



Methodist Healthcare Ministries of South Texas, Inc.

Consolidated Financial Report
December 31, 2018

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
Methodist Healthcare Ministries of South Texas, Inc.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Methodist Healthcare Ministries of South Texas, Inc. (MHM), which comprise the consolidated statements of financial position as of December 31, 2018 and 2017, the related consolidated statements of activities and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Methodist Healthcare System of San Antonio, Ltd., LLP, a partnership, and as discussed in Note 1 to the consolidated financial statements, an investment which is accounted for using the equity method of accounting. The investment in Methodist Healthcare System of San Antonio, Ltd., LLP totaled \$607,097,501 and \$531,556,220 as of December 31, 2018 and 2017, respectively, and the equity in earnings totaled \$133,041,281 and \$104,835,704, respectively, for the years then ended. The consolidated financial statements of Methodist Healthcare System of San Antonio, Ltd., LLP were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for MHM, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. The consolidated financial statements of Methodist Healthcare System of San Antonio, Ltd., LLP, audited separately by other auditors, were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to MHM's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MHM's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

MHM adopted Accounting Standards Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, during the current year, see Note 14. The adoption of the standard resulted in additional footnote disclosures and significant changes to classification of net assets and the disclosures related to net assets. The adoption was retrospectively applied to January 1, 2017, the earliest year presented. Our opinion is not modified with respect to this matter.

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Methodist Healthcare Ministries of South Texas, Inc. as of December 31, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2019, on our consideration of MHM's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MHM's internal control over financial reporting and compliance.

RSM US LLP

San Antonio, Texas
June 29, 2019

Methodist Healthcare Ministries of South Texas, Inc.

**Consolidated Statements of Financial Position
December 31, 2018 and 2017**

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,614,097	\$ 9,761,099
Prepaid expenses and other current assets	1,136,965	862,814
Total current assets	13,751,062	10,623,913
Assets limited as to use:		
Board-designated investments	479,675,242	547,514,162
Cash held at BBT Master Fund Liquidating Trust	1,668,930	1,630,217
Board-designated cash	761,415	247,706
Total board-designated portfolio	482,105,587	549,392,085
Research and Development Fund, net of adjustment to carrying value of \$1,319,541 (\$1,319,541 for 2017)	1,400,203	1,923,591
Endowment funds	207,109	218,922
Total assets limited as to use	483,712,899	551,534,598
Other investments	-	68,206
Property, equipment and land, net	37,422,500	33,355,983
Investment in Methodist Healthcare System of San Antonio, Ltd., LLP	607,097,501	531,556,220
Total assets	\$ 1,141,983,962	\$ 1,127,138,920
Liabilities and Net Assets		
Current liabilities:		
Accounts payable, accrued expenses and other current liabilities	\$ 7,079,284	\$ 7,662,280
Current portion of grants payable	31,995,387	30,965,468
Total current liabilities	39,074,671	38,627,748
Long-term liabilities—grants payable, net, less current portion	314,423	194,423
Total liabilities	39,389,094	38,822,171
Net assets:		
Without donor restrictions:		
Undesignated	1,102,494,868	1,088,216,749
With donor restrictions:		
Restricted in perpetuity	100,000	100,000
Total net assets	1,102,594,868	1,088,316,749
Total liabilities and net assets	\$ 1,141,983,962	\$ 1,127,138,920

See notes to consolidated financial statements.

Methodist Healthcare Ministries of South Texas, Inc.

**Consolidated Statements of Activities
Years Ended December 31, 2018 and 2017**

	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Revenue, gains and other support:			
Equity in earnings from Methodist Healthcare System of San Antonio, Ltd., LLP	\$ 133,041,281	\$ -	\$ 133,041,281
Net investment return	(25,699,387)	-	(25,699,387)
Grant revenue	5,044,107	-	5,044,107
Other operating income	588,452	-	588,452
Total revenue, gains and other support	112,974,453	-	112,974,453
Expenses:			
Program expenses	87,997,710	-	87,997,710
Management and general expenses	10,698,624	-	10,698,624
Total expenses	98,696,334	-	98,696,334
Change in net assets	14,278,119	-	14,278,119
Net assets at beginning of year	1,088,216,749	100,000	1,088,316,749
Net assets at end of year	\$ 1,102,494,868	\$ 100,000	\$ 1,102,594,868

See notes to consolidated financial statements.

2017

Without Donor Restrictions	With Donor Restrictions	Total
\$ 104,835,704	\$ -	\$ 104,835,704
66,930,820	-	66,930,820
4,280,483	-	4,280,483
295,438	-	295,438
<u>176,342,445</u>	<u>-</u>	<u>176,342,445</u>
84,263,043	-	84,263,043
9,937,736	-	9,937,736
<u>94,200,779</u>	<u>-</u>	<u>94,200,779</u>
82,141,666	-	82,141,666
<u>1,006,075,083</u>	<u>100,000</u>	<u>1,006,175,083</u>
<u>\$ 1,088,216,749</u>	<u>\$ 100,000</u>	<u>\$ 1,088,316,749</u>

Methodist Healthcare Ministries of South Texas, Inc.

**Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017**

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ 14,278,119	\$ 82,141,666
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	2,040,239	1,802,407
Loss on disposal of equipment	9,967	26,356
Reserve for unused grant payable funds	(2,144,700)	(2,375,054)
Long-term grants payable discount to net present value	(23,777)	(12,716)
Realized gain on investments	(29,933,471)	(43,896,521)
Unrealized (gain) loss on investments	59,917,870	(19,318,955)
Realized (gain) loss on Research and Development Fund assets	514,405	(10,819)
Reserve on Research and Development Fund assets	-	500,000
Earnings from investment in Methodist Healthcare System of San Antonio, Ltd., LLP	(133,041,281)	(104,835,704)
Changes in:		
Prepaid expenses and other current assets	(274,151)	190,412
Accounts payable, accrued expenses and other current liabilities	(582,996)	4,069,182
Grants payable	3,318,396	4,663,212
Net cash used in operating activities	(85,921,380)	(77,056,534)
Cash flows from investing activities:		
Purchases of property and equipment	(6,116,723)	(6,468,236)
Purchases of Research and Development Fund assets	-	(200,000)
Proceeds from Research and Development Fund assets	8,983	10,819
Transfers to operations	41,569,362	41,000,000
Transfers to investment portfolio	-	(20,000,000)
Purchases of investments	(317,528,239)	(521,455,073)
Proceeds from sales/maturities of investments	313,340,995	518,040,750
Distributions from investment in Methodist Healthcare System of San Antonio, Ltd., LLP	57,500,000	15,000,000
Net cash provided by investing activities	88,774,378	25,928,260
Cash flows from financing activities:		
Line of credit proceeds	19,324,043	47,901,706
Line of credit payments	(19,324,043)	(47,901,706)
Net cash provided by financing activities	-	-
Net increase (decrease) in cash and cash equivalents	2,852,998	(51,128,274)
Cash and cash equivalents at beginning of year	9,761,099	60,889,373
Cash and cash equivalents at end of year	\$ 12,614,097	\$ 9,761,099
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 49,462	\$ 109,684
Cash paid for income tax	\$ 135,256	\$ 69,128

See notes to consolidated financial statements.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies

Organization: Methodist Healthcare Ministries of South Texas, Inc. (MHM), a faith-based, tax-exempt nonprofit corporation incorporated under the laws of the state of Texas, was originally chartered in 1955 by the Rio Texas Conference (the Conference), formerly known as the Southwest Texas Conference of The United Methodist Church. The members of the Board of Directors (the Board) 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 must be members of The United Methodist Church. MHM was formerly known as Southwest Texas Methodist Hospital (the Hospital), a hospital operated for charitable, scientific, educational and religious purposes.

On January 11, 1995, MHM 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., LLP (the Partnership), to provide healthcare services to San Antonio and the 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 healthcare entities. The Partnership is structured with two general partners, MHM and HCA-Central, each with a 20% general partnership interest. The two general partners also hold limited partnership interests, with MHM 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 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. As a nonprofit corporation, MHM has the responsibility to ensure quality care is available to everyone at Methodist Healthcare System facilities, including those without financial means to pay for hospital services, in accordance with its eligibility policy for charity care.

Since MHM owns 50% of the Partnership and appoints 50% of the Partnership's Board of Governors, including the chair, the investment in the Partnership is accounted for using the equity method of accounting. Under the equity method of accounting, the Partnership's accounts are not reflected within MHM's consolidated statements of financial position and consolidated statements of activities; however, MHM's share of the earnings or losses of the Partnership is reflected in the caption equity in earnings from Methodist Healthcare System of San Antonio, Ltd., LLP in the consolidated statements of activities.

On April 10, 1996, Wesley Primary Care Clinic (WPCC) was originally incorporated as a not-for-profit corporation under the Texas Non-Profit Corporation Act. WPCC is currently certified as a not-for-profit health organization under Chapter 177 of the Texas Medical Board Rules and Regulations and Section 162.001(b) of the Texas Occupation Code. MHM is the sole member of WPCC, which was created for the purpose of hiring physicians, dentists and advanced practice professionals to provide medical and dental services at MHM's clinics.

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

Mission statement—Serving Humanity to Honor God

Vision Statement—To be the leader for improving wellness of the least served

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

Charity program spending: MHM 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 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 MHM to ensure the greatest results are achieved and existing services are not duplicated, but enhanced.

MHM incurred \$87,997,710 and \$84,263,043 in 2018 and 2017, respectively, for program expenses for operating programs and grants, and \$6,116,723 and \$6,468,236 in 2018 and 2017, respectively, for all capital expenditures, including construction in progress, and related to programs to improve individual and family health in South Texas for the least-served.

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

	Years Ended December 31	
	2018	2017
Medical and dental services:		
Operating programs:		
Wesley Health & Wellness Center; Dixon Health & Wellness Center and School-Based Health Centers	\$ 25,079,416	\$ 20,998,595
Health and wellness programs:		
Operating programs:		
Wesley Nurse Program	10,437,381	10,438,103
Parenting Programs	1,570,833	1,436,133
Family Wellness Programs	2,253,827	2,150,573
Behavioral Health Services	4,847,533	4,236,985
Health Education/Nutrition	2,011,481	2,031,642
Total operating programs	46,200,471	41,292,031
Policy and Research Department	2,700,070	7,980,061
Community Grants Department	1,189,718	914,013
Si Texas (Social Innovation Fund Grant)	9,190,152	7,549,453
Grants to external partners	28,717,299	26,527,485
Total program expenses	<u>\$ 87,997,710</u>	<u>\$ 84,263,043</u>
Capital expenditures for programs	<u>\$ 6,116,723</u>	<u>\$ 6,468,236</u>

Brief descriptions of the operating programs funded by MHM include the following.

Medical and dental services: MHM owns and operates the Wesley Health & Wellness Center (WHWC), the Dixon Health & Wellness Center (DHWC) and School-Based Health Centers. Both WHWC and DHWC clinics provide holistic, multidisciplinary programs for families, adults and children. Services include a primary care medical clinic and general and specialty dentistry, as well as patient education and behavioral health services, including counseling, case management and emergency assistance. The clinics address the needs of people who cannot afford health insurance. Services are provided on a sliding scale fee based upon ability to pay, household income and family size.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

Primary medical, dental and counseling services are provided by MHM through School-Based Health Centers to school-age children and their siblings up to age 21 who live in the Schertz-Cibolo-Universal City Independent School District and Marion Independent School District, where such services are not readily available. The sites currently are at Krueger Elementary in Marion, Texas, and Schertz Elementary in Schertz, Texas.

Health and wellness programs: The Wesley Nurse Program (WNP) is a faith-based, holistic program committed to serving the least served through more than 80 sites throughout South Texas and is MHM's largest geographic outreach program. The professional practice of the Wesley Nurse is not limited to the physical dimension of medical needs; rather, it includes a mind, body and spirit holistic approach. A key component Wesley Nurses undertake in their communities is providing health education, health promotion and facilitation of resources to least served communities. Wesley Nurses assist individuals and communities in achieving improved health and wellness through self-empowerment and access to resources.

Family wellness programs are available for youth, adults and seniors to promote health and wellness through social interaction, building family unity and education. Activities include exercise classes, parent and family trainings, support groups and a community justice program. Parenting programs include Parents as Teachers' Meld program, Nurturing Parenting Programs and Parents Helping Parents (PHP)—parent education programs designed to inform parents about the importance of early education in the development of their children. MHM is a licensed network affiliate of the Parents as Teachers' Meld program. MHM offers Meld programs for young mothers, young fathers, growing families and parents of children with special needs. MHM conducts personal home visits with parents of children ages 0-5, including prenatal visits.

PHP is a program developed by MHM 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.

MHM behavioral health services have been extended into the Coastal Bend Area, Rio Grande Valley and Laredo through Community Based Counseling programs. Counseling is provided by licensed professional counselors and licensed clinical social workers.

Nutrition and Health Education is a vital component of MHM. The primary focus is to provide educational support through MHM clinics by offering health education programs to clinic patients on an individual and group basis and to the general community.

Grants to external partners: Beginning in 1996, MHM has partnered with other community health centers and providers with similar missions through grants. This collaborative effort allows MHM to provide healthcare services at a lower cost through partnering with existing organizations in the underserved areas of San Antonio and South Texas.

All grants to partners are funded based on the demonstrated performance of the specific grant objectives. Grantees must spend the funds awarded for the intended purpose of the grant and report outcomes to MHM, which are reviewed on at least a quarterly basis by MHM staff and Board members.

Basis of accounting: The accompanying consolidated financial statements have been prepared on the accrual basis of accounting applicable to not-for-profit organizations in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

Support and revenue are reported as an increase in net assets without donor restrictions unless use of the related assets is limited by donor or Board-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor or Board stipulation or by law. Expirations of temporary restrictions on net assets (e.g., the donor or Board stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Use of estimates: The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

Basis of presentation: In accordance with Not-for-Profit Entities topic of the *FASB Accounting Standards Codification* (ASC), MHM reports information regarding its financial position and activities according to two classes of net assets: without and with donor restrictions.

Under these provisions, net assets and revenue, expenses, gains and losses are classified as without and with donor restrictions based on the following criteria:

- Without donor restrictions—Net assets not subject to donor-imposed restrictions.
- With donor restrictions—Net assets subject to irrevocable donor or Board restrictions requiring that assets be maintained in perpetuity, usually for the purpose of generating investment income to fund annual operations or to be used for a charitable purpose, or net assets that are subject to donor or Board-imposed restrictions contingent upon specific performance of a future event or passage of time before MHM may spend the funds.

Cash and cash equivalents: Highly liquid investments with original maturities of three months or less are reported as cash equivalents, excluding amounts whose use is limited by Board designation. MHM routinely invests its surplus operating funds in vehicles such as interest-earning and noninterest-earning bank accounts, money market funds and other short-term investments. The carrying amount reported in the consolidated statements of financial position approximates the fair value of all short-term cash positions.

Investments: Managed accounts and mutual funds are reported at fair value based on readily available quoted market prices. Private, alternative investments, such as hedge funds, are carried at fair value based on net asset values (NAVs) disclosed in the respective audited financial statements. The estimated fair value of securities for which there are no quoted market prices can be based on other methods such as the pricing of similar types of securities, broker quotes and price modeling. These pricing inputs typically apply to assets held by hedge funds in which MHM invests, and the pricing of those assets and the fund overall is performed by the manager and its administrator and reported in the financial statements of the manager. Unrealized gains and losses in investments are included in the consolidated statements of activities.

MHM has an investment policy that sets guidelines and constraints to ensure the portfolio is appropriately diversified.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

Assets limited as to use: Assets limited as to use consisting of cash, money market funds, mutual funds, endowments and debt and equity positions are carried at fair value. The Research and Development Fund is carried at cost. Investments in partnerships are recorded based on MHM's share of the partnership's underlying value of portfolio securities, as reported to MHM by the related investment managers. Gains and losses and investment income/losses are reported as net assets without or with donor restrictions, as appropriate. Any changes in the NAV of these assets are reflected as unrealized gains or losses.

Property, equipment and land: Property and equipment acquisitions are recorded at cost. Depreciation is calculated on the straight-line method over the estimated useful life of the depreciable assets. Leasehold improvements are amortized over the lease term.

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 moveable equipment/office furnishings	3-15 years

Impairment of long-lived assets: MHM reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results; trends and prospects; and the effects of obsolescence, demand, competition and other economic factors. MHM did not recognize an impairment loss during the years ended December 31, 2018 and 2017.

Grants: MHM considers all government grants and contracts as exchange transactions rather than contributions. MHM recognizes revenue for cost reimbursement grants, as eligible expenditures are incurred. Advances from government agencies are recorded as refundable advances. Eligible expenditures incurred in excess of grant fund reimbursements are recorded as receivables. Any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds, or both, as a result of any noncompliance with the terms of the grant or contract. If a restriction is fulfilled in the same period in which the contribution is received, MHM reports the grant as income without donor restrictions.

In 2014, MHM was awarded a federal grant by the Social Innovation Fund (SIF), a program of the Corporation for National and Community Service (CNCS) that combines public and private resources to grow the impact of innovative, community-based solutions that have compelling evidence of improving the lives of people in low-income communities throughout the United States. Through this grant, MHM developed the Sí Texas: Social Innovation for a Healthy South Texas project, focusing on integrated behavioral health models that are effectively improving health outcomes in South Texas communities with high rates of poverty, depression, diabetes, obesity and associated risk factors. The project leverages both federal and nonfederal dollars. The federal amount awarded is \$5,000,000 per year from September 1, 2014 through August 31, 2019. As of December 31, 2018, MHM incurred \$4,199,049 in matching expenses (nonfederal) associated with this grant (\$3,382,479 in 2017). Federal dollars passed through to subrecipients as of December 31, 2018, totaled \$4,991,103 (\$4,166,974 in 2017).

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

Contributions: All contributions (recorded in other operating income on the consolidated statements of activities) 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 support with donor restrictions that increases that net asset class. However, if a restriction is fulfilled in the same time period in which the contribution is received, MHM reports the support as income without donor restrictions.

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 requirements of Not-for-Profit Entities of the ASC. In accordance with the ASC, for contributed services to be recognized as revenue, services must be those that would normally be paid for, the same as those normally provided by the donor and clearly measurable. Volunteers at WHWC donate their time to support the various programs. Donated volunteer hours, for which no value has been assigned (since they did not meet the criteria under the ASC), totaled 4,355 hours and 3,881 hours at December 31, 2018 and 2017, respectively.

MHM receives rental space, for a nominal amount, for the medical and dental operating sites at the Marion and Schertz-Cibolo-Universal City Independent School Districts. No amounts have been recognized for this rental space in the consolidated statements of activities due to the insignificant amount of the donation.

Functional allocation of costs: The costs of providing the program and other activities have been summarized on a functional basis in the consolidated statements of activities. Accordingly, costs are allocated to the programs and management and general expenses based on actual use or estimated use, if actual use is not readily determinable.

Concentrations of credit risk: MHM may maintain all or a portion of its cash balances in bank deposit accounts that, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation up to a maximum of \$250,000 per bank. To date MHM has not experienced any losses in such accounts.

Recent accounting pronouncements: In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective-interest method or on a straight-line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months, regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The standard is effective for MHM beginning in fiscal year 2020, with early adoption permitted. MHM is in the process of evaluating the effect the updated standard will have on its consolidated financial statements.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 1. Organization and Significant Accounting Policies (Continued)

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09 one year, making it effective for MHM beginning in fiscal year 2019. MHM has not yet selected a transition method and is currently evaluating the effects the standard will have on its consolidated financial statements.

On January 5, 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, the final standard on the recognition and measurement of financial instruments. The ASU applies to all entities that hold financial assets or owe financial liabilities and represent the finalization of just one component of the FASB's broader financial instruments project. ASU No. 2016-01 is effective for MHM's year ending December 31, 2020. Earlier application is permitted.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU No. 2016-15 provides guidance on how certain cash receipts and cash payments should be presented and classified in the statement of cash flows with the objective of reducing existing diversity in practice with respect to these items. ASU No. 2016-15 will be effective for MHM on January 1, 2019. Early adoption is permitted. ASU No. 2016-15 requires a retrospective-transition method. However, if it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. MHM does not expect the impact of the adoption of this guidance to be significant to its consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The ASU clarifies and improves the scope and the accounting guidance for contributions received and contributions made. The amendments in this update should assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of ASC Topic 958, Not-for-Profit Entities, or as exchange (reciprocal) transactions subject to other guidance and (2) determining whether a contribution is conditional. ASU No. 2018-08 will be effective for MHM beginning on January 1, 2019, for contributions received and January 1, 2020, for contributions made. ASU No. 2018-08 should be applied on a modified-prospective basis. Retrospective application is permitted.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures

The accounting guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in its principal market, or in the absence of a principal market, the most advantageous market for the investment. MHM accounts for its investments at fair value. MHM has elected to report the fair value of certain NAV instruments, primarily those included in alternative investments and mutual funds, using the practical expedient. The practical expedient allows for the use of NAV, either as reported by the investee fund or as adjusted by MHM based on various factors, to be used to determine fair value, under certain conditions. The fair value of the investment is based on a combination of audited financial statements of the investees and monthly or quarterly statements received from the investees. In accordance with the guidance, MHM has categorized its investments, based on the priority of the inputs to the valuation technique, which gives the highest priority to quoted prices in active markets and the lowest priority to unobservable inputs, into a three-level fair value hierarchy. These levels are as follows:

Level 1: Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are observable, other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Inputs are unobservable, supported by little or no market activity and significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth in the following pages.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures (Continued)

The following table represents assets measured at fair value on a recurring basis as reported on the consolidated statements of financial position as of December 31, 2018 and 2017, and by level within the fair value measurement hierarchy:

	Fair Value Measurement at December 31, 2018				
	Total	Level 1	Level 2	Level 3	Investments Valued at NAV
Managed accounts:					
Equity	\$ 159,407,551	\$ 159,407,551	\$ -	\$ -	\$ -
Fixed income	30,938,805	28,042,980	-	2,895,825	-
Total managed accounts	190,346,356	187,450,531	-	2,895,825	-
Mutual funds	143,448,861	-	-	-	143,448,861
Alternative investments:					
Black Diamond, Ltd.	25,624,387	-	-	-	25,624,387
Double Black Diamond, Ltd.	14,716,666	-	-	-	14,716,666
Black Diamond Thematic, Ltd.	6,714,507	-	-	-	6,714,507
Balyasny Atlas Global Investments, Ltd.	24,705,133	-	-	-	24,705,133
Evanston Weatherlow Offshore Fund I, Ltd.	32,625,177	-	-	-	32,625,177
Eagle Income Appreciation II, LP	217,000	-	-	-	217,000
Alternative Fund SAC Limited	17,265,509	-	-	-	17,265,509
Chatham Asset High Yield Offshore Fund, Ltd.	17,669,369	-	-	-	17,669,369
SEI Core Property Fund LP	1,155,432	-	-	-	1,155,432
SEI Energy Debt Fund LP	1,516,567	-	-	-	1,516,567
SEI Structured Credit Fund LP	194,980	-	-	-	194,980
SEI Special Situations Fund LP	2,366,663	-	-	-	2,366,663
SEI Global Private Assets Fund LP	1,108,635	-	-	-	1,108,635
Total alternative investments	145,880,025	-	-	-	145,880,025
Total board-designated investments	479,675,242	187,450,531	-	2,895,825	289,328,886
Roy Campbell, III Endowment Fund	107,109	107,109	-	-	-
Endowment Fund	100,000	100,000	-	-	-
Total endowment funds	207,109	207,109	-	-	-
	\$ 479,882,351	\$ 187,657,640	\$ -	\$ 2,895,825	\$ 289,328,886
Percent of investment portfolio	100.0%	39.1%	0.0%	0.6%	60.3%

Investments in managed accounts have prices in actively traded markets that are easily quoted. Mutual funds offer daily liquidity and provide daily NAV updates.

MHM's participation in alternative investments is through a corporation or limited partnership structure. For Black Diamond, Ltd.; Double Black Diamond, Ltd.; Black Diamond Thematic, Ltd.; Balyasny Atlas Global Investments, Ltd.; Evanston Weatherlow Offshore Fund I, Ltd.; ACL Alternative Fund SAC Limited; Chatham Asset High Yield Offshore Fund, Ltd.; SEI Core Properties Fund LP; SEI Energy Debt Fund LP; SEI Structured Credit Fund LP; SEI Special Situations Fund LP and SEI Global Private Assets Fund LP, MHM owns shares of the corporation or partnership, and the value of those shares is reflected in the NAV. While these shares are not traded in an active market, the NAV of the shares is reported by the investment manager or its administrator on a monthly basis.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures (Continued)

In 2016, Overseas CAP Partners, Inc. closed its fund and distributed the majority of assets back to investors, including MHM. MHM has a balance of \$1,668,930 from its investment in Overseas CAP Partners, Inc. that is being held in cash equivalents in the BBT Master Fund Liquidating Trust pending the outcome of a securities litigation case. These funds were deemed by Overseas CAP Partners, Inc. as sufficient to cover a potential negative outcome of the litigation.

	Fair Value Measurement at December 31, 2017				
	Total	Level 1	Level 2	Level 3	Investments Valued at NAV
Managed accounts:					
Equity	\$ 177,758,457	\$ 177,758,457	\$ -	\$ -	\$ -
Fixed income	52,001,123	49,166,839	-	2,834,284	-
Total managed accounts	229,759,580	226,925,296	-	2,834,284	-
Mutual funds	162,994,924	-	-	-	162,994,924
Alternative investments:					
Black Diamond, Ltd.	24,973,246	-	-	-	24,973,246
Double Black Diamond, Ltd.	14,312,565	-	-	-	14,312,565
Black Diamond Thematic, Ltd.	6,764,376	-	-	-	6,764,376
Eagle Income Appreciation II, LP	10,167,286	-	10,167,286	-	-
Balyasny Atlas Global Investments, Ltd.	25,981,604	-	-	-	25,981,604
Evanston Weatherlow Offshore Fund I, Ltd.	33,630,041	-	-	-	33,630,041
ACL Alternative Fund	18,671,113	-	-	-	18,671,113
Chatham Asset High Yield Offshore Fund, Ltd.	14,015,760	-	-	-	14,015,760
SEI Core Properties Fund LP	1,062,101	-	-	-	1,062,101
SEI Energy Debt Fund LP	1,655,210	-	-	-	1,655,210
SEI Structured Credit Fund LP	1,087,418	-	-	-	1,087,418
SEI Special Situations Fund LP	2,427,112	-	-	-	2,427,112
SEI Global Private Assets Fund LP	11,826	-	-	-	11,826
Total alternative investments	154,759,658	-	10,167,286	-	144,592,372
Total board-designated investments	547,514,162	226,925,296	10,167,286	2,834,284	307,587,296
Roy Campbell, III Endowment Fund	118,922	118,922	-	-	-
Endowment Fund	100,000	100,000	-	-	-
Total endowment funds	218,922	218,922	-	-	-
Quintis Ltd. Stock (formerly TFS)	68,206	68,206	-	-	-
Total other investments	68,206	68,206	-	-	-
	<u>\$ 547,801,290</u>	<u>\$ 227,212,424</u>	<u>\$ 10,167,286</u>	<u>\$ 2,834,284</u>	<u>\$ 307,587,296</u>
Percent of investment portfolio	100.0%	41.5%	1.9%	0.5%	56.1%

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures (Continued)

The investments in Black Diamond, Ltd.; Double Black Diamond, Ltd. and Balyasny Atlas Global Investments, Ltd. are each multi-strategy market-neutral hedge funds that are designed to have a nondirectional correlation with financial markets. Strategies used by these funds include relative value arbitrage, risk arbitrage, convertible arbitrage, long/short equity and credit. Black Diamond Thematic, Ltd. is a hedged strategy that attempts to take advantage of certain themes it identifies in the marketplace. The investment in Eagle Income Appreciation II, LP is a limited partnership that invests primarily in the shares of publicly traded master limited partnerships, with a very small percentage of the portfolio that could be allocated to special situations. Evanston Weatherlow Offshore Fund I, Ltd. operates in a fund of fund structure that invests in hedge fund managers that pursue a number of different strategies, including long/short equities, macro and event-driven. The ACL Alternative Fund is a managed futures strategy. Chatham Asset High Yield Offshore Fund, Ltd. is a hedged strategy that takes long and short positions in the high yield debt space.

Investments in the SEI Core Property Fund LP seek both current income and long-term capital appreciation through investing in underlying funds that acquire, manage and dispose of commercial real estate properties. Investments in the SEI Energy Debt Fund, LP seek investments in debt instruments of companies in the energy sector that have strong liquidity profiles, high asset coverage and potential upside with improving energy fundamentals. The SEI Global Private Assets Fund IV LP invests in corporate finance and venture capital funds, as well as secondary partnership and co-investment deals. The SEI Special Situations Fund LP is a fund of funds strategy that allocates across several hedge fund styles and strategy. Investments in the SEI Structured Credit Fund LP is comprised of collateralized debt obligations and other structured credit investments.

The following table represents the redemption frequency and redemption notice period for alternative investments held by MHM:

	Redemption Frequency*	Redemption Notice Period	Fair Value at December 31	
			2018	2017
Debt	Quarterly or Semi Annual	45-95 days	\$ 20,294,571	\$ 16,758,389
Fund of funds	Semi Annual or Rolling 3 Year	65-95 days	34,991,840	36,057,153
Multi-strategy hedge funds	Monthly or Quarterly	45-60 days	65,046,186	65,267,415
Managed futures	Daily	Same day	17,265,509	18,671,113
Master limited partnership funds	Quarterly	30 days	217,000	10,167,286
Private assets	None*	None*	194,980	11,826
Real estate	Quarterly	95 days	1,155,432	1,062,101
Thematic funds	Quarterly	60 days	6,714,507	6,764,375
Total			<u>\$ 145,880,025</u>	<u>\$ 154,759,658</u>

*MHM must remain invested throughout the life of the fund

Black Diamond, Ltd. Series A offers quarterly redemptions with a 45-day withdrawal notification period. As of December 31, 2018, no part of MHM's investment in Black Diamond, Ltd. was subject to a hard or soft lock-up period.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures (Continued)

Double Black Diamond, Ltd. offers quarterly redemptions with different requirement notification periods, but similar lock-up conditions, depending upon the type of share purchased. As of December 31, 2018, \$11,708,870, or 79.6% of MHM's position in Double Black Diamond, Ltd., were in Series B shares that were in a three-year soft-lock that has expired. Series B shares offer quarterly redemption and require a 45-day notification period. The remaining \$3,007,796, or 20.4% of MHM's position in Double Black Diamond, Ltd., is invested in Series E shares, which were under an initial three-year soft-lock and are now under a rolling one-year soft-lock into perpetuity. Series E shares require a 60-day notification period. For

Series E shares, the terms of the rolling one-year soft-lock state that a 3.0% fee will be applied to redemptions in the three quarters that are not on the anniversary of the original investment. Redemptions made on that anniversary quarter are not subject to a fee.

Black Diamond Thematic, Ltd. offers quarterly redemptions with a 60-day withdrawal notification requirement. Redemption on shares held less than one year would be subject to a 3% redemption fee. As of December 31, 2018, MHM no longer had any positions in Black Diamond Thematic, Ltd. subject to the one-year soft lock.

Balyasny Atlas Global Investments, Ltd. offers monthly redemptions with a 45-day notification period. There are no hard or soft lock-up periods or early redemption fees for this investment.

Abbey Capital's ACL Alternative Fund SAC Limited offers daily liquidity. Redemptions will be processed the same day as long as instructions are received by Abbey prior to 11:00 am Central Standard Time. Cash from redemptions will typically be distributed to investors within five business days.

The Evanston Weatherlow Fund I, Ltd. operates under a three-year rolling hard-lock period. There is a 65-day notification period required prior to the end of each three-year hard-lock period. MHM first invested with Evanston Weatherlow Fund I, Ltd. during 2016, and hence all shares held by MHM as of December 31, 2018, were subject to the hard-lock period.

The Chatham Asset High Yield Offshore Fund, Ltd. offers quarterly redemptions with 45-day notice. There is a one-year soft lock-up period that has a 3% redemption fee for funds withdrawn in the first year of investment. As of December 31, 2018, \$2,998,380, or 17% of MHM's position in Chatham Asset High Yield Offshore Fund, Ltd., were subject to the soft lock-up.

The SEI Core Properties Fund LP does not have a lock-up period and offers quarterly redemptions with a 95-day notification period.

The SEI Energy Debt Fund LP has a 36-month hard lock-up period. Following the three-year lock-up period, 50% of the investment is redeemable immediately. Another 25% is released six months later, and then the remaining 25% after an additional six months. The fund has a 95-day notification period. Redemptions are semiannually per the terms detailed above. As of December 31, 2018, all of MHM's investment in this fund were in the hard lock-up period.

The SEI Global Private Assets IV Fund LP does not offer redemptions. MHM will remain invested throughout the life of the fund and receive distributions from the fund during its lifetime.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 2. Fair Value Measurements and Disclosures (Continued)

The SEI Special Situations Fund LP has a 24-month hard lock-up period. Following the lock-up period, redemptions are semiannually with a 95-day notification period. As of December 31, 2018, all of MHM's investment in this fund were in the hard lock-up period.

The SEI Structured Credit Fund LP has a 24-month hard lock-up period. Following the lock-up period, redemptions are quarterly with a 65-day notification period. As of December 31, 2018, all of MHM's investment in this fund were in the hard lock-up period.

Due to the volatility of the stock market, there is a reasonable possibility of changes in the fair market value and additional gains and losses in the near term subsequent to December 31, 2018.

The following table summarizes the valuation techniques and significant unobservable inputs used for MHM's assets and liabilities that are categorized within Level 3 of the fair value hierarchy:

Financial Instrument Type	Fair Value	Valuation Techniques	Unobservable Input	Range of Inputs
Assets:				
Texas Methodist Loan Fund	\$ 2,895,825	Account value derived from stated rate of return of fund offering	Discount for historical performance of individual loans in fund	No discount applied*

*As of June 30, 2018, the Texas Methodist Foundation (TMF) has foreclosed on six loans originated by the Methodist Loan Fund. In each case, TMF transferred the defaulted loans out of the Methodist Loan Fund by purchasing the defaulted loans with TMF's capital at the then principal amount of the loans plus accrued and unpaid interest, thereby removing the risk of loss from the Methodist Loan Fund. TMF generally intends, but is not obligated, to continue such practice.

The changes in investments measured at fair value for which MHM has used Level 3 inputs to determine fair value are as follows:

Fair value at January 1, 2018	\$ 2,834,284
Interest earned	61,541
Fair value at December 31, 2018	<u>\$ 2,895,825</u>

Note 3. Research and Development Fund

In February 2010, the Board approved the creation of the South Texas Healthcare Research and Development Fund (R&D Fund). The purpose of the R&D Fund is to boost healthcare-related research and development in MHM's service area by making strategic capital investments that focus on development of healthcare-related devices, treatments, processes and drugs. The R&D Fund investments are carried at cost and adjusted for perceived asset impairment.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 3. Research and Development Fund (Continued)

The initial amount allocated to this fund by the Board was up to \$5,000,000. The R&D Fund operates under its own investment policy statement. The initial funding is to be put to work over time as suitable opportunities present themselves. As of December 31, 2018 and 2017, the Board has limited the amount of this investment to the current committed amount of \$4,100,000 and \$4,100,000, respectively.

As of December 31, 2018, the R&D Fund had made investments as limited partners in three venture capital funds: InCube Ventures II, LP; Targeted Technology Fund I, LP and Targeted Technology Fund II, LP. Additionally, the R&D Fund had made direct investments in shares of four individual companies: BiO2 Medical, Inc.; Innovative Trauma Care, Inc.; Invictus Medical and ViroXis Corporation. The R&D Fund had also made direct investments in individual companies via convertible promissory notes in three companies: Azaya Therapeutics, Inc.; Innovative Trauma Care, Inc. and ViroXis Corporation.

Investments in the venture capital funds are made by MHM as limited partners and the general partners of those funds are responsible for selecting and managing the investments made by the funds.

Investments in equity or debt of individual companies are held by MHM until, typically, the company is acquired or goes out of business, or the debt is repaid or converted into an equity position.

As of December 31, 2018 and 2017, the total committed capital for these partnerships and direct investments was \$4,100,000 and \$4,100,000, respectively. As of December 31, 2018, \$4,050,000 of that had been called (\$4,050,000 in 2017).

As of December 31, 2018, the remaining \$50,000 in uncalled capital commitments is related solely to InCube Ventures II, LP and unlikely to be called.

MHM at its discretion will write-down investments in the R&D Fund, which it believes have impairments, which bring into question the company's viability as a going concern. This conclusion can be reached either by a going concern opinion from the auditor of the company, or by MHM itself through information gathered about the company in the course of MHM's due diligence.

As of December 31, 2018, MHM has wrote down four positions for a total of \$1,319,541 in the R&D Fund due to going concern issues. Those positions were the \$500,000 invested directly in Innovative Trauma Care, Inc., as well as the \$19,541 invested in Innovative Trauma Care, Inc. via Targeted Technology Fund I, LP; \$500,000 invested in Azaya Therapeutics; and \$300,000 invested in Invictus Medical.

During 2018, MHM wrote off its investment in BiO2 Medical, Inc. who ceased operations. That consisted of a \$300,000 in direct investments, as well as \$90,380 that was held in the Targeted Technology Fund I, LP portfolio and \$53,779 in the Targeted Technology Fund II portfolio. Additionally, MHM wrote-off \$30,533 in its InCube Ventures II, LP position due to the portfolio company Jawbone going out of business.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 3. Research and Development Fund (Continued)

The following table reflects commitments outstanding and capital calls funded as of December 31, 2018 and 2017, and during the periods then ended.

	Agreement Date	Total Commitment	Carrying Amount December 31, 2017	Adjustment to Carrying Amount	2018 Called Capital	2018 Write-Offs	Returned Capital and Other Adjustments	Carrying Amount December 31, 2018
<u>Venture Capital Funds</u>								
InCube Ventures II, LP	September 2010	\$ 1,000,000	\$ 809,832	\$ -	\$ -	\$ (30,533)	\$ (48,696)	\$ 730,603
Targeted Technology Fund I, LP	February 2010	500,000	313,759	-	-	(90,380)	-	223,379
Targeted Technology Fund II, LP	August 2013	500,000	500,000	-	-	(53,779)	-	446,221
<u>Individual Companies (Shareholders)</u>								
BiO2 Medical, Inc.	October 2012	250,000	250,000	-	-	(250,000)	-	-
BiO2 Medical, Inc.	July 2015	50,000	50,000	-	-	(50,000)	-	-
ViroXis Corporation	February 2013	250,000	-	-	-	-	-	-
Innovative Trauma Care, Inc.—Class B	June 2014	350,000	-	-	-	-	-	-
Invictus Medical—Series B	July 2015	300,000	-	-	-	-	-	-
<u>Individual Companies (Convertible Debt Holders)</u>								
Azaya Therapeutics, Inc.—Bridge Note	February 2013	335,000	-	-	-	-	-	-
Azaya Therapeutics, Inc.—Bridge Note	May 2015	165,000	-	-	-	-	-	-
ViroXis Corporation—Bridge Note	May 2014	250,000	-	-	-	-	-	-
Innovative Trauma Care, Inc.—Bridge Note	December 2014	150,000	-	-	-	-	-	-
		\$ 4,100,000	\$ 1,923,591	\$ -	\$ -	\$ (474,692)	\$ (48,696)	\$ 1,400,203

	Agreement Date	Total Commitment	Carrying Amount December 31, 2016	Adjustment to Carrying Amount	2017 Called Capital	2017 Write-Offs	Returned Capital and Other Adjustments	Carrying Amount December 31, 2017
<u>Venture Capital Funds</u>								
InCube Ventures II, LP	September 2010	\$ 1,000,000	\$ 709,832	\$ -	\$ 100,000	\$ -	\$ -	\$ 809,832
Targeted Technology Fund I, LP	February 2010	500,000	313,759	-	-	-	-	313,759
Targeted Technology Fund II, LP	August 2013	500,000	400,000	-	100,000	-	-	500,000
<u>Individual Companies (Shareholders)</u>								
BiO2 Medical, Inc.	October 2012	250,000	250,000	-	-	-	-	250,000
BiO2 Medical, Inc.	July 2015	50,000	50,000	-	-	-	-	50,000
ViroXis Corporation	February 2013	250,000	-	-	-	-	-	-
Innovative Trauma Care, Inc.—Class B	June 2014	350,000	-	-	-	-	-	-
Invictus Medical—Series B	July 2015	300,000	-	-	-	-	-	-
<u>Individual Companies (Convertible Debt Holders)</u>								
Azaya Therapeutics, Inc.—Bridge Note	February 2013	335,000	335,000	(335,000)	-	-	-	-
Azaya Therapeutics, Inc.—Bridge Note	May 2015	165,000	165,000	(165,000)	-	-	-	-
ViroXis Corporation—Bridge Note	May 2014	250,000	-	-	-	-	-	-
Innovative Trauma Care, Inc.—Bridge Note	December 2014	150,000	-	-	-	-	-	-
		\$ 4,100,000	\$ 2,223,591	\$ (500,000)	\$ 200,000	\$ -	\$ -	\$ 1,923,591

During 2018 and 2017, \$57,500,000 and \$15,000,000, 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 \$15,000,000.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 4. Investment in Methodist Healthcare System of San Antonio, Ltd., LLP—Equity Method

A summary of MHM's earnings and distributions received from its investment in the Partnership is as follows:

	December 31	
	2018	2017
Investment in the Partnership at beginning of year	\$ 531,556,220	\$ 441,720,516
Earnings from the Partnership	133,041,281	104,835,704
Distributions from the Partnership	(57,500,000)	(15,000,000)
Investment in the Partnership at end of year	<u>\$ 607,097,501</u>	<u>\$ 531,556,220</u>

A summary of the Partnership's assets, liabilities, partners' capital and results of operations as of and for the years ended December 31, 2018 and 2017, is as follows:

	2018	2017
Total assets	<u>\$ 1,615,351,000</u>	<u>\$ 1,444,240,000</u>
Total liabilities	<u>\$ 252,823,000</u>	<u>\$ 238,142,000</u>
Partners' capital	1,339,110,000	1,188,028,000
Noncontrolling interest	23,418,000	18,070,000
Total equity	<u>1,362,528,000</u>	<u>1,206,098,000</u>
Total liabilities and partners' capital	<u>\$ 1,615,351,000</u>	<u>\$ 1,444,240,000</u>
Total revenues	\$ 2,107,697,000	\$ 1,916,811,000
Total expenses	1,832,502,000	1,699,415,000
	<u>\$ 275,195,000</u>	<u>\$ 217,396,000</u>

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

	December 31	
	2018	2017
Partners' capital at December 31	\$ 673,098,501	\$ 597,557,220
Less excess working capital payments by HCA Inc.	(13,714,000)	(13,714,000)
Less parity payment by HCA Inc.	(74,750,000)	(74,750,000)
Plus equity reclassified to intercompany debt with HCA Inc.	22,463,000	22,463,000
Investment in the Partnership	<u>\$ 607,097,501</u>	<u>\$ 531,556,220</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 4. Investment in Methodist Healthcare System of San Antonio, Ltd., LLP—Equity Method (Continued)

In furtherance of MHM’s mission, the Partnership provides charity care to patients without financial means to pay for hospital services in accordance with its eligibility policy. The Partnership’s policy provides for 100% charity care for patients who have income at or below 200% of the federal poverty level. The federal poverty level is established by the federal government and is based on income and family size. In addition, a sliding scale charity discount is applied to accounts for patients whose income is greater than 200% of the federal poverty level and whose remaining account balance, after any third-party payments, exceeds a specified percentage of their income. Because the Partnership does not pursue collection of amounts determined to qualify as charity care, it does not report these amounts as revenue. The charges forgone for charity care based on established rates were \$316,700,000 in 2018 and \$249,000,000 in 2017. Charity cost (calculated based on the overall cost-to-charge ratio) was \$46,100,000 and \$39,300,000 in 2018 and 2017, respectively. Charity cost as a percentage of net patient revenue was 2.2% and 2.1% in 2018 and 2017, respectively.

Note 5. Classification of Expenses

In the below analysis, the costs of maintenance and depreciation have been allocated across all functional expense categories to reflect the full cost of those activities. Costs are allocated using the following method:

- Expenses for the maintenance and depreciation of fixed assets are allocated based on square footage.

	2018		
	Program Expenses	Management and General Expenses	Total Expenses
Salaries and benefits	\$ 30,430,573	\$ 7,789,241	\$ 38,219,814
Supplies	4,927,027	471,376	5,398,403
Services	16,286,003	705,795	16,991,798
Grants	34,663,715	-	34,663,715
Depreciation	1,680,425	359,813	2,040,238
Interest	-	49,462	49,462
Other expenses	9,967	1,322,937	1,332,904
Total expenses	<u>\$ 87,997,710</u>	<u>\$ 10,698,624</u>	<u>\$ 98,696,334</u>
	2017		
Salaries and benefits	\$ 27,965,046	\$ 7,410,746	\$ 35,375,792
Supplies	3,330,245	269,343	3,599,588
Services	19,929,397	1,268,773	21,198,170
Grants	31,607,632	-	31,607,632
Depreciation	1,405,852	396,555	1,802,407
Interest	-	101,178	101,178
Other expenses	24,871	491,141	516,012
Total expenses	<u>\$ 84,263,043</u>	<u>\$ 9,937,736</u>	<u>\$ 94,200,779</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 6. Financial Assets Available and Liquidity

MHM regularly monitors liquidity required to meet its annual operating needs and other contractual commitments while also striving to maximize the return on investment of its funds not required for annual operations. The following financial assets are available to meet annual operating needs of the next year:

	December 31	
	2018	2017
Cash and cash equivalents	\$ 12,614,097	\$ 9,761,099
Other receivables, net	50,752	36,719
Investments	483,712,899	551,602,804
Financial assets as of December 31	496,377,748	561,400,622
Less:		
Amounts subject to donor restrictions	100,000	100,000
Board-designated cash and investments and quasi endowment	479,782,361	547,633,084
Other investments not available for operations	3,830,548	3,801,514
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 12,664,839</u>	<u>\$ 9,866,024</u>

Generally MHM invests its excess cash in its Board-designated investments; uninvested cash is held in a Board-designated cash account. MHM relies upon multiple sources to fund current-year operations and grant payments. These sources include:

- (1) Available cash that has not been restricted or designated in its use
- (2) Distributions from the Methodist Healthcare System (\$57,500,000 and \$15,000,000 in 2018 and 2017, respectively)
- (3) Distributions from the MHM's Board-designated investments
- (4) Draws from the dedicated \$50 million line of credit

Historically, available cash and distributions from the Methodist Healthcare System have provided sufficient liquidity to fund MHM's annual operating needs.

Note that the Board-designated investments do contain investments with lock-up provisions that would reduce the total investments that could be made available (see Note 2 for disclosures about investments).

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 7. Property, Equipment and Land

Property, equipment and land consist of the following:

	December 31	
	2018	2017
Land	\$ 4,308,564	\$ 4,308,564
Buildings and improvements	43,177,954	36,100,039
Leasehold improvements	38,327	38,327
Office furnishings and equipment	7,415,616	5,923,875
Construction in progress	-	2,817,127
	<u>54,940,461</u>	<u>49,187,932</u>
Less accumulated depreciation and amortization	17,517,961	15,831,949
Net property and equipment	<u>\$ 37,422,500</u>	<u>\$ 33,355,983</u>

In furtherance of the mission of the MHM, the Board approved the relocation of the Dixon Clinic to land and buildings purchased at 4212 East Southcross. The renovation of the new DHWC was completed and capitalized in May 2018.

Depreciation and amortization expense for the years ended December 31, 2018 and 2017, totaled \$2,040,239 and \$1,802,407, respectively.

Note 8. Assets Limited as to Use

Endowment funds: MHM's endowment consists of two individual funds established for a variety of purposes. The endowment includes both donor-restricted funds and funds designated by the Board to function as endowments. As required by U.S. GAAP, net assets associated with endowment funds, including Board-designated endowments, are classified and reported based on the existence or absence of donor or Board-imposed restrictions.

	December 31, 2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted endowment funds	\$ -	\$ 100,000	\$ 100,000
Board-designated endowment funds	107,109	-	107,109
	<u>\$ 107,109</u>	<u>\$ 100,000</u>	<u>\$ 207,109</u>

	December 31, 2017		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted endowment funds	\$ -	\$ 100,000	\$ 100,000
Board-designated endowment funds	118,922	-	118,922
	<u>\$ 118,922</u>	<u>\$ 100,000</u>	<u>\$ 218,922</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 8. Assets Limited as to Use (Continued)

MHM had the following changes in endowment net assets:

	Year Ended December 31, 2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets at beginning of year	\$ 118,922	\$ 100,000	\$ 218,922
Investment return:			
Investment income	-	1,489	1,489
Net appreciation	(6,813)	-	(6,813)
Amounts appropriated for expenditures	(5,000)	(1,489)	(6,489)
Endowment net assets at end of year	<u>\$ 107,109</u>	<u>\$ 100,000</u>	<u>\$ 207,109</u>

	Year Ended December 31, 2017		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets at beginning of year	\$ 106,142	\$ 100,000	\$ 206,142
Investment return:			
Investment income	-	4,001	4,001
Net appreciation	16,790	-	16,790
Amounts appropriated for expenditures	(4,010)	(4,001)	(8,011)
Endowment net assets at end of year	<u>\$ 118,922</u>	<u>\$ 100,000</u>	<u>\$ 218,922</u>

Board-designated investments: Investments that are designated by the Board 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.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 8. Assets Limited as to Use (Continued)

Investments are composed of the following:

	December 31, 2018		
	Cost	Estimated Fair Value	Unrealized Appreciation (Depreciation)
Equities	\$ 135,136,964	\$ 159,407,551	\$ 24,270,587
Mutual funds	138,917,725	143,448,861	4,531,136
Fixed income	32,283,961	30,938,805	(1,345,156)
Alternative investments	139,114,318	145,880,025	6,765,707
	<u>\$ 445,452,968</u>	<u>\$ 479,675,242</u>	<u>\$ 34,222,274</u>

	December 31, 2017		
	Cost	Estimated Fair Value	Unrealized Appreciation
Equities	\$ 124,089,497	\$ 177,758,457	\$ 53,668,960
Mutual funds	138,408,354	162,994,924	24,586,570
Fixed income	50,844,258	52,001,123	1,156,865
Alternative investments	140,031,909	154,759,658	14,727,749
	<u>\$ 453,374,018</u>	<u>\$ 547,514,162</u>	<u>\$ 94,140,144</u>

A summary of activity for assets limited as to use is as follows:

Fair value at December 31, 2016	\$ 501,694,806
Net contributions	(21,231,923)
Realized gains	43,896,521
Interest and dividend income	5,591,450
Investment fees	(1,755,647)
Change in fair value	19,318,955
Fair value at December 31, 2017	<u>547,514,162</u>
Net contributions	(42,121,783)
Realized gains	29,933,471
Interest and dividend income	6,171,777
Investment fees	(1,904,515)
Change in fair value	(59,917,870)
Fair value at December 31, 2018	<u>\$ 479,675,242</u>

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 9. Grants Payable

MHM awards grants to organizations for various programs to improve the health of underserved individuals in the South Texas area. The amount for which MHM is obligated is recorded in the consolidated financial statements upon Board approval. Grants payable beyond one year are reported at the present value of their estimated future cash flows using a discounted rate of 4.01%, which approximates MHM's incremental borrowing rate.

Schedule of grant payments are as follows:

	December 31	
	2018	2017
Primary and Preventive Care	\$ 16,602,213	\$ 15,306,306
Behavioral Health and Social Services	9,988,244	9,025,947
Health Professional shortage	4,235,823	4,867,337
Dental Services	3,252,129	3,633,696
Regionalization	399,878	714,375
Total awards and grants	34,478,287	33,547,661
Less reserve for unused grant payable funds	2,144,700	2,375,054
Less discounts to net present value	23,777	12,716
	32,309,810	31,159,891
Less current portion	31,995,387	30,965,468
Grants payable, less current portion	\$ 314,423	\$ 194,423

Schedule of grant payments at December 31, 2018, were as follows:

Years ending December 31:	
2019	\$ 34,163,864
2020	314,423
	<u>\$ 34,478,287</u>

Note 10. Retirement Plan

MHM has established a defined contribution plan offered through two different options, a 401(k) plan and a 403(b) plan, which cover substantially all eligible employees. All employees are eligible to participate in either plan; however, matching employer contributions are only made to the 401(k) plan. MHM matches employee contributions to the 401(k) plan up to 7% of annual salary (employees with 10 years of service are eligible for an additional 2% match), subject to Internal Revenue Service (IRS) limitations. Employer contributions to the defined contribution plan totaled \$1,679,432 and \$1,607,625 at December 31, 2018 and 2017, respectively. In addition to these plans, MHM also makes available a 457 deferred compensation plan for top management of MHM. Employer contributions to the 457 deferred compensation plan totaled \$11,250 and \$3,019 at December 31, 2018 and 2017, respectively.

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 11. Commitments and Contingencies

Certain conditions may exist as of the date the consolidated financial statements are issued, which may result in a loss to MHM, but which will only be resolved when one or more future events occur or fail to occur. MHM's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings, if any, that are pending against MHM or unasserted claims that may result in such proceedings, MHM's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in MHM's consolidated financial statements. If the assessment indicates a potentially material loss contingency is not probable, but is reasonably possible, or is probable, but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

MHM maintains 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 \$5,000 deductible. An excess liability umbrella policy covering both general liability and professional liability claims is also in effect with a \$15,000,000 limit per claim.

In September 2018, MHM renewed its agreement with Frost Bank for a \$50,000,000 revolving line of credit with a variable rate at one-month LIBOR plus 1.5% and a maturity date of September 9, 2019. The line imposes certain minimum investment balance restrictions. There was no amount outstanding on this line of credit as of December 31, 2018 and 2017.

Leases: MHM leases three facilities for programs and clinics under operating leases expiring at various dates through November 2022. Rental expense in 2018 and 2017 for all operating building and equipment leases totaled \$82,887 and \$89,912, respectively. Future minimum rental commitments under noncancelable operating leases (with an initial or remaining term in excess of one year) at December 31, 2018, are as follows:

Years ending December 31:	
2019	\$ 69,062
2020	60,987
2021	60,987
2022	5,082
	<u>\$ 196,118</u>

Note 12. Income Taxes

MHM has been determined to be exempt from federal income taxes pursuant to section 501(c)(3) of the Internal Revenue Code, as amended.

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

Methodist Healthcare Ministries of South Texas, Inc.

Notes to Consolidated Financial Statements

Note 12. Income Taxes (Continued)

MHM files IRS Form 990T, Exempt Organization Business Income Tax Return, annually. Taxes paid and accrued for unrelated business income in 2018 and 2017 totaled \$720,376 and \$69,128, respectively.

MHM's policy is to record interest and penalty expense related to income taxes as interest and other expense, respectively. At December 31, 2018 and 2017, no interest or penalties have been or are required to be accrued.

Note 13. Subsequent Events

MHM has evaluated subsequent events through June 29, 2019, the date the consolidated financial statements were available to be issued. Through this date, there were no significant events requiring disclosure.

Note 14. Adoption of ASU No. 2016-14

During the current year ended December 31, 2018, MHM adopted ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which amends the requirements for financial statements and notes in Topic 958 to require MHM to make reporting changes affecting the following:

- Net asset classifications and related disclosures
- Additional disclosures useful in assessing liquidity within one year of the statement of financial position date
- New reporting requirements related to expenses including disclosure of expenses by both nature and function
- Reporting of net investment return

MHM made changes to terminology and classification as described above, as well as additional and modified disclosures, particularly in Notes 5 and 6 to the consolidated financial statements. Amounts previously reported for the year ended December 31, 2017, have been reclassified, on a retrospective basis, to achieve consistent presentation. Amounts previously reported as temporarily restricted have been reclassified to be reported as with donor restrictions.

