, all of which arose from business combinations. The values assigned to the covenants not to compete are amortized on a straight-line basis over their contractual terms. Customer list and patient referral sources are amortized over their period of expected benefit. Management tests for impairment in accordance with SFAS No. 142. The intangible assets resulting from the December 3, 2007 acquisition of Coram are based upon preliminary estimates that are subject to change in 2008 upon completion of final valuation analysis.

Deferred Debt Issuance Costs: Capitalized debt issuance costs include those associated with the Company's revolving credit facility and the convertible senior notes. Such costs are classified as non-current assets. Costs relating to the revolving credit facility are being amortized through the maturity date of June, 2011. Costs relating to the convertible senior notes are amortized from the issuance date through September 2008. See Note 7 Long-term Debt.

Fair Value of Financial Instruments: The carrying value of Apria's bank debt approximates fair value because the underlying instruments are variable notes that reprice frequently. The fair value of the convertible senior notes, as determined by reference to quoted market prices, is \$249,455,000 and \$242,398,000 at December 31, 2007 and 2006, respectively. The carrying amounts of cash and cash equivalents, accounts receivable, trade payables and accrued expenses approximate fair value due to their short maturity.

Product and Supply Costs: Product and supply costs presented within cost of net revenues are comprised primarily of cost of supplies and equipment provided to patients, infusion drug costs and enteral product costs.

Home Respiratory Therapy Expenses: Home respiratory therapy expenses presented within cost of net revenues are comprised primarily of employee salary and benefit costs or contract fees paid to respiratory therapists and other

related professionals who are deployed to service a patient. Home respiratory therapy personnel are also engaged in a number of administrative and marketing tasks, and accordingly, these costs are classified within selling, distribution and administrative expenses and amounted to \$19,766,000 in 2007 and \$15,694,000 in 2006.

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Distribution Expenses: Distribution expenses are included in selling, distribution and administrative expenses and totaled \$175,947,000, \$174,273,000 and \$171,724,000 in 2007, 2006, and 2005, respectively. Such expense represents the cost incurred to coordinate and deliver products and services to the patients. Included in distribution expenses are leasing, maintenance, licensing and fuel costs for the vehicle fleet; salaries and other costs related to drivers and dispatch personnel; and amounts paid to courier and other outside shipping vendors. Such expenses fall within the definition of shipping and handling costs as discussed in Emerging Issues Task Force (EITF) No. 00-10 *Accounting for Shipping and Handling Fees and Costs*, which permits their income statement classification within selling and administrative expenses.

Self-Insurance: Coverage for certain employee medical claims and benefits, as well as workers compensation, vehicle liability, professional and general liability are self-insured. Accruals for medical claims at December 31, 2007 and 2006 were \$8,484,000 and \$10,061,000, respectively. Amounts accrued for costs of the other liability coverages totaled \$15,456,000 and \$10,977,000 at December 31, 2007 and 2006, respectively. All such amounts are classified in other accrued liabilities.

Advertising: Advertising costs are initially established as a prepaid expense and amortized over the period of expected benefit. Such expenses are included in selling, distribution and administrative expenses and amounted to \$3,831,000, \$5,849,000 and \$6,844,000 for 2007, 2006 and 2005, respectively.

Income Taxes: Income taxes are provided for in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*. Accordingly, deferred income tax assets and liabilities are computed for differences between the carrying amounts of assets and liabilities for financial statement and tax purposes. Deferred income tax assets are required to be reduced by a valuation allowance when it is determined that it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining the necessity and amount of a valuation allowance, management considers current and past performance, the operating market environment, tax planning strategies and the length of tax benefit carryforward periods.

As of January 1, 2007, Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of SFAS No. 109 was adopted. Prior to January 1, 2007, tax contingencies were accounted for under the principles of SFAS No. 5, *Accounting for Contingencies*. See Note 3 Recent Accounting Pronouncements to the Consolidated Financial Statements for further discussion regarding adoption of FIN 48.

Derivative Instruments and Hedging Activities: From time to time derivative financial instruments are used to limit exposure to interest rate fluctuations on the Company's variable rate long-term debt. The interest rate swap agreements are being accounted for in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Unrealized gains and losses on the fair value of the swap agreements are reflected, net of taxes, in operating income, as the transactions no longer qualify for hedge accounting treatment. Exposure to credit loss under the swap agreement is limited to the interest rate spread in the event of counterparty nonperformance. The Company does not anticipate losses due to counterparty nonperformance as our counterparties to the swap agreement are nationally recognized financial institutions with strong credit ratings.

Share-Based Compensation: Prior to 2006, stock-based compensation plans were accounted for under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. For 2005, net income reflects compensation expense for restricted stock awards and restricted stock purchase rights valued in accordance with APB Opinion No. 25.

The provisions of SFAS No. 123(R), *Share-Based Payment* were adopted on January 1, 2006. The modified prospective transition method was elected and, accordingly, financial statement amounts for prior periods presented have not been restated to reflect the fair value method of expensing share-based compensation. The short-cut method was elected, as provided by SFAS No. 123(R), for determining the historical pool of tax benefits. See Note 8 Share-Based Compensation and Stockholders' Equity.

Comprehensive Income: For the years ended December 31, 2007, 2006, and 2005, the difference between net income and comprehensive income is \$122,000, \$(105,000) and \$482,000, respectively, net of taxes, which is attributable to unrealized (losses) and gains on various interest rate swap agreements.

Per Share Amounts: Basic net income per share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding. Diluted net income per share includes the effect of the potential shares outstanding, including dilutive stock options and other awards, using the treasury stock method.

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Historically, the Company accounted for deferred revenues and deferred expenses related to equipment it rents to patients under a reimbursement contract method. These deferred amounts were included in its consolidated financial statements for the year ended December 31, 2006, on which the Company's independent registered public accountants, Deloitte & Touche LLP, issued an unqualified opinion. In the course of a review in the fourth quarter of 2007, of the Company's accounting for deferred revenue and deferred expenses it was identified that the Company had incorrectly deferred revenue related to all of the Company's capitated contracts (albeit, in the fee for service arrangements line item) and that the Company incorrectly deferred certain indirect and overhead expenses. The Company concluded that the rental of such equipment should be accounted for under SFAS No. 13, *Accounting for Leases*. Under SFAS No. 13 lessors are required to recognize rental income over the lease term. The Company bills for the rental of patient equipment on a monthly basis beginning on the date the equipment is delivered. Since deliveries can occur on any day during a month revenue must be deferred for the amount of billings that apply to the next month.

The accounting for the deferral of expenses by lessors is addressed by SFAS No. 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. Under SFAS No. 91 only the direct costs associated with leases are to be deferred. The Company has re-evaluated the amount of costs to be deferred and now will be deferring only the direct costs associated with the initial rental period under SFAS No. 91 and have adjusted our financial statements accordingly.

On December 31, 2007, the Company's management and the Audit Committee of the Board of Directors concluded to restate its previously issued financial statements because of reporting errors solely relating to its accounting for deferred revenue and deferred expenses related to equipment it rents to patients. Accordingly, the Company restated its consolidated balance sheet as of December 31, 2006, and its consolidated statements of income, cash flows and stockholders' equity for the years ended December 31, 2006 and 2005. The impact of the restatement decreased net income for 2006 by \$0.7 million, or 0.9%, and increased net income for 2005 by \$1.5 million or 2.4%. The cumulative effect of the errors decreased stockholders' equity as of December 31, 2006 by \$10.7 million or 3.0% of retained earnings and 2.6% of total stockholders' equity. The cumulative effect of the errors decreased stockholders' equity as of January 1, 2005 by \$17.1 million or 7.7% of retained earnings and 4.2% of total stockholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In 2006, the Company made adjustments to its financial statements related to deferral of certain revenue and expenses pursuant to Staff Accounting Bulletin (SAB) No. 108 issued by the Securities and Exchange Commission. In the SAB 108 adjustment, the Company included all costs, including indirect and overhead costs which should have not been deferred. Prior to the SAB 108 adjustment in 2006, the Company did not record any deferred revenues or expenses. As a result of the restatement, the SAB 108 adjustment has been eliminated.

The following tables show the impact of the restatement.

CONSOLIDATED BALANCE SHEET ITEMS

(in thousands)	December 31, 2006		
	(As Previously Reported)	(Adjustments)	(As Restated)
Deferred income taxes	\$ 36,648	\$ 5,832	\$ 42,480
Deferred expenses	22,712	(19,692)	3,020
Total current assets	344,937	(13,860)	331,077
Total assets	1,168,496	(13,860)	1,154,636
Deferred revenue	32,280	(3,122)	29,158
Total current liabilities	203,523	(3,122)	200,401
Total liabilities	758,065	(3,122)	754,943
Retained earnings	357,470	(10,738)	346,732
Total stockholders' equity	\$ 410,431	\$ (10,738)	\$ 399,693

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	Year Ended December 31, 2006		
	(As		
(in thousands, except per share data)	Previously	(Adjustments)	(As
	Reported)		Restated)
Fee for service arrangements	\$ 1,355,818	\$ (616)	\$ 1,355,202
Total net revenues	1,517,307	(616)	1,516,691
Product and supply costs	345,552	141	345,693
Total cost of net revenues	521,439	141	521,580
Selling, distribution and administrative	804,365	(80)	804,285
Total costs and expenses	1,369,607	61	1,369,668
Operating income	147,700	(677)	147,023
Income before taxes	118,237	(677)	117,560
Income tax expense	43,257	40	43,297
Net income	74,980	(717)	74,263
Basic net income per common share	1.77		1.75
Diluted net income per common share	\$ 1.75		\$ 1.73

CONSOLIDATED STATEMENT OF INCOME ITEMS

	Year Ended December 31, 2005		
	(As		
(in thousands, except per share data)	Previously	(Adjustments)	(As
	Reported)		Restated)
Fee for service arrangements	\$ 1,327,777	\$ 1,569	\$ 1,329,346
Total net revenues	1,474,101	1,569	1,475,670
Product and supply costs	309,413	(75)	309,338
Total cost of net revenues	479,288	(75)	479,213
Selling, distribution and administrative	792,177	(146)	792,031
Total costs and expenses	1,344,612	(221)	1,344,391
Operating income	129,489	1,790	131,279
Income before taxes	107,370	1,790	109,160
Income tax expense	40,429	248	40,677
Net income	66,941	1,542	68,483
Basic net income per common share	1.39		1.42
Diluted net income per common share	\$ 1.37		\$ 1.40

CONSOLIDATED STATEMENT OF CASH FLOWS ITEMS

	Year Ended December 31, 2006		
	(As		
(in thousands)	Previously	(Adjustments)	(As
	Reported)		Restated)
Net income	\$ 74,980	\$ (717)	\$ 74,263
Deferred income taxes	24,673	39	24,712
Deferred revenue, net of deferred expenses	\$ 560	\$ 678	\$ 1,238

CONSOLIDATED STATEMENT OF CASH FLOWS ITEMS**Year Ended December 31, 2005****(As**

(in thousands)	(As Previously Reported)	(Adjustments)	Restated)
Net income	\$ 66,941	\$ 1,542	\$ 68,483
Deferred income taxes	(5,210)	248	(4,962)
Deferred revenue, net of deferred expenses	\$	\$ (1,790)	\$ (1,790)

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Table of Contents**NOTE 3 RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2006, the FASB issued FIN 48. This interpretation creates a comprehensive model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized for financial statement purposes. FIN 48 also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

FIN 48 was adopted as of January 1, 2007 and the Company increased its liability for unrecognized tax benefits by recording a cumulative effect adjustment of \$4,233,000. This cumulative effect adjustment was recorded as a reduction to the retained earnings balance at January 1, 2007. Potential accrued interest and penalties relevant to unrecognized tax benefits are recognized within income tax expense.

FASB Staff Position FIN 48-1 (FSP 48-1), *Definition of Settlement in FASB Interpretation No. 48* was issued by the FASB in May 2007. FSP 48-1 amended FIN 48 to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP 48-1 required application upon the initial adoption of FIN 48. The adoption of FSP 48-1 did not have a material effect on the consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management is currently evaluating the statement to determine what, if any, impact the statement will have on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS No. 159. SFAS No. 159 expands opportunities to use fair value measurement in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Management is currently in the process of evaluating the potential impact of adopting SFAS No. 159 on the consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) replaces SFAS No. 141, *Business Combinations*. SFAS No. 141(R) retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. SFAS No. 141(R) amends the recognition provisions for assets and liabilities acquired in a business combination, including those arising from contractual and noncontractual contingencies. SFAS No. 141(R) also amends the recognition criteria for contingent consideration. In addition, under SFAS No. 141(R), changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Early adoption is not permitted. Management is currently evaluating the potential impact of adopting SFAS No. 141(R) on the consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Management does not currently expect the adoption of SFAS No. 160 to have a material impact on the consolidated financial statements.

FASB Staff Position No. FAS 157-2 (FSP 157-2), *Effective Date of FASB Statement No. 157* was issued in February 2008. FSP 157-2 delays the effective date of SFAS No. 157, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value at least once a year, to fiscal years beginning after November 15, 2008, and for interim periods within those fiscal years.

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Property, equipment and improvements consist of the following:

(in thousands)	December 31,	
	2007	2006
Leasehold improvements	\$ 41,826	\$ 36,770
Equipment and furnishings	84,581	56,696
Information systems hardware	96,155	88,396
Information systems software	80,756	51,753
	303,318	233,615
Less accumulated depreciation	(200,491)	(180,640)
	\$ 102,827	\$ 52,975

Depreciation expense for property, equipment and improvements was \$20,869,000, \$20,387,000 and \$21,918,000 for 2007, 2006 and 2005, respectively.

NOTE 5 BUSINESS COMBINATIONS

On December 3, 2007, the acquisition of Coram, Inc. (Coram) was completed. Coram, which was privately-held, is a national provider of home infusion and specialty pharmaceutical services. The Coram acquisition strategically provided the Company an opportunity to diversify the existing product and payor mix. Additionally it positioned the Company in the growing clinical and specialty pharmaceutical and infusion market. During 2006, three complementary businesses were acquired within specific geographic markets, comprised primarily of home respiratory therapy businesses. Similarly, 21 companies were acquired during 2005. For all periods presented, these all-cash transactions were accounted for as purchases and, accordingly, the results of operations of the acquired businesses are included in the consolidated income statements from the dates of acquisition. The purchase prices were allocated to the various underlying tangible and intangible assets and liabilities on the basis of estimated fair value.

The following table summarizes the allocation of the purchase prices of all acquisitions. Payments for prior years acquisitions totaled \$83,000, \$4,523,000 and \$8,576,000 for the years 2007, 2006 and 2005, respectively. At December 31, 2007, 2006 and 2005, unpaid consideration totaled \$25,000, \$108,000 and \$5,682,000, respectively, and is included in the consolidated balance sheets in other accrued liabilities.

Cash paid for acquisitions:

(in thousands)	Year Ended December 31,		
	2007	2006	2005
Fair value of patient service equipment acquired	\$ 7,014	\$ 1,923	\$ 7,453
Fair value of property and equipment acquired	24,916	4	985
Fair value of other assets acquired	132,070(1)	641	1,577
Intangible assets	104,284	1,100	7,613
Goodwill	176,048	(1,112)	85,362
Total assets acquired	444,332	2,556	102,990
Liabilities assumed and accrued, net of payments from prior years acquisitions	(89,754)(2)	5,526	2,481
Net assets acquired	\$ 354,578	\$ 8,082	\$ 105,471

The amounts shown above for 2007 relate to the Coram acquisition and are based upon preliminary estimates that are subject to change in 2008 upon completion of the final valuation analysis.

The following supplemental unaudited pro forma information presents the combined operating results of Apria and the businesses that were acquired during 2007, 2006 and 2005, as if the acquisitions had occurred at the beginning of each of the periods presented. The pro forma information is based on the historical financial statements of Apria and those of the acquired businesses. Amounts are not necessarily indicative of the results that may have been attained had the combinations been in effect at the beginning of the periods presented or that may be achieved in the future.

(1) Consists primarily of \$82.5 million in net accounts receivable, \$14.0 million in net inventory and \$28.3 million in deferred tax assets.

(2) Consists primarily of \$44.9 million in accounts payable, \$17.7 million in accrued compensation and \$9.4 million in other accrued liabilities.

(in thousands, except per share data)	Year Ended December 31,		
	2007	2006	2005
Net revenues	\$ 2,103,791	\$ 1,997,106	\$ 1,552,571
Net income	86,275	61,558	72,407
Basic net income per common share	\$ 1.98	\$ 1.45	\$ 1.50
Diluted net income per common share	\$ 1.95	\$ 1.43	\$ 1.48

Table of Contents**NOTE 6 GOODWILL AND INTANGIBLE ASSETS**

Business combinations are accounted for in accordance with SFAS No. 141, *Business Combinations*, which requires that the purchase method of accounting be applied to all business combinations and addresses the criteria for initial recognition of intangible assets and goodwill. In accordance with SFAS No. 142, goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment annually, or more frequently if circumstances indicate the possibility of impairment. If the carrying value of goodwill or an intangible asset exceeds its fair value, an impairment loss shall be recognized.

Goodwill impairment testing is conducted at a reporting unit level and compares each reporting unit's fair value to its carrying value as of December 31 annually. The Company has determined that its geographic divisions are reporting units under SFAS No. 142. The measurement of fair value for each division is based on an evaluation of future discounted cash flows and is further tested using a multiple of earnings approach. For all years presented, testing indicated that no impairment existed and, accordingly, no loss has been recognized.

For the year ended December 31, 2007, the net increase in the carrying amount of goodwill of \$176,048,000 is the result of the acquisition of Coram on December 3, 2007. Most of the goodwill recorded in conjunction with business combinations for the periods presented is expected to be deductible for tax purposes. Goodwill and intangible assets from our Coram acquisition are based upon preliminary estimates that are subject to change in 2008 upon completion of the final valuation analysis.

Intangible assets consist of the following:

(dollars in thousands)	Average Life in Years	December 31, 2007			December 31, 2006		
		Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Intangible assets subject to amortization:							
Covenants not to compete	5.0	\$ 11,380	\$ (7,744)	\$ 3,636	\$ 13,506	\$ (7,313)	\$ 6,193
Patient referral sources	20.0	34,300	(143)	34,157			
Customer lists	1.0				1,283	(925)	358
Favorable leases	3.1	584	(20)	564			
Total	7.3	46,264	(7,907)	38,357	14,789	(8,238)	6,551
Intangible assets not subject to amortization:							
Trade names		69,400		69,400			
Total	7.3	\$ 115,664	\$ (7,907)	\$ 107,757	\$ 14,789	\$ (8,238)	\$ 6,551

Amortization expense amounted to \$3,079,000, \$5,080,000 and \$6,941,000 for the years 2007, 2006 and 2005, respectively. Estimated amortization expense for each of the fiscal years ending December 31, is presented below:

Year Ending December 31,	(in thousands)
2008	\$ 7,194
2009	4,425
2010	2,611
2011	2,129
2012	1,992

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Long-term debt consists of the following:

(in thousands)	December 31,	
	2007	2006
Notes payable relating to revolving credit facilities	\$ 424,000	\$ 235,000
Convertible senior notes	250,000	250,000
Capital lease obligations (see Note 11)	7,031	
Other	6,252	2,145
	687,283	487,145
Less: current maturities	(254,252)	(2,145)
	\$ 433,031	\$ 485,000

Revolving Credit Facility: The senior secured credit agreement with Bank of America and a syndicate of lenders was amended effective June 23, 2006. The amendment extended the maturity date from November 23, 2009 to June 23, 2011 and lowered the applicable interest rate margins and commitment fees.

The credit agreement is structured as a \$500 million revolving credit facility and permits Apria to select one of two variable interest rates. One option is the base rate, which is expressed as the higher of (a) the Federal Funds rate plus 0.50% or (b) the Bank of America prime rate. The other option is the Eurodollar rate, which is based on the London Interbank Offered Rate (LIBOR). Interest on outstanding balances under the credit agreement is determined by adding a margin to the Eurodollar rate or base rate in effect at each interest calculation date. The applicable margin for the revolving credit facility is based on Apria's debt rating as determined by either Standard and Poor's Ratings Services or Moody's Investor Services with respect to the credit facility.

The new applicable margins range from 0.625% to 1.25% for Eurodollar loans and from zero to 0.25% for base rate loans. The range for commitment fees on the unused portion of the revolving credit facility is now 0.10% to 0.20%. The effective interest rate at December 31, 2007, after consideration of the effect of the swap agreements, was 6.09%. Without the effect of the swap agreements, such rate would have been 6.14%.

At December 31, 2007, borrowings under the revolving credit facility were \$424,000,000, outstanding letters of credit totaled \$12,136,000 and credit available under the revolving facility was \$63,864,000. The Company must maintain compliance with certain financial covenants measured on a quarterly basis, including a consolidated interest coverage ratio and a leverage ratio. At December 31, 2007, the Company was in compliance with all of the financial covenants required by the credit agreement. Borrowings under the credit facility are secured by a pledge of the common stock of certain of the Company's subsidiaries.

Convertible Senior Notes: In August 2003, convertible senior notes in the aggregate principal amount of \$250,000,000 were issued under an indenture with U.S. Bank National Association. The notes were issued in a private placement at an issue price of \$1,000 per note (100% of the principal amount at maturity) and were subsequently registered with the Securities and Exchange Commission. The notes will mature on September 1, 2033, unless earlier converted, redeemed or repurchased. Some or all of the notes may be redeemed at any time after September 8, 2010, at a redemption price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest and contingent interest, if any, to the redemption date. The holders of the notes may require the repurchase of some or all of the notes at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest, including contingent interest, up to but excluding the applicable repurchase date, initially on September 1, 2008, and subsequently on September 1 of 2010, 2013, 2018, 2023 and 2028, or at any time prior to their maturity following a fundamental change, as defined in the indenture. Any notes required to be repurchased will be paid for in cash, pursuant to the terms of a December 2004 amendment to the indenture which eliminated the option of paying part of the repurchase price in common stock. Since the holders of the notes may require us to redeem some or all of the notes on September 1, 2008, the principal amount of \$250 million has been reclassified to the current portion of

long-term debt on the consolidated balance sheet as of December 31, 2007.

The notes bear interest at the rate of 3 3/8% per annum, which is payable on September 1 and March 1 of each year, beginning on March 1, 2004. Also, during certain periods commencing on September 8, 2010, contingent interest will be payable on the interest payment date for the applicable interest period if the average trading price of the notes during the five trading days ending on the third day immediately preceding the first day of the applicable interest period equals or exceeds 120% of the principal amount of the notes. The contingent interest payable per note will equal 0.25% per year of the average trading price of such note during the applicable five trading-day reference period. During certain periods, the notes are convertible, at the holders' option, into shares of Apria common stock, initially at a conversion rate of 28.6852 shares of common stock per \$1,000 principal amount of notes, subject to adjustment and under certain circumstances as outlined in the indenture.

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The notes are unsecured and unsubordinated obligations and are senior in right of payment to any subordinated debt. The notes rank junior to the Company's senior secured credit facility to the extent of the assets securing such indebtedness.

Maturities of long-term debt are as follows:

Year Ending December 31,	(in thousands)
2008	\$ 254,252
2009	3,436
2010	2,612
2011	426,304
2012	679
Thereafter	
	\$ 687,283

Total interest paid on debt in 2007, 2006 and 2005 amounted to \$18,062,000, \$29,891,000 and \$18,783,000, respectively.

Hedging Activities: Interest rate risk exists on the variable rate long-term debt. Interest rate risk is managed by evaluating and monitoring all available relevant information, including but not limited to, the structure of its interest-bearing assets and liabilities, historical interest rate trends and interest rate forecasts published by major financial institutions. The tools that may be utilized to moderate exposure to fluctuations in the relevant interest rate indices include, but are not limited to: (1) strategic determination of repricing periods and related principal amounts, and (2) derivative financial instruments such as interest rate swap agreements, caps or collars. Derivatives are not used for trading or other speculative purposes.

During 2007, the Company had one interest rate swap agreement in effect to fix its LIBOR-based variable rate debt. The agreement, a forward-starting contract with a three-year term, became effective in January 2006, and has a notional amount of \$25,000,000 that fixes an equivalent amount of its variable rate debt at 4.44%. In 2006, the Company had two interest rate swap agreements. Each agreement had a notional amount of \$25,000,000, with one agreement expiring in December 2006 and the other agreement expiring in January 2009. In 2005, the Company had two interest rate swap agreements. Each agreement had a notional amount of \$25,000,000, with one agreement expiring in December 2005 and the other agreement expiring in December 2006. For the years ended December 31, 2007, 2006 and 2005, the Company received net settlement amounts of \$233,000, \$540,000, and \$11,000, respectively. At December 31, 2007, the aggregate fair value of the swap agreement was a liability of \$105,000 and is reflected in the accompanying consolidated balance sheets in current liabilities. At December 31, 2006, the aggregate fair value of the swap agreements was an asset of \$356,000, and is reflected in other assets.

The interest rate swap agreements are being accounted for in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Unrealized gains and losses on the fair value of the swap agreements are reflected, net of taxes, in operating income, as the transactions no longer qualify for hedge accounting treatment. Exposure to credit loss under the swap agreement is limited to the interest rate spread in the event of counterparty nonperformance. The Company does not anticipate losses due to counterparty nonperformance as our counterparties to the swap agreement are nationally recognized financial institutions with strong credit ratings.

NOTE 8 SHARE-BASED COMPENSATION AND STOCKHOLDERS' EQUITY

Effective January 1, 2006, the provisions of SFAS No. 123(R) were adopted which establish accounting for equity instruments exchanged for employee services. Under the provisions of SFAS No. 123(R), share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant). Prior to January 1, 2006, share-based compensation to employees was accounted for in accordance with APB Opinion No. 25 and related interpretations. The disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation: Transition and Disclosure* were followed.

The modified prospective transition method was elected as provided by SFAS No. 123(R) and, accordingly, financial statement amounts for the prior periods presented have not been restated to reflect the fair value method of expensing share-based compensation.

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For the year ended December 31, 2007, share-based compensation expense was \$11,150,000, of which \$1,751,000 was related to awards issued prior to the adoption of SFAS No. 123(R). All such compensation is reflected in the accompanying condensed consolidated income statement within the selling, distribution and administrative expense line item. The related awards were granted to administrative personnel or members of the Board of Directors and therefore no portion of the share-based compensation has been classified within cost of net revenues. Share-based compensation expense recognized in 2007 is based on awards ultimately expected to vest; therefore, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information presented for periods prior to 2006, forfeitures were accounted for as they occurred.

For the year ended December 31, 2007, cash received from the exercise of options totaled \$17,521,000. Income tax benefits related to stock-based compensation arrangements amounted to \$3,958,000.

Estimates of the fair value of stock options are determined using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's term, and the expected annual dividend yield. Management believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of stock options granted in 2007. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

The key input assumptions that were utilized in the valuation of the stock options granted are summarized in the table below.

	Year Ended December 31,		
	2007	2006	2005
Expected option term in years (1)	4.6	4.8	4.1
Expected volatility (2)	29.9%	27.3%	32.0%
Risk-free interest rate (3)	4.5%	4.6%	3.8%
Expected annual dividend yield	0%	0%	0%

(1) The expected option term is based on historical exercise and post-vesting termination patterns.

(2) Expected volatility represents a combination of historical stock price volatility and implied volatility from publicly-traded options on Apria's common stock.

- (3) The risk-free interest rate is based on the implied yield on a U.S. Treasury zero coupon issue with a remaining term equal to the expected term of the option.

2003 Performance Incentive Plan: In July 2003, stockholders approved the 2003 Performance Incentive Plan (2003 Plan), which permits the grant of stock options, stock appreciation rights (SARs), stock bonuses, restricted stock, performance stock, stock units, phantom stock, dividend equivalents, or similar rights to purchase or acquire shares, and cash awards. At the discretion of the Compensation Committee of the Board of Directors, any award may be paid or settled in cash. The 2003 Plan is currently the only plan from which stock-based awards may be granted.

The maximum number of shares that may be issued as awards under the 2003 Plan equals the sum of (1) 6,500,000 shares, plus (2) the number of shares subject to stock options granted under previous plans, which expire or are cancelled or terminated without being exercised, after the effective date of the 2003 Plan.

The 2003 Plan also contains the following limits:

grants of incentive stock options up to 2,000,000 shares,

grants of options and SARs during any calendar year to any individual up to 500,000 shares,

shares subject to all awards granted to an individual during any calendar year up to 1,000,000 shares,

awards granted to non-employee directors up to 700,000 shares,

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awards granted, other than for stock options and SARs, up to 2,275,000 shares,

performance-based awards, other than stock options and SARs, granted to an individual up to 500,000 shares in a calendar year, and

performance-based awards, payable in cash at the discretion of the Compensation Committee, granted to an individual up to \$10,000,000 in a calendar year.

The per share exercise price of an option or SAR (collectively referred to as options) generally may not be less than the per share fair market value on the date of grant. The maximum term of an option is ten years from the date of grant. Performance-based awards may also be issued from the 2003 Plan. The vesting or payment of such awards will depend on the Company's performance to established measurement criteria. The performance measurement period may range from three months to ten years. Performance-based awards may be paid in stock or, at the discretion of the Compensation Committee, in cash. Historically, new shares are issued when options or stock-based awards are exercised.

The Company believes that share-based awards better align the interests of its senior management and other key employees with those of its stockholders as well as serving as an effective tool to attract, retain and motivate plan participants.

Stock Options: The 2003 Plan provides for the granting of stock options to employees and non-employee directors. Such grants to employees may include non-qualified and incentive stock options. The exercise price of an option is established at the fair market value of a share of common stock on the date of grant. Vesting of stock options is time-based and is generally over a three-year period.

The following table summarizes the activity for stock options for the years ended December 31, 2005, 2006 and 2007:

	Options	Weighted-Average Exercise Price	Weighted-Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2005	5,114,145	\$ 24.84	7.37	\$ 41,774,469
Granted	49,000	32.45		
Exercised	(920,385)	22.49		
Forfeited	(166,055)	29.20		
Outstanding at December 31, 2005	4,076,705	\$ 25.28	6.60	\$ 7,881,252
Granted	1,056,000	23.23		
Exercised	(349,596)	20.64		
Forfeited	(726,795)	29.48		
Outstanding at December 31, 2006	4,056,314	\$ 24.59	6.38	\$ 13,750,742
Granted	759,830	30.84		
Exercised	(863,693)	20.23		
Forfeited	(219,068)	29.26		
Outstanding at December 31, 2007	3,733,383	\$ 26.60	6.28	\$ 1,690,040
Vested or expected to vest as of December 31, 2007	3,503,580	\$ 26.56	6.12	\$ 1,680,053
Exercisable at December 31, 2007	2,581,277	\$ 26.21	5.17	\$ 1,638,973

The weighted-average fair value of stock options granted during the years ended December 31, 2007, 2006 and 2005 were \$10.20, \$7.39 and \$10.11, respectively. There were 1,056,000 stock options granted in the corresponding period in 2006. The total intrinsic value of options exercised was \$9,642,000, \$1,272,000 and \$10,239,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

As of December 31, 2007, total unrecognized stock-based compensation cost related to unvested stock options was \$6,907,000, which is expected to be expensed over a weighted-average period of 1.89 years.

Restricted Stock Purchase Rights: In 2003 and 2004, restricted stock purchase rights were granted under the 2003 Plan to certain members of executive management. The awards represented the right to purchase a certain number of shares of common stock at a future date at a specified exercise price. The exercise price was established at 25% of the fair market value of a share of common stock on the date of grant. Such awards generally require that certain performance conditions and service conditions be met before the awards will vest.

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The following table summarizes the activity for restricted stock purchase rights for the years ended December 31, 2005, 2006 and 2007:

	Restricted Stock Purchase Rights	Weighted- Average Exercise Price	Weighted Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2005	586,000	\$ 6.70	8.71	\$ 15,385,350
Granted				
Exercised	(16,000)	6.46		
Forfeited	(24,000)	6.46		
Outstanding at December 31, 2005	546,000	\$ 6.71	7.72	\$ 9,499,110
Granted				
Exercised	(158,500)	6.49		
Forfeited	(87,500)	6.85		
Outstanding at December 31, 2006	300,000	\$ 6.79	6.76	\$ 5,957,820
Granted				
Exercised	(23,000)	6.46		
Forfeited				
Outstanding at December 31, 2007	277,000	\$ 6.82	5.77	\$ 4,086,290
Vested or expected to vest as of December 31, 2007	211,718	\$ 6.79	5.76	\$ 3,128,576
Exercisable at December 31, 2007	8,000	\$ 6.46	5.61	\$ 120,880

The total intrinsic value of restricted stock purchase rights exercised was \$534,000 and \$2,592,000 for the years ended December 31, 2007 and 2006, respectively. No such awards were granted during these two periods.

As of December 31, 2007, total unrecognized stock-based compensation cost related to unvested restricted stock purchase rights was \$2,044,000, which is expected to be expensed over a weighted-average period of 2.32 years.

Restricted Stock Awards and Units: The 2003 Plan provides for the granting of restricted stock and restricted stock units to its non-employee directors and employees. Such awards generally require that certain performance conditions and service conditions be met before the awards will vest.

The following table summarizes the activity for restricted stock awards and units for the years ended December 31, 2005, 2006 and 2007:

	Shares or Share Units	Weighted-Average Grant-Date Fair Value
Nonvested restricted stock awards and units at January 1, 2005	226,000	\$ 32.80
Granted	81,384	34.98
Vested and released	(26,000)	28.21
Forfeited		
Nonvested restricted stock awards and units at December 31, 2005	281,384	33.86
Granted	339,000	22.71

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Vested and released	(38,462)		33.95
Forfeited	(95,000)		28.35
Nonvested restricted stock awards and units at December 31, 2006	486,922		27.16
Granted	405,310		29.82
Vested and released	(186,901)		24.09
Forfeited	(64,460)		27.32
Nonvested restricted stock awards and units at December 31, 2007	640,871	\$	29.73

The total intrinsic value of restricted stock awards or units released was \$5,081,000 and \$768,000 for the years ended December 31, 2007 and 2006, respectively.

As of December 31, 2007, total unrecognized stock-based compensation cost related to unvested restricted stock awards and units was \$11,871,000, which is expected to be expensed over a weighted-average period of 2.43 years.

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The following activity occurred under the 2003 Plan:

	Year Ended December 31		
	2007	2006	2005
Total fair value of stock awards vested	\$ 5,081,411	\$ 768,204	\$ 832,520

Prior Period Pro Forma Presentation: Apria had previously adopted the provisions of SFAS No. 123 through disclosure only. The following table illustrates the effects on net income and earnings per share for the year ended December 31, 2005 as if the fair value recognition provisions of SFAS No. 123 had been applied to share-based employee awards.

(in thousand, except per share data)	Year Ended December 31, 2005	
Net income as reported	\$	68,483
Add: stock-based compensation expense included in reported net income, net of related tax effects		2,032
Deduct: total stock-based compensation expense determined for all awards under fair value-based method, net of related tax effects		(13,070)
Pro forma net income	\$	57,445
Basic net income per share:		
As reported	\$	1.42
Pro forma	\$	1.19
Diluted net income per share:		
As reported	\$	1.40
Pro forma	\$	1.17

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for 2005: risk-free interest rate of 3.78%; dividend yield of 0%; expected life of 4.13 years; and volatility of 31.73%.

Stock Option Acceleration: On November 30, 2005, the Compensation Committee of the Board of Directors approved the acceleration of vesting of certain outstanding employee stock options with per share prices above \$26.00, so that each such option became fully vested. As a result of this action, options to purchase 863,227 shares of Apria common stock became immediately exercisable. The accelerated options represented approximately 18.6% of total outstanding options at the time of the action.

The purpose of accelerating the vesting of these options was to eliminate the compensation expense that would otherwise be recognized in the consolidated statements of income in future financial statements with respect to these options upon the adoption of SFAS No. 123(R). More than half of the accelerated options would have vested according to their terms during 2006 and more than 77% would have vested by February 2007. As a result of the acceleration, the Company expects to reduce its future share-based compensation expense by approximately \$7,580,000.

Treasury Stock: All repurchased shares of common stock are held as treasury shares.

In 2007, 68,863 shares of employee restricted stock, valued at \$1,828,000, were retained upon vesting to satisfy the related tax obligations and 8,689 shares of employee restricted stock purchase rights valued at \$250,000, were retained upon vesting to satisfy the related exercise price and tax obligations.

In 2006, 7,672 shares of employee restricted stock, valued at \$141,000, were retained upon vesting to satisfy related tax obligations.

In October 2005, the Board of Directors authorized the repurchase of up to \$250,000,000 worth of outstanding common stock. On November 7, 2005, 7,337,526 shares of common stock were purchased for \$175,000,000 through an accelerated share repurchase program. Under the agreement, the Company's counterparty borrowed shares that were

sold to the Company at an initial price of \$23.83. The counterparty then repurchased shares over a period that commenced immediately after the sale of shares to Apria. The repurchase transaction was completed in February 2006. The agreement contained a provision that subjected Apria to a purchase price adjustment based on the volume weighted average price of the Company's common stock over the period during which the counterparty purchased the shares. Such provision resulted in an additional \$242,000 owed to the counterparty that Apria elected to settle in cash in February 2006. This amount was recorded as a liability at December 31, 2005, with a corresponding charge to interest expense reflecting the change in the fair value of the settlement contract. The amount remaining on the aforementioned Board authorization expired at the end of the first quarter of 2007.

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Significant components of deferred tax assets and liabilities are as follows:

(in thousands)	Year Ended December 31,	
	2007	2006
Deferred tax assets:		
Allowance for doubtful accounts	\$ 26,530	\$ 13,007
Accruals	15,367	5,020
Accrued vacation	10,064	9,001
Asset valuation reserves	6,768	13,919
Share-based payment	5,108	1,588
Net operating loss carryforward and tax credits	49,381	8,448
Intangible assets	8,752	8,994
Deferred revenue and expenses	9,632	9,567
Tax benefits related to unrecognized state tax benefits and interest accrued	5,817	
Other, net	12,203	7,676
	149,622	77,220
Less: valuation allowance	(5,696)	(904)
Total deferred tax assets	143,926	76,316
Deferred tax liabilities:		
Tax over book depreciation	(21,538)	(28,213)
Tax over book goodwill amortization	(58,649)	(43,737)
Separately identifiable intangibles	(38,743)	
Contingent debt interest	(17,703)	(19,353)
Other, net	(3,385)	(3,348)
Total deferred tax liabilities	(140,018)	(94,651)
Net deferred tax asset/(liabilities)	\$ 3,908	\$ (18,335)

Deferred income taxes are recognized for the difference between the carrying amounts of assets and liabilities for financial statement and tax purposes. Deferred income tax assets are required to be reduced by a valuation allowance when it is determined that it is more likely than not that all or a portion of a deferred tax asset will not be realized. During 2007, the valuation allowance was increased by a net \$4,792,000 primarily related to state tax net operating loss (NOLs) carryforwards from the December 2007 acquisition of Coram.

As of December 31, 2007, federal NOLs of approximately \$111,186,000 are available to offset future federal taxable income. Such NOLs will expire at various times and in varying amounts during our calendar 2027 through 2028 tax years. These NOLs were acquired in connection with the Coram acquisition and are subject to an annual utilization limitation of approximately \$17,500,000 as required by Section 382 of the Internal Revenue Code of 1986, as amended (the Code). Additionally, our ability to utilize federal tax NOLs and certain acquisition-related state tax NOLs may be further limited due to certain tax rules involving the exchange of Coram stock for its debt and associated interest. These debt for stock exchanges occurred in Coram s 2000 through 2002 tax years.

Additionally, Coram s NOLs, tax assets and other attributes could be subject to substantial utilization limitations due to previous Section 382 ownership changes which may have occurred prior to our acquisition of Coram. In general, an ownership change, as defined by Section 382 of the Code, occurs when a transaction or series of transactions over a three-year period results in an ownership change of more than 50 percentage points of the outstanding stock of a company. The Company is currently analyzing whether a Section 382 ownership change occurred prior to our

December 2007 acquisition of Coram and the impact, if any, that such an ownership change could have on NOL carryforwards, tax assets and other tax attributes.

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Income tax expense (benefit) consists of the following:

(in thousands)	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 28,710	\$ 16,734	\$ 45,652
State	3,954	2,490	(719)
	32,664	19,224	44,933
Deferred:			
Federal	16,388	21,062	(4,979)
State	2,946	3,011	723
	19,334	24,073	(4,256)
	\$ 51,998	\$ 43,297	\$ 40,677

Included in the 2007 current tax expense is approximately \$1,405,000 relating to FIN 48. Excess tax benefits from share-based payments of \$3,958,000, \$17,000 and \$4,117,000 were credited to additional paid-in capital in 2007, 2006, and 2005, respectively. See Consolidated Statements of Stockholders' Equity.

A reconciliation of the differences between income tax expense and an amount calculated utilizing the federal statutory rate is as follows:

(in thousands)	Year Ended December 31,		
	2007	2006	2005
Income tax expense at statutory rate	\$ 48,294	\$ 41,146	\$ 38,206
Non-deductible expenses	1,002	711	2,958
State taxes, net of federal benefit and state loss carryforwards	6,033	5,134	4,592
Change in valuation allowance	(336)	(53)	(2,218)
Change in contingency reserve		(4,063)	(2,483)
Change in liability for unrecognized tax benefits under FIN 48	(1,405)		
Other	(1,590)	422	(378)
	\$ 51,998	\$ 43,297	\$ 40,677

In conjunction with the Company's January 1, 2007 adoption of FIN 48, the liability for unrecognized tax benefits was increased by recording a cumulative effect adjustment of \$4,233,000. This cumulative effect adjustment was recorded as a reduction to the retained earnings balance at January 1, 2007.

A reconciliation of the beginning and ending balances of the gross liability for unrecognized tax benefits at December 31, 2007 is as follows (in thousands):

Balance at January 1, 2007 (included in Income Taxes Payable and Other Non-Current Liabilities)	\$ 17,687
Balance at January 1, 2007 (included in Deferred Income Taxes)	10,029
Total gross unrecognized tax benefits at January 1, 2007	27,716
Additions for tax positions related to the current year	3,630

Additions for tax positions related to prior years	6,661
Reductions for tax positions related to prior years	(941)
Settlements	(1,231)
Reductions due to lapse in statute of limitations	(3,078)
Gross unrecognized tax benefits at December 31, 2007 (excluding Coram)	32,757
Coram's Gross unrecognized tax benefits at December 31, 2007	83,203
Total Gross unrecognized tax benefits at December 31, 2007 (including Coram)	\$ 115,960

Total gross unrecognized tax benefits (including Coram) of \$115,960,000 is reflected on the Company's December 31, 2007 balance sheet as follows: (a) \$27,000,000 included in Income Taxes Payable and Other Non-Current Liabilities and (b) \$88,960,000 included in Deferred Income Taxes.

The amount of unrecognized tax benefits which, if ultimately recognized, could affect the effective tax rate in a future period is \$16,948,000 as of January 1, 2007 and \$15,543,000 as of December 31, 2007. The \$16,948,000 and \$15,543,000 unrecognized tax benefits amounts are both net of federal and/or state tax benefits and are inclusive of \$2,679,000 and \$3,793,000 of penalties and interest (net of tax benefit), respectively.

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Based on purchase accounting rules at December 31, 2007, Coram's unrecognized tax benefit liability of \$80,034,000 (net), if recognized, would only impact goodwill (versus the Company's effective tax rate). However, upon adoption of SFAS No. 141(R), the amount of Coram's unrecognized tax benefits which, if ultimately recognized, could affect the Company's effective tax rate in a future period is \$80,034,000 (net).

As of December 31, 2007, it is reasonably possible that unrecognized tax benefits could be increased or decreased by the following estimated amounts within the succeeding 12 months.

Gross increase of \$2,800,000 (net \$2,600,000) related to the timing uncertainty for when certain deductions should be recognized for tax return purposes. This uncertainty is subject to review by taxing agencies.

Gross increase of \$1,100,000 (net \$700,000) related to state tax uncertainties involving tax filing positions and allocation of income among various jurisdictions. This uncertainty is subject to review by state taxing agencies.

Gross increase of \$1,800,000 (net \$1,200,000) for interest and penalties primarily related to other tax uncertainties taken in prior years. The increase is an annual expense which will be accrued until the associated tax uncertainties are extinguished through such means as audit settlement, payment, or lapse in statutes of limitations.

Gross decrease of \$2,900,000 (net \$1,900,000) related to state tax uncertainties. Ultimate realization of this decrease is dependent upon the occurrence of certain events (including the lapse in statutes of limitations).

Interest expense and penalties related to unrecognized tax benefits are recognized as part of the provision for income taxes. Gross interest and penalties of \$3,844,000 and \$6,412,000 are provided for within the liability for unrecognized tax benefits as of January 1, 2007 and December 31, 2007, respectively.

We file federal and state income tax returns in jurisdictions with varying statutes of limitations expiration dates. The calendar 2004 through 2007 tax years generally remain subject to examination by federal and most state tax authorities. The Internal Revenue Service is currently examining the calendar 2005 tax year and certain state tax agencies are examining the calendar tax years 2001 through 2004.

Net income taxes paid in 2007, 2006, and 2005 amounted to \$26,885,000, \$16,406,000, and \$52,099,000, respectively.

NOTE 10 PER SHARE AMOUNTS

The following table sets forth the computation of basic and diluted per share amounts:

(in thousands, except per share data)	Year Ended December 31,		
	2007	2006	2005
Numerator:			
Net income	\$ 86,039	\$ 74,263	\$ 68,483
Numerator for basic and diluted per share amounts — income available to common stockholders	\$ 86,039	\$ 74,263	\$ 68,483
Denominator:			
Denominator for basic per share amounts — weighted-average shares	43,552	42,462	48,154
Effect of dilutive securities:			
Employee stock options — dilutive potential common shares	588	473	831
Denominator for diluted per share amounts — adjusted weighted-average shares	44,140	42,935	48,985
Basic net income per common share	\$ 1.98	\$ 1.75	\$ 1.42

Diluted net income per common share	\$	1.95	\$	1.73	\$	1.40
Employee stock options excluded from the computation of diluted per share amounts:						
Shares for which exercise price exceeds average market price of common stock		1,502		3,145		2,073
Average exercise price per share that exceeds average market price of common stock	\$	31.75	\$	26.71	\$	30.21

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The Company leases all of its facilities. Lease terms are generally ten years or less with renewal options for additional periods. The occasionally unused facility space is subleased when a lease buyout is not a viable option. Sublease income is recognized monthly and is offset against facility lease expense. Sublease income in 2007, 2006 and 2005 amounted to \$761,000, \$1,046,000 and \$988,000, respectively. In addition, delivery vehicles and office equipment are leased under operating leases. Many leases provide that taxes, maintenance, insurance and other expenses are the responsibility of the Company. Rentals are generally increased annually by the Consumer Price Index, subject to certain maximum amounts defined within individual agreements. Net rent expense in 2007, 2006 and 2005 amounted to \$76,228,000, \$73,293,000 and \$74,835,000, respectively.

In December 2007, infusion pumps and vehicles were acquired, as a result of the acquisition of Coram, totaling \$6,887,000 under capital lease arrangements with lease terms ranging from 36 to 60 months. Related amortization for the one-month period amounted to \$182,000.

During 2004, information systems hardware and software totaling \$3,156,000 were acquired under capital lease arrangements with lease terms ranging from 24 to 36 months. Related amortization amounted to \$796,000 and \$709,000 in 2006 and 2005, respectively. The obligations under those capital lease arrangements were satisfied during 2006. There were no purchases of assets under capital lease arrangements during 2006.

The following amounts for assets under capital lease obligations are included in property, equipment and improvements (in thousands):

	December 31,	
	2007	2006
Information systems hardware and software	\$	\$ 3,156
Infusion pumps	6,204	
Vehicles	683	
Less accumulated depreciation	(182)	(1,734)
	\$ 6,705	\$ 1,422

Future minimum payments, by year and in the aggregate, required under capital lease obligations and noncancelable operating leases consist of the following at December 31, 2007 (in thousands):

	Capital Leases	Operating Leases
2008	\$ 2,745	\$ 66,287
2009	2,300	55,231
2010	1,507	43,234
2011	1,122	31,908
2012	60	14,912
Thereafter		21,542
	\$ 7,734	\$ 233,114
Less interest included in minimum lease payments	703	
Present value of minimum lease payments	7,031	
Less current portion	2,353	
	\$ 4,678	

NOTE 12 EMPLOYEE BENEFIT PLANS

401(k) Savings Plan: The Company has a 401(k) defined contribution plan, whereby eligible employees may contribute up to 35% of their annual base earnings. For 2005, the Company matched 50% of the first 8% of employee contributions. For 2006, the Company suspended the employer matching contribution. For 2007, the Company matched 25% of the first 8% of employee contributions. Total expenses related to the defined contribution plans were \$1,915,000, \$0 and \$4,970,000 in the years 2007, 2006 and 2005, respectively.

Deferred Compensation Plan: A non-qualified deferred compensation plan is available for approximately 250 employees and members of the Board of Directors. The plan provides participants with the advantages of pre-tax contributions and tax deferred compounding of interest. Plan assets, which represent the fair market value of the investments, were \$5,136,000 and \$4,966,000, and plan liabilities were \$4,892,000 and \$4,128,000 at December 31, 2007 and 2006, respectively.

Table of Contents**NOTE 13 COMMITMENTS AND CONTINGENCIES**

Litigation: The Company is the defendant in a purported California class action lawsuit asserting blanket claims of liability under various California employee protection statutes and regulations relating to payment of regular and overtime wages, the timeliness of such payments, the maintenance and provision of access to required payroll records, and the provision of meal and rest periods. The original claim was filed by Jesus Venegas on February 21, 2006 in the California Superior Court for the County of San Francisco (Case No. CGC 06 449669). The complaint seeks compensatory damages in an unspecified amount as well as other relief on behalf of a purported class consisting of certain of the Company's hourly employees in the State of California. An answer to the complaint was filed denying all material allegations and asserting a number of affirmative defenses, and successfully pursued motions for summary adjudication eliminating the tort based claims such as false imprisonment, fraud and unjust enrichment, as well as claims for punitive damages and a declaratory judgment. Based on the investigation of the allegations made to date, the Company believes there are meritorious defenses to the claims and intends to continue a vigorous defense of the lawsuit. At a case management conference held on January 30, 2008, the Court established a new trial date of January 26, 2009. In addition, the court set March 7, 2008 as the date for a hearing on the composition of the putative class and August 27, 2008 as the date for a hearing on the issue of whether this case may be certified as a class action. Until a final decision is made with respect to the plaintiff's class action allegations, no assurances can be given that the ultimate disposition of this case will not have a material adverse effect on the Company's financial condition or results of operations.

The Company is also engaged in the defense of certain claims and lawsuits arising out of the ordinary course and conduct of its business, the outcomes of which are not determinable at this time. Insurance policies covering such potential losses where such coverage is cost effective are maintained. In the opinion of management, any liability that might be incurred upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on the Company's financial condition or results of operations.

Qui Tam Settlement and Related Costs: In 1998, the Company was the subject of an investigation launched by the U.S. Attorney's office in Los Angeles and the U.S. Department of Health and Human Services. The investigation concerned the documentation supporting billings for services provided to patients whose healthcare costs were paid by Medicare and other federal programs. The investigation related to two civil *qui tam* lawsuits against the Company filed by individuals suing on behalf of the government. The Company and representatives of the government and the individual plaintiffs reached a preliminary agreement in August 2005 to settle these lawsuits for the aggregate sum of \$17,600,000, without any admission of wrongdoing by the Company. The settlement was finalized in a definitive agreement that was fully executed and became effective on September 30, 2005, and the settlement amount was paid on that date. An additional \$1,658,000 in legal fees and other related costs were incurred during 2005.

Medicare and Medicaid Reimbursement: There are a number of provisions contained within recent legislation or proposed legislation that affect or may affect Medicare reimbursement policies for items and services provided. The Company cannot be certain of the ultimate impact of all legislated and contemplated changes, and therefore, cannot provide assurance that these changes will not have a material adverse effect on the results of operations.

Supplier Concentration: Currently, approximately 66% of purchases for patient service equipment and supplies are from four vendors. Although there are a limited number of suppliers, management believes that other vendors could provide similar products on comparable terms. However, a change in suppliers could cause delays in service delivery and possible losses in revenue, which could adversely affect operating results.

Guarantees and Indemnities: From time to time, certain types of contracts are entered into that contingently require indemnification of parties against third party claims. These contracts primarily relate to (i) certain asset purchase agreements, under which indemnification may be provided to the seller of the business being acquired; (ii) certain real estate leases, which may require indemnification to property owners for environmental or other liabilities and other claims arising from use of the applicable premises; and (iii) certain agreements with officers, directors and employees, which may require indemnification of such persons for liabilities arising out of their relationship with the Company. The terms of such obligations vary by contract and in most instances a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, no liabilities have been recorded for these obligations on the balance sheets for any of

the periods presented.

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The following table sets forth a summary of net revenues by service line:

(in thousands)	Year Ended December 31,		
	2007	2006	2005
Net revenues:			
Home respiratory therapy	\$ 1,087,126	\$ 1,032,651	\$ 1,011,321
Home infusion therapy	334,182	274,723	256,225
Home medical equipment/other	210,493	209,317	208,124
Total net revenues	\$ 1,631,801	\$ 1,516,691	\$ 1,475,670

NOTE 15 SELECTED QUARTERLY FINANCIAL DATA (unaudited)

As indicated in Note 2, on December 31, 2007, the Company's management and the Audit Committee of the Board of Directors concluded to restate previously issued financial statements because of reporting errors solely relating to its accounting for deferred revenue and deferred expenses related to equipment it rents to patients. Accordingly, the quarters for 2007 and 2006 are effected as disclosed below:

(in thousands, except per share data)	Quarter					
	First		Second			
	(As Previously Reported)	(Adjustments) Restated)	(As Previously Reported)	(Adjustments) Restated)	(As Previously Reported)	(Adjustments) Restated)
2007						
Net Revenues	\$ 389,290	1,489	\$ 390,779	\$ 394,044	(2,115)	\$ 391,929
Gross Profit	254,494	1,668	256,162	259,559	(2,061)	257,498
Operating Income	37,225	1,767	38,992	38,354	(1,967)	36,387
Net Income	\$ 19,144	1,706	\$ 20,850	\$ 20,829	(1,578)	\$ 19,251
Basic net income per common share	\$ 0.44		\$ 0.48	\$ 0.48		\$ 0.44
Diluted net income per common share	\$ 0.44		\$ 0.47	\$ 0.47		\$ 0.44

(in thousands, except per share data)	Third				Fourth	
	(As Previously Reported)	(Adjustments) Restated)	(As Previously Reported)	(Adjustments) Restated)	(As Previously Reported)	(Adjustments) Restated)
	2007					
Net Revenues	\$ 396,116	264	\$ 396,380	\$ 452,712		
Gross Profit	262,316	(25)	262,291	290,857		
Operating Income	37,941	(247)	37,694	45,457		
Net Income	\$ 21,269	(349)	\$ 20,920	\$ 25,018		
Basic net income per common share	\$ 0.49		\$ 0.48	\$ 0.57		
Diluted net income per common share	\$ 0.48		\$ 0.47	\$ 0.57		

(in thousands, except per share data)	First		Second	
	(As Previously Reported)	(Adjustments) Restated)	(As Previously Reported)	(Adjustments) Restated)
	2007			

			(As Restated)			(As Restated)	
2006							
Net Revenues	\$ 368,056	(1,558)	\$ 366,498	\$ 376,079	795	\$ 376,874	
Gross Profit	241,082	(1,347)	239,735	247,109	621	247,730	
Operating Income	31,944	(1,336)	30,608	37,355	595	37,950	
Net Income	\$ 16,123	(1,646)	\$ 14,477	\$ 18,458	1,030	\$ 19,488	
Basic net income per common share	\$ 0.38		\$ 0.34	\$ 0.44		\$ 0.46	
Diluted net income per common share	\$ 0.38		\$ 0.34	\$ 0.43		\$ 0.46	

	Third			Fourth		
	(As Previously Reported)	(Adjustments)	(As Restated)	(As Previously Reported)	(Adjustments)	(As Restated)
2006						
Net Revenues	\$ 382,214	(215)	\$ 381,999	\$ 390,958	362	\$ 391,320
Gross Profit	251,120	(369)	250,751	256,557	338	256,895
Operating Income	38,209	(348)	37,861	40,192	412	40,604
Net Income	\$ 19,306	(401)	\$ 18,905	\$ 21,093	300	\$ 21,393
Basic net income per common share	\$ 0.45		\$ 0.45	\$ 0.50		\$ 0.50
Diluted net income per common share	\$ 0.45		\$ 0.44	\$ 0.49		\$ 0.50

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APRIA HEALTHCARE GROUP INC.
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

(in thousands)	Balance at Beginning of Period	Increase Due to Coram Acquisition	Charged to Costs and Expenses	Deductions	Balance at End of Period
Year ended December 31, 2007					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 27,324	\$ 21,557	\$ 43,138	\$ 44,196	\$ 47,823
Reserve for inventory and patient service equipment shortages	\$ 4,420	\$ 195	\$ 3,351	\$ 2,600	\$ 5,366
Year ended December 31, 2006					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 41,527		\$ 38,723	\$ 52,926	\$ 27,324
Reserve for inventory and patient service equipment shortages	\$ 3,753		\$ 3,623	\$ 2,956	\$ 4,420
Year ended December 31, 2005					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 45,064		\$ 46,948	\$ 50,485	\$ 41,527
Reserve for inventory and patient service equipment shortages	\$ 3,230		\$ 2,309	\$ 1,786	\$ 3,753

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: September 11, 2008

APRIA HEALTHCARE GROUP INC.

By: /s/ Lawrence M. Higby
Lawrence M. Higby
Chief Executive Officer

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The Exhibit Index is amended by substituting the following revised exhibits:

- 31.1 Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a). (*)
- 31.2 Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a). (*)
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350. (*)
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C Section 1350. (*)

* Filed herewith.