

CONSOLIDATED FINANCIAL STATEMENTS

Methodist Healthcare Ministries of South Texas, Inc.  
Years Ended December 31, 2008 and 2007  
With Report of Independent Auditors

Methodist Healthcare Ministries of South Texas, Inc.

Consolidated Financial Statements

Years Ended December 31, 2008 and 2007

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## Report of Independent Auditors

The Board of Directors  
Methodist Healthcare Ministries of South Texas, Inc.

We have audited the accompanying consolidated statements of financial position of Methodist Healthcare Ministries of South Texas, Inc. as of December 31, 2008 and 2007, and the related consolidated statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Methodist Healthcare Ministries of South Texas, Inc. at December 31, 2008 and 2007, and the consolidated results of its activities and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

*Ernst & Young LLP*

June 4, 2009

Methodist Healthcare Ministries of South Texas, Inc.

Consolidated Statements of Financial Position

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 255,877	\$ 12,816,583
Prepaid expenses and other current assets	218,792	223,771
Current portion of grant receivable	38,100	38,100
Current portion of board-designated investments	48,833,901	27,835,845
Total current assets	<u>49,346,670</u>	40,914,299
Assets limited as to use:		
Endowment fund	100,000	100,000
Grant receivable	38,100	38,100
Board-designated investments	154,377,047	218,048,413
Total assets limited as to use	<u>154,515,147</u>	218,186,513
Less amount required to meet current obligations:		
Grant receivable	(38,100)	(38,100)
Board-designated investments	(48,833,901)	(27,835,845)
Noncurrent assets limited as to use	<u>105,643,146</u>	190,312,568
Net property, equipment, and land	10,315,913	9,718,376
Construction in progress	5,390,921	242,467
Investment in Methodist Healthcare System of San Antonio, Ltd.	261,602,123	226,538,650
Total assets	<u><u>\$ 432,298,773</u></u>	<u><u>\$ 467,726,360</u></u>

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable, accrued expenses, and other current liabilities	\$ 1,969,286	\$ 1,114,853
Grants payable	14,161,684	10,071,450
Line of credit	6,500,000	–
Total current liabilities	<u>22,630,970</u>	11,186,303
Net assets:		
Unrestricted	409,545,228	456,420,043
Temporarily restricted	22,575	20,014
Permanently restricted	100,000	100,000
Total net assets	<u>409,667,803</u>	456,540,057
Total liabilities and net assets	<u><u>\$ 432,298,773</u></u>	<u><u>\$ 467,726,360</u></u>

*See accompanying notes.*

Methodist Healthcare Ministries of South Texas, Inc.

Consolidated Statements of Activities

	<b>Years Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Unrestricted net assets</b>		
Revenues, gains, and other support:		
Equity in earnings from Methodist Healthcare System of San Antonio, Ltd.	\$ 56,063,473	\$ 54,569,090
Total investment (loss) return	(61,871,365)	19,062,818
Grant revenue and in-kind support	115,826	142,731
Other operating income	520,563	618,277
	<u>(5,171,503)</u>	<u>74,392,916</u>
Net assets released from restrictions – grants/contributions	<b>10,439</b>	163,841
Total unrestricted revenues, (losses) gains, and other support	<b>(5,161,064)</b>	74,556,757
Expenses and losses:		
Program expenses	37,427,923	25,255,999
Management and general expenses	3,769,427	3,524,739
Management and general fixed expenses	516,401	467,557
Total expenses and losses	<u>41,713,751</u>	<u>29,248,295</u>
(Decrease) increase in unrestricted net assets	<b>(46,874,815)</b>	45,308,462
<b>Temporarily restricted net assets</b>		
Contributions	13,000	75,849
Net assets released from restrictions – contributions	(10,439)	(163,841)
Increase (decrease) in temporarily restricted net assets	<u>2,561</u>	<u>(87,992)</u>
<b>(Decrease) increase in net assets</b>	<b>(46,872,254)</b>	45,220,470
Net assets at beginning of year	<b>456,540,057</b>	411,319,587
Net assets at end of year	<b>\$ 409,667,803</b>	<b>\$ 456,540,057</b>

See accompanying notes.

Methodist Healthcare Ministries of South Texas, Inc.

Consolidated Statements of Cash Flows

	<b>Years Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
(Decrease) increase in net assets	\$ (46,872,254)	\$ 45,220,470
Adjustments to reconcile (decrease) increase in net assets to net cash used in operating activities:		
Depreciation and amortization	1,382,934	692,740
Realized loss (gain) on investments	9,176,744	(7,094,983)
Unrealized loss (gain) on investments	56,081,255	(2,499,186)
Earnings from investment in Methodist Healthcare System of San Antonio, Ltd.	(56,063,473)	(54,569,090)
Changes in assets and liabilities:		
Decrease in prepaid expenses and other assets	4,979	56,159
Increase (decrease) in accounts payable, accrued expenses and other liabilities	4,944,667	(1,609,071)
Net cash used in operating activities	<u>(31,345,148)</u>	<u>(19,802,961)</u>
<b>Investing activities</b>		
Purchases of property and equipment	(7,128,925)	(481,059)
Distributions from investment in Methodist Healthcare System of San Antonio, Ltd.	21,000,000	29,000,000
Purchases of investments	(218,589,241)	(342,479,162)
Proceeds from sales/maturities of investments	217,002,608	337,596,457
Net cash provided by investing activities	<u>12,284,442</u>	<u>23,636,236</u>
<b>Financing activities</b>		
Proceeds from line of credit	6,500,000	-
Net cash provided by financing activities	<u>6,500,000</u>	<u>-</u>
(Decrease) increase in cash and cash equivalents	(12,560,706)	3,833,275
Cash and cash equivalents at beginning of year	12,816,583	8,983,308
Cash and cash equivalents at end of year	<u>\$ 255,877</u>	<u>\$ 12,816,583</u>

See accompanying notes.

# Methodist Healthcare Ministries of South Texas, Inc.

## Notes to Consolidated Financial Statements

December 31, 2008 and 2007

### 1. Organization and Significant Accounting Policies

#### Organization

Methodist Healthcare Ministries of South Texas, Inc. (Ministries), a faith-based, tax-exempt nonprofit corporation incorporated under the laws of the state of Texas, was originally chartered in 1955 by the Southwest Texas Conference of The United Methodist Church (Conference). The members of the Board of Directors are approved annually by the Conference and represent a variety of community leaders, including a number of local United Methodist Church officials. At all times, at least 60% of the Board of Directors must be members of The United Methodist Church. Ministries was formerly known as Southwest Texas Methodist Hospital (Hospital), a hospital operated for charitable, scientific, educational, and religious purposes.

On January 11, 1995, Ministries entered into a partnership agreement with Columbia/HCA Healthcare Corporation of Central Texas (HCA-Central), an indirect wholly owned subsidiary of HCA Inc. (HCA Inc. was acquired effective November 17, 2006, by Hercules Holding II, LLC), to form a Texas limited partnership, Methodist Healthcare System of San Antonio, Ltd. (Partnership), to provide health care services to San Antonio and surrounding areas. The Partnership filed a certificate to add the designation of limited liability partnership effective June 5, 2003. HCA Inc. is a holding company whose affiliates own and operate hospitals and related health care entities. The Partnership is structured with two general partners, Ministries and HCA-Central, each with a 20% general partnership interest. The two general partners also hold limited partnership interests, with Ministries holding 30% and HCA-Central and other wholly owned subsidiaries of HCA Inc. holding a combined 30%. Each partner, in exchange for its partnership interest, contributed substantially all of its hospital-related assets and liabilities located in the San Antonio area. All distributions shall be in proportion to each partner's sharing percentage. Under the partnership agreement, as amended, the partners' sharing percentages for allocation of partnership income or loss were 20% to each general partner and 30% to each limited partner. The partnership provides charity care to patients without financial means to pay for hospital services in accordance with its eligibility policy.

On April 10, 1996, Wesley Primary Care Clinic (WPCC) was incorporated as a not-for-profit corporation under the Texas Non-Profit Corporation Act. WPCC is certified as a not-for-profit health corporation under 177.1 of the Texas State Board of Medical Examiners (TSBME) rules and Section 5.01a of the Medical Practice Act of Texas. Ministries is the sole member of WPCC, which was created for the purpose of hiring physicians, and dentists to provide medical and dental services at Ministries' clinics.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**1. Organization and Significant Accounting Policies (continued)**

WPCC has responsibility for all medical and dental practice issues, including salaries and benefits for physicians and dentists. All other activities and expenses of WPCC are managed by Ministries and are reflected as direct program expenses of Ministries. The consolidated financial statements of Ministries include the accounts of Ministries and WPCC. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Mission Statement**

*“Serving Humanity to Honor God”*

To serve by improving the physical, mental, and spiritual health of those least served in the Southwest Texas Conference of The United Methodist Church.

**Charity Program Spending**

Ministries is committed to nurturing the health and well-being of the whole individual—physically, mentally, and spiritually. It is also committed to the concept of empowering others—existing agencies, programs, and people—by providing resources so that the specific needs of the local communities are identified and met. Strict policies of review, selection, and oversight in resource allocation are maintained by the Board and staff of Ministries to ensure that the greatest results are achieved and that existing services are not duplicated but enhanced.

Ministries incurred \$37,427,923 in 2008 and \$25,255,999 in 2007 for program expenses for operating programs and grants, and \$1,147,079 in 2008 and \$216,688 in 2007 for routine capital expenditures related to programs to improve individual and family health in South Texas for the least-served.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**1. Organization and Significant Accounting Policies (continued)**

The following is a summary of program expenses for operating programs and grants:

	<u>2008</u>	<u>2007</u>
<b>Medical and dental services</b>		
Operating programs:		
WPCC sites, Bishop Ernest T. Dixon, Jr. Clinic, and School-Based Health Centers	\$ 8,140,347	\$ 7,441,447
<b>Health and wellness programs</b>		
Operating programs:		
Wesley Nurse Health Ministries™	4,921,843	3,959,090
Parenting programs: Meld and PHP	1,426,449	1,234,516
Wesley Family Wellness Programs	1,357,657	780,665
Support services	2,053,092	1,644,063
Total operating programs	<u>17,899,388</u>	<u>15,059,781</u>
<b>Research and policy</b>	761,182	670,179
<b>Grants to external partners</b>	18,496,678	9,378,830
<b>Other minor grants</b>	270,675	147,209
Total program expenses	<u>\$ 37,427,923</u>	<u>\$ 25,255,999</u>
Capital expenditures for programs	<u>\$ 1,147,079</u>	<u>\$ 216,688</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**1. Organization and Significant Accounting Policies (continued)**

Brief descriptions of the programs funded by Ministries include the following:

*Medical and Dental Services*

Operating Programs

Ministries' clinics include the WPCC, with sites at Columbia Heights and Villa Coronado, and the Bishop Ernest T. Dixon Jr. Clinic. All of these sites provide full-time medical and/or dental services and counseling/support services to individuals and families who do not qualify for Medicaid or Medicare, or who cannot afford health insurance. Patient revenue is nominal and is based on a sliding fee scale determined by family size and income level. Ministries also operates School-Based Health Centers in two separate school districts, providing medical, dental, and support services.

*Health and Wellness Programs*

Operating Programs

The Wesley Nurse Health Ministries™ provides specially trained registered nurses who are based in churches throughout South Texas. The Wesley Nurses are charged with defining the health and wellness needs of the least-served of the congregations they serve and the community as a whole. The Wesley Nurses also facilitate meeting the needs of the least-served by interfacing with other community resources.

Parenting programs include: Meld, Born to Learn®, and Parents Helping Parents (PHP)—early childhood parent education programs designed to inform parents about the importance of early education in the development of their children. Ministries' is a licensed network affiliate of the National Center for Parents As Teachers' Meld program. Ministries' offers Meld programs for young moms, young dads, growing families, and parents of children with special needs. Born to Learn® is a licensed program of the National Center for Parents As Teachers. Ministries' conducts personal home visits with parents with children ages 0-3, including prenatal visits. PHP is a program that Ministries developed in partnership with the Texas Cooperative Extension in 1999. PHP provides training and technical assistance for volunteers to implement parent support groups in the rural areas of South Texas.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Significant Accounting Policies (continued)**

Support services for the Wesley clinics and Dixon Primary Care Clinic expand services to include the health and wellness educational components of holistic care, plus case management and counseling. Ministries has also extended the counseling services into the Corpus Christi and Rio Grande Valley areas through church-based counseling.

Wesley Health & Wellness Center (WHWC) offers holistic integrated services to include medical and dental services; support, counseling, and case management services; and family wellness programs for the least-served in the surrounding neighborhoods. The Wesley Family Wellness Programs offer activities for individuals of all ages, including an “out of school time” program and summer camp for children and youth ages 6-18, youth and adult sports leagues, exercise classes, and many other learning opportunities. WHWC provides free legal assistance as a Community Justice Program site.

#### *Grants to External Partners*

In 1996, Ministries began funding grants to community health centers. This collaborative effort allows Ministries to provide health care services at a lower cost through partnering with existing community health centers in the underserved areas of San Antonio. In addition, Ministries’ goal of extending its services throughout the Rio Grande Valley and South Texas is achieved through partnering with community health centers to supplement dental salaries in areas of high need and to provide medical services to low-income clients in these communities. During 2008, additional grants were approved to fund various short-term funding proposals for external partners primarily in Bexar County and the lower Rio Grande areas. These short-term grants included direct services to patients and capital funding for construction of new clinic facilities, as well as renovations to existing clinic facilities for the underserved.

In furtherance of the spiritual aspect of Ministries’ mission, a grant was made to The Southwest Texas Conference to provide pastoral education for pastors in The Southwest Texas Conference and The Rio Grande Conference, as well as a clergy health and wellness program. In addition, a grant was given to the Ecumenical Center for Religion and Health to provide other educational opportunities for pastors, including courses provided in Spanish.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Significant Accounting Policies (continued)**

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

##### **Cash and Cash Equivalents**

Highly liquid investments are reported as cash equivalents, excluding amounts whose use is limited by Board designation. Ministries routinely invests its surplus operating funds in a money market mutual fund and/or high-grade governmental notes and corporate commercial paper. The money market mutual fund generally invests in highly liquid direct obligations of the U.S. Treasury and repurchase agreements secured by such obligations. The carrying amount reported in the consolidated statements of financial position approximate its fair value.

##### **Assets Limited as to Use**

Assets limited as to use consisting of cash, U.S. Treasury obligations, money market funds, mutual funds, and debt and equity positions are carried at fair value. Investments in certain partnerships are recorded based on Ministries' share of the partnership's underlying value of portfolio securities, as reported to Ministries by the related investment managers. Gains and losses and investment income/losses are reported as unrestricted or temporarily/permanently restricted net assets, as appropriate. Any changes in the net asset value of the partnerships are reflected as unrealized gains or losses.

##### **Property and Equipment**

Property and equipment acquisitions are recorded at cost. Depreciation is computed by the straight-line method over the estimated useful life of the depreciable assets. Leasehold improvements are amortized over the lease term. During 2008, the Board approved the construction of a new building at the Columbia Heights location—the new Wesley Health & Wellness Center.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### 1. Organization and Significant Accounting Policies (continued)

It was determined that the existing WHWC building would be demolished in June 2009. Depreciation estimates on the existing building were revised to reflect the use of the asset over its shortened useful life. This adjustment resulted in additional depreciation expense of approximately \$426,000 in 2008. The remaining net book value was \$686,000 as of December 31, 2008. The estimated life used in computing depreciation and amortization is as follows:

Buildings	30 years
Building improvements	10–15 years
Leasehold improvements	3–5 years
Major movable/office furnishings	3–15 years

#### Investment in Methodist Healthcare System of San Antonio, Ltd.

The investment in the Partnership is accounted for using the equity method of accounting.

#### Medical Malpractice Self-Insurance

Prior to January 11, 1995, Southwest Texas Methodist Hospital (Hospital) self-insured against malpractice claims. The Hospital established a trust for the purpose of setting aside assets based on actuarial funding recommendations. All assets and contingent liabilities for claims occurring prior to January 11, 1995, related to the trust, were transferred to Ministries. Various levels of self-insurance and excess coverage were in effect from July 1977 through January 10, 1995. As of December 31, 2003, all trust assets have been expended for malpractice claims and all known claims have been resolved. If necessary, any future settlements or claims, which are not covered by insurance, would be paid out of Board-designated assets.

Ministries obtained a tail policy on January 11, 1995, in the amount of \$10,000,000 per claim and \$10,000,000 annual aggregate above \$3,000,000 per occurrence and \$6,000,000 aggregate, retroactive to November 30, 1989. Any future settlements or claims would have to be paid out of other Board-designated assets.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Significant Accounting Policies (continued)**

Currently, Ministries maintain a professional liability policy for nurses and other ancillary staff with a \$1,000,000 per claim and \$3,000,000 aggregate per year limit with a \$10,000 deductible. An excess liability umbrella policy covering both general liability and professional liability claims is also in effect with a \$10,000,000 limit per claim.

#### **Income Taxes**

Ministries is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

#### **Grants**

Grants are reported as either temporarily or permanently restricted support when they are received with donor stipulation that limits the use of the donated assets. When a grantor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

#### **Contributions**

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. However, if a restriction is fulfilled in the same time period in which the contribution is received, the organization reports the support as unrestricted income.

#### **In-Kind Support and Donated Personal Services of Volunteers**

In-kind support is recorded as revenue and expense in the accompanying consolidated statements of activities only if the contribution meets the requirement of Statement of Financial Accounting Standards (SFAS) No. 116, *Accounting for Contributions Received and Contributions Made*. In accordance with SFAS No. 116, for contributed services to be recognized as revenue, services

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Significant Accounting Policies (continued)**

must be those that would normally be paid for, the same as those normally provided by the donor, and clearly measurable. In-kind support consists primarily of donated meals for the youth summer programs at the WHWC. The costs of the meals are recorded at their estimated fair value at the date of donation. The estimated value of these meals is \$71,226 for 2008 and \$74,283 for 2007. Volunteers at the WHWC donate their time to support the various programs. Donated volunteer hours, for which no value has been assigned, were 5,528 for 2008 and 7,287 for 2007.

Ministries receives rental space, for a nominal amount, for the medical and dental operating sites at Villa Coronado and the Marion and Schertz-Cibolo-Universal City Independent School Districts. In addition, Ministries leases a portion of the Columbia Heights property for a nominal amount. No amounts have been recognized for this rental space in the consolidated statements of activities because an estimated value could not be determined.

#### **Net Assets**

Unrestricted net assets generally result from revenues from providing services, producing and delivering services, receiving unrestricted contributions, recognition of earnings from the Partnership, and receiving dividends or interest from investing in income-producing assets, fewer expenses incurred in providing services, producing and delivering services, raising contributions, and performing administrative functions. Temporarily restricted net assets are those whose use has been limited by grantors or donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Ministries in perpetuity with the earnings to be used to provide charity care.

#### **Reclassification**

Certain amounts in the 2007 financial statements have been reclassified to conform to the 2008 presentation. In 2008, Ministries determined it was more appropriate to classify the construction in progress separately on the balance sheet. The amount reclassified was \$242,467 in 2007.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **1. Organization and Significant Accounting Policies (continued)**

##### **Adoption of Accounting Pronouncements**

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), in September 2006. SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. SFAS 157 also requires expanded disclosure about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on changes in net assets. The adoption of SFAS 157, effective January 1, 2008, did not have a material impact on Ministries' consolidated financial position or results from operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS 159 specifies that all subsequent changes in fair value be reported in changes in net assets. The adoption of SFAS 159, effective January 1, 2008, did not have a material impact on Ministries' consolidated financial position or results from operations as Ministries did not elect fair value accounting for any asset or liability not currently required to be reflected at fair value.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**2. Investment in Methodist Healthcare System of San Antonio, Ltd.**

During 2008 and 2007, \$21 million and \$29 million, respectively, were distributed to each partner. The Partnership evaluates the cash position and projected future cash flows each month and proposes distributions or cash calls with the goal of maintaining cash on hand of approximately \$15 million.

	<u>2008</u>	<u>2007</u>
Investment in the Partnership as of beginning of year	\$ 226,538,650	\$ 200,969,560
Earnings from the Partnership	56,063,473	54,569,090
Distributions from the Partnership	<u>(21,000,000)</u>	<u>(29,000,000)</u>
Investment in the Partnership as of end of year	<u>\$ 261,602,123</u>	<u>\$ 226,538,650</u>

A summary of the Partnership's assets, liabilities, and partners' capital at December 31, 2008 and 2007, and results of operations for the years ended December 31, 2008 and 2007, is as follows:

	<b>December 31</b>	
	<u>2008</u>	<u>2007</u>
Total assets	\$ 755,175,000	\$ 697,381,000
Total liabilities	\$ 107,053,000	\$ 119,385,000
Partners' capital	<u>648,122,000</u>	<u>577,996,000</u>
Total liabilities and partners' capital	<u>\$ 755,175,000</u>	<u>\$ 697,381,000</u>

	<b>Years Ended December 31</b>	
	<u>2008</u>	<u>2007</u>
Total revenue	\$ 1,205,242,000	\$ 1,122,899,000
Total expenses	<u>1,093,116,000</u>	<u>1,013,761,000</u>
Net income	<u>\$ 112,126,000</u>	<u>\$ 109,138,000</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**2. Investment in Methodist Healthcare System of San Antonio, Ltd. (continued)**

The approximate difference between the amount of underlying equity in partners' capital and the amount at which the investment in the Partnership is carried at December 31, 2008, is as follows:

Partners' capital at December 31, 2008	\$ 327,603,123
Less excess working capital payment by HCA (1995)	(13,714,000)
Less parity payment by HCA (1995)	(74,750,000)
Plus equity reclassified to intercompany debt with HCA (1995)	22,463,000
Investment in the Partnership	<u>\$ 261,602,123</u>

In furtherance of Ministries' mission, the Partnership provides charity care to patients without financial means to pay for hospital services in accordance with its eligibility policy. The charges forgone based on established rates were \$90,875,000 in 2008 and \$73,621,000 in 2007. Charity admissions as a percentage of total patient admissions were 3.1% and 2.7% in 2008 and 2007, respectively. Charity cost (calculated based on the overall cost-to-charge ratio per the Partnership's financial statements) as a percentage of net patient revenue was 2.2% in 2008 and 1.9% in 2007.

**3. Grant Receivable**

As of December 2008 and 2007, Ministries had received unconditional grants totaling \$44,600 and \$68,448, respectively. Unconditional grants are temporarily restricted by grantors and are due as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Less than one year	<u>\$ 38,100</u>	<u>\$ 38,100</u>
Total grant receivable	<u>\$ 38,100</u>	<u>\$ 38,100</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**4. Property, Equipment, and Land**

A summary of property, equipment, and land at December 31 is as follows:

	<u>2008</u>	<u>2007</u>
Building and land improvements	\$ 8,286,627	\$ 7,623,111
Leasehold improvements	668,920	661,861
Office furnishings and equipment	3,746,519	2,715,247
	<u>12,702,066</u>	11,000,219
Less accumulated depreciation and amortization	4,603,630	3,422,363
Net property and equipment	8,098,436	7,577,856
Land	2,217,477	2,140,520
Net property, equipment, and land	<u>\$ 10,315,913</u>	<u>\$ 9,718,376</u>

**5. Construction in Progress**

In furtherance of the mission of Ministries, a new building for the WHWC is being constructed at the Columbia Heights location. Cost incurred as of December 31, 2008, was \$5,390,921. The estimated total cost to complete this project, including equipment and furnishings, is approximately \$6,449,079 at December 31, 2008. The construction of the new building began during the first quarter of 2008, and is estimated to be completed in May of 2009.

**6. Assets Limited as to Use**

**Endowment Fund**

The endowment fund is considered a permanently restricted asset. The investment is to be held in perpetuity with the income designated for charity care. Investments are stated at fair value, which approximates cost and are composed of the following at December 31:

	<u>2008</u>	<u>2007</u>
Texas Methodist Foundation	\$ 100,000	\$ 100,000

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**6. Assets Limited as to Use (continued)**

**Board-Designated Investments**

Investments that are designated by the Board of Directors for funding of future programs and potential partnership capital calls are stated at fair value, based on market prices with the exception of certain investments in partnerships that hold investments in market-neutral hedge funds. All investments stated at fair value have an inherent level of market risk associated. Investments are composed of the following at December 31:

	<u>2008</u>	<u>2007</u>
Texas Methodist Foundation	\$ 2,374,378	\$ 2,261,945
State of Israel bond	25,000	25,000
Managed accounts – equities	81,628,384	129,842,671
Managed account – fixed income	7,575,039	–
Market-neutral hedge funds	31,679,591	40,946,096
Mutual funds	31,034,943	44,902,921
Interest receivable	59,712	69,780
	<u>\$ 154,377,047</u>	<u>\$ 218,048,413</u>

**Summary of Activity**

Market value at December 31, 2006	\$ 203,571,539
Net deductions	(4,585,944)
Realized gains	7,589,761
Interest/dividend income	5,865,611
Investment fees	(910,644)
Change in market value	<u>6,518,090</u>
Market value at December 31, 2007	<b>218,048,413</b>
Net deductions	<b>(1,800,000)</b>
Realized losses	<b>(9,176,745)</b>
Interest/dividend income	<b>4,281,066</b>
Investment fees	<b>(894,432)</b>
Change in market value	<u><b>(56,081,255)</b></u>
Market value at December 31, 2008	<u><b>\$ 154,377,047</b></u>

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### 6. Assets Limited as to Use (continued)

Due to the volatility of the stock market, there is a reasonable possibility of changes in fair value and additional gains and losses in the near term subsequent to December 31, 2008.

#### 7. Retirement Plan

Ministries has established a defined contribution plan, which covers substantially all eligible employees. Ministries matches employees' contributions up to 7% of annual salary subject to Internal Revenue Service (Service) limitations. Contributions to the defined contribution pension plan totaled \$387,859 and \$368,459 in 2008 and 2007, respectively.

#### 8. Commitments and Contingencies

Malpractice claims that fall within the Hospital/Ministries' adopted policy of self-insurance (see Note 1) could be asserted against the Hospital/Ministries. There could be additional incidents that could have occurred through January 10, 1995, which may result in the assertion of additional claims. Management has no knowledge of potential claims.

In July 2007, Ministries entered into an agreement with Frost Bank for a \$50 million line of credit with a variable rate at 30-day LIBOR plus 1%. The line imposes certain minimum investment balance restrictions. The revolving line of credit is effective for two years and was activated by the Board during 2008. The amount drawn as of December 31, 2008, was \$6.5 million. Management plans to extend the line of credit beyond July 2009.

#### Leases

Ministries leases seven facilities for programs and clinics under operating leases expiring at various dates through December 2013. Total rental expense in 2008 and 2007, for all operating leases was \$204,931 and \$181,790, respectively. Future minimum rental commitments under noncancelable operating leases (with an initial or remaining term in excess of one year) at 2008 are as follows:

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013 and Thereafter</b>
Future minimum lease requirements	\$ 178,400	\$ 142,361	\$ 91,905	\$ 1,801	\$ 1,801

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **9. Income Taxes**

Ministries has been determined to be exempt from federal income taxes pursuant to Section 501(c)(3) of the Code, as amended.

After examination by the Service challenging Ministries' tax-exempt status, Ministries entered into a closing agreement dated October 2, 2001, which reaffirms Ministries' tax-exempt status under Section 501(c)(3).

In July 2006, FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes*, was issued. FIN 48 creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of FIN 48, tax-exempt organizations could now be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. Prior to FIN 48, the determination of when to record a liability for a tax exposure was based on whether a liability was considered probable and reasonably estimable in accordance with FASB Statement No. 5, *Accounting for Contingencies*. During 2008, FASB Staff Position (FSP) FIN 48-3 was issued. This FSP deferred the effective date of FIN 48. This deferral was intended to give the FASB additional time to develop guidance on the application of FIN 48 by pass-through entities and not-for-profit organizations. The effective date of FIN 48 for nonpublic entities was deferred until fiscal years beginning after December 15, 2008. Ministries does not expect the adoption of FIN 48 to have a material effect on the financial position or results of operations.

#### **10. Fair Values Measurements**

In September 2006, the FASB issued SFAS 157. Ministries adopted SFAS 157 on January 1, 2008, which among other things, requires enhanced disclosures about investments that are measured and reported at fair value. SFAS 157 establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value.

## Methodist Healthcare Ministries of South Texas, Inc.

### Notes to Consolidated Financial Statements (continued)

#### 10. Fair Values Measurements (continued)

Market price observability is impacted by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Investments measured and reported at fair value are classified and disclosed in one of the following categories:

*Level I:* Quoted prices are available in active markets for identical investments as of the reporting date. The types of investments Ministries classify as Level I include listed equities, U.S. government and agency obligations, and frequently traded corporate bonds.

*Level II:* Pricing inputs are other-than-quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of comparables, modeling, or other valuation methodologies. Investments Ministries classify as Level II include positions in Ministries' fixed income investments that provide a stated rate of return and observable prices on a monthly basis.

*Level III:* Pricing inputs may have unobservable inputs for the investment and include situations where there is no independent market price quote for the investment. Investments that Ministries lists in this category include alternative investments which are made in the form of Limited Partnerships (LPs) and report their value in terms of net asset value (NAV). Ministries must depend on the managers of those partnerships to provide accurate pricing and NAV calculation. Ministries takes the necessary steps to obtain a comfort level with the procedures being used by these managers. Additionally, these LPs may hold investments that have been identified as Level III themselves.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**10. Fair Values Measurements (continued)**

The following table summarizes the valuation of Ministries' investment portfolio by the above SFAS 157 fair value hierarchy levels as of December 31, 2008:

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
Texas Methodist Foundation	\$ —	\$ 2,374,378	\$ —	\$ 2,374,378
State of Israel Jubilee Bond	—	25,165	—	25,165
<b>Managed accounts (equity)</b>				
Chase Large Cap	10,599,408	—	—	10,599,408
Chase Mid Cap	4,744,563	—	—	4,744,563
Crawford Investments	8,670,068	—	—	8,670,068
DSM Large Cap	11,466,326	—	—	11,466,326
Eagle Capital Management	9,790,710	—	—	9,790,710
Eagle Global International	8,181,446	—	—	8,181,446
Luther King Small/Mid Cap	5,356,565	—	—	5,356,565
Northroad International	12,156,559	—	—	12,156,559
South Texas Management	8,722,286	—	—	8,722,286
The Mitchell Group	2,000,000	—	—	2,000,000
	<u>81,687,931</u>	<u>—</u>	<u>—</u>	<u>81,687,931</u>
<b>Managed accounts (fixed income)</b>				
Pacific Income Advisers	7,575,039	—	—	7,575,039
<b>Mutual funds (fixed income)</b>				
PIMCO Total Return	9,361,893	—	—	9,361,893
<b>Mutual funds (equity)</b>				
Vanguard Institutional Index Fund	21,673,050	—	—	21,673,050
<b>Alternative investments</b>				
Overseas CAP Partners, Inc.	—	—	15,926,465	15,926,465
Black Diamond Ltd	—	—	7,736,069	7,736,069
Double Black Diamond Ltd.	—	—	8,017,057	8,017,057
	<u>—</u>	<u>—</u>	<u>31,679,591</u>	<u>31,679,591</u>
	<u>\$ 120,297,913</u>	<u>\$ 2,399,543</u>	<u>\$ 31,679,591</u>	<u>\$ 154,377,047</u>
<b>Percent of investment portfolio</b>	77.9%	1.6%	20.5%	100%

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements (continued)

**10. Fair Values Measurements (continued)**

Investments in Managed Accounts and Mutual Funds have prices in actively traded markets that are easily quoted. These investments consist of equity shares, fixed income units, and mutual fund shares. Investments in the Texas Methodist Foundation and the State of Israel Jubilee Bond are fixed income investments for which Ministries receive monthly pricing.

Alternative investments consist of Ministries' investments in market-neutral hedge funds. Participation in these funds is achieved via ownership of shares in a Limited Partnership. These shares are not traded in an active market; however, the NAV of the shares is reported by the fund manager on a monthly basis. Due to the limited transparency of the underlying investments in these partnerships, they have been placed in Level III. Ministries also considered external issues with the market-neutral hedge funds, such as liquidity concerns, turnover in personnel, and the reliability of the reported NAV, and determined that no premium or discount should be applied based on those factors.

These market-neutral hedge funds are designed to have a nondirectional correlation with financial markets. Strategies used by these funds include relative value arbitrage, risk arbitrage, convertible arbitrage, long-term/short-term equity, and credit. Short positions and derivatives, though prohibited as stand-alone positions by Ministries' Investment Policy Statement, are allowable investments as part of these strategies. These investments may be exposed to certain lock-up periods and gate restrictions dependent upon the terms of the agreement.

The changes in investments measured at fair value for which Ministries has used Level III inputs to determine fair value are as follows:

	<b>Overseas CAP Partners</b>	<b>Black Diamond Ltd.</b>	<b>Double Black Diamond Ltd.</b>	<b>Total</b>
Balance at December 31, 2007	\$ 22,626,844	\$ 9,159,109	\$ 9,160,143	\$ 40,946,096
Net realized gain	160,056	-	-	160,056
Net change in unrealized loss	(5,060,435)	(1,423,040)	(1,143,086)	(7,626,561)
Distributions	(1,800,000)	-	-	(1,800,000)
Balance at December 31, 2008	<u>\$ 15,926,465</u>	<u>\$ 7,736,069</u>	<u>\$ 8,017,057</u>	<u>\$ 31,679,591</u>