

CONSOLIDATED FINANCIAL STATEMENTS,
DETAILS OF CONSOLIDATION, AND OTHER
FINANCIAL INFORMATION

Methodist Health Services Corporation and Subsidiaries
Years Ended December 31, 2008 and 2007
With Report of Independent Auditors

Methodist Health Services Corporation and Subsidiaries

Consolidated Financial Statements, Details of Consolidation,
and Other Financial Information

Years Ended December 31, 2008 and 2007

Contents

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Operations and Changes in Net Assets	4
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7
Details of Consolidation	
Report of Independent Auditors on Details of Consolidation	34
Methodist Health Services Corporation and Subsidiaries	
Details of Consolidated Balance Sheet, December 31, 2008.....	35
Details of Consolidated Statement of Operations, Year Ended December 31, 2008	37
Methodist Health Services Corporation and Subsidiaries (Parent Only)	
Details of Consolidated Balance Sheet, December 31, 2008.....	38
Details of Consolidated Statement of Operations, Year Ended December 31, 2008	40
Other Financial Information	
Report of Independent Auditors on Other Financial Information	41
Statement of Operations of the Methodist College of Nursing.....	42

Report of Independent Auditors

The Board of Directors
Methodist Health Services Corporation and Subsidiaries
Peoria, Illinois

We have audited the accompanying consolidated balance sheets of Methodist Health Services Corporation and Subsidiaries (the Corporation) as of December 31, 2008 and 2007, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 Corporation'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 Corporation'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 Health Services Corporation and Subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 31, 2009

Methodist Health Services Corporation and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 24,794,402	\$ 19,170,249
Cash held by trustee as collateral	39,631,734	–
Short-term investments	72,675,469	132,199,225
Receivables:		
Patient accounts receivable, less allowances for uncollectible accounts (2008 – \$14,073,000; 2007 – \$13,676,000)	55,485,096	53,290,164
Inventory	3,923,180	3,500,897
Prepaid expenses	2,372,643	2,144,655
Other current assets	15,042,304	10,765,994
Total current assets	213,924,828	221,071,184
Assets held by trustee:		
Self-insurance trust	5,898,957	9,469,637
Deferred compensation	1,574,412	1,631,061
Total assets held by trustee	7,473,369	11,100,698
Property, plant, and equipment, net	212,108,468	182,587,930
Other long-term assets:		
Interest in trust	5,016,776	7,163,193
Investment in nonconsolidated affiliates	4,329,517	4,037,009
Deferred financing costs, net	775,497	852,267
Other	1,304,250	680,195
Total other long-term assets	11,426,040	12,732,664
	\$ 444,932,705	\$ 427,492,476

	December 31	
	2008	2007
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 53,592,234	\$ 41,349,049
Amounts due to third-party payors	19,210,960	11,361,754
Current portion of line of credit	–	3,000,000
Current portion of long-term debt	3,365,000	3,486,451
Total current liabilities	<u>76,168,194</u>	<u>59,197,254</u>
Noncurrent liabilities:		
Long-term debt, less current portion	88,476,035	69,949,134
Accrued pension cost	62,251,095	25,904,363
Estimated self-insurance liabilities	8,032,809	12,081,397
Amount due under interest rate swap agreement	46,371,518	725,377
Other liabilities	4,097,269	4,512,110
Total noncurrent liabilities	<u>209,228,726</u>	<u>113,172,381</u>
Total liabilities	<u>285,396,920</u>	<u>172,369,635</u>
Net assets:		
Unrestricted	148,009,124	239,296,486
Temporarily restricted	7,733,945	5,134,838
Permanently restricted	3,792,716	10,691,517
Total net assets	<u>159,535,785</u>	<u>255,122,841</u>
	<u><u>\$ 444,932,705</u></u>	<u><u>\$ 427,492,476</u></u>

See accompanying notes.

Methodist Health Services Corporation and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended December 31	
	2008	2007
Unrestricted revenues, gains, and other support		
Net patient service revenue	\$ 311,803,630	\$ 304,190,597
Medicaid assessment	16,591,962	12,374,310
	328,395,592	316,564,907
Other revenue:		
Other operating revenue	11,328,923	12,214,605
Unrestricted gifts and bequests	999,270	128,282
Net assets released from restrictions and used for operations	726,961	668,517
Total operating revenue	341,450,746	329,576,311
Expenses		
Salaries and benefits	158,335,568	148,909,472
Supplies and other	111,657,299	106,856,912
Depreciation and amortization	18,547,342	17,755,382
Interest	3,161,229	4,102,744
Provision for uncollectible accounts	21,340,762	26,435,794
Medicaid assessment	8,688,899	8,199,290
Total operating expenses	321,731,099	312,259,594
Operating income	19,719,647	17,316,717
Nonoperating income (loss)		
Investment (loss) income	(29,458,246)	18,088,780
Interest rate swap valuation	(45,646,141)	(604,124)
Total nonoperating (loss) income, net	(75,104,387)	17,484,656
Revenues (less than) in excess of expenses	(55,384,740)	34,801,373

Methodist Health Services Corporation and Subsidiaries

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

	Year Ended December 31	
	2008	2007
Unrestricted net assets		
Revenues (less than) in excess of expenses	\$ (55,384,740)	\$ 34,801,373
Net change in unrealized investment gains and losses for other-than-trading securities	–	(14,716,122)
Transfer to permanently restricted net assets	(165,686)	–
Net assets released from restrictions and used for capital purposes	334,007	199,750
Pension-related changes other than net periodic pension cost	(36,070,943)	–
Change in additional minimum pension liability	–	2,816,565
Adjustment to initially apply recognition provisions of SFAS No. 158	–	(18,554,320)
(Decrease) increase in unrestricted net assets	<u>(91,287,362)</u>	<u>4,547,246</u>
Temporarily restricted net assets		
Restricted contributions	1,095,580	1,544,774
Investment (loss) income	(4,598,698)	1,026,657
Reclassification from permanently restricted net assets	7,163,193	–
Net assets released from restrictions and used for operations	(726,961)	(668,517)
Net assets released from restrictions and used for capital purposes	(334,007)	(199,750)
Increase in temporarily restricted net assets	<u>2,599,107</u>	<u>1,703,164</u>
Permanently restricted net assets		
Interest in trust	–	(4,364)
Reclassification to temporarily restricted net assets	(7,163,193)	–
Transfer from unrestricted net assets	165,686	
Investment (loss) income	(287,635)	77,203
Restricted contributions	386,341	242,470
(Decrease) increase in permanently restricted net assets	<u>(6,898,801)</u>	<u>315,309</u>
Change in net assets	(95,587,056)	6,565,719
Net assets at beginning of year	<u>255,122,841</u>	<u>248,557,122</u>
Net assets at end of year	<u>\$ 159,535,785</u>	<u>\$ 255,122,841</u>

See accompanying notes.

Methodist Health Services Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2008	2007
Operating activities		
Change in net assets	\$ (95,587,056)	\$ 6,565,719
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net change in unrealized gains and losses on investments	–	14,716,122
Pension-related changes other than net periodic pension cost	36,070,942	–
Change in minimum pension liability	–	(2,816,564)
Adjustment to initially apply recognition provisions of SFAS No. 158	–	18,554,320
Restricted contributions, investment income, and other, net of assets released from restrictions	4,299,694	(2,018,474)
Depreciation and amortization	18,624,112	17,829,020
Provision for uncollectible accounts	21,340,762	26,435,794
Interest rate swap valuation	45,646,141	604,124
Changes in operating assets and liabilities:		
Cash held by trustee as collateral	(39,631,734)	–
Patient accounts receivable	(23,535,694)	(27,883,913)
Inventory, prepaid expenses, and other current assets	(4,926,581)	2,055,967
Trading securities	59,523,756	(45,745,161)
Other assets	5,133,031	404,162
Amounts due to third-party payors	7,849,206	4,053,039
Accounts payable and accrued expenses	12,243,185	7,364,771
Accrued pension cost	275,790	(3,000,206)
Estimated self-insurance liabilities and other long-term liabilities	(4,463,429)	3,197,737
Net cash provided by operating activities	42,862,125	20,316,457
Investing activities		
Acquisition of property, plant, and equipment, net	(48,051,220)	(26,964,530)
Change in investments in nonconsolidated affiliates	(292,508)	(409,000)
Purchases of other-than-trading investments	–	(123,045)
Net cash used in investing activities	(48,343,728)	(27,496,575)
Financing activities		
Payments of long-term debt	(3,515,563)	(5,331,768)
Draw on line of credit	18,921,013	1,328,252
Restricted contributions, investment income, and other, net of assets released from restrictions	(4,299,694)	2,018,474
Net cash provided by (used in) financing activities	11,105,756	(1,985,042)
Increase (decrease) in cash and cash equivalents	5,624,153	(9,165,160)
Cash and cash equivalents at beginning of year	19,170,249	28,335,409
Cash and cash equivalents at end of year	\$ 24,794,402	\$ 19,170,249
Supplemental disclosures of cash flow information		
Interest payments	\$ 3,161,229	\$ 4,102,700

See accompanying notes.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

Our Mission

We are committed to delivering outstanding health care. Period.

1. Organization and Summary of Significant Accounting Policies

Methodist Health Services Corporation (MHSC)

Methodist Health Services Corporation (the Corporation) is an integrated health care organization dedicated to providing comprehensive health care services, including inpatient, outpatient, and emergency care services to residents of Peoria, Illinois, and surrounding communities. The Corporation is an Illinois not-for-profit, tax-exempt 501(c)(3) corporation that was incorporated to promote and encourage health and human services in the communities it serves.

The Corporation does not have employees or conduct active health-care-related activities. It controls the activities of its subsidiaries through the appointment of its Board as the sole member of each of these organizations and delegation of certain responsibilities to each. MHSC has five subsidiaries as of December 31, 2008: The Methodist Medical Center of Illinois (Medical Center), The Methodist Medical Center Foundation (Foundation), Provider Resource Management Services, Inc., Heartland Home Health Care, Inc., and Methodist Services, Inc.

The Methodist Medical Center of Illinois (MMCI)

The Methodist Medical Center of Illinois is a not-for-profit, tax-exempt 501(c)(3) Illinois corporation that provides inpatient, outpatient, emergency care, physician services, and nonacute health services for residents of Peoria and the surrounding communities.

The Methodist Medical Center Foundation (MMCF)

The Methodist Medical Center Foundation is a not-for-profit, tax-exempt organization established to solicit and manage gifts and bequests on behalf of The Methodist Medical Center of Illinois.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Provider Resource Management Services, Inc. (PRM)

Provider Resource Management Services (d/b/a Methodist First Choice) is an Illinois for-profit corporation wholly owned by Methodist Health Services Corporation. Its purpose is to function as a physician hospital organization (PHO), entering into contracts with physician and Methodist institutional providers and representing those providers in patient care agreements with employers and managed care organizations.

Methodist Services, Inc. (MSI)

Methodist Services, Inc. is an Illinois not-for-profit, tax-exempt corporation. Its purpose is to manage properties for the advancement of health care in Peoria and surrounding communities.

Heartland Home Health Care, Inc. (HHHC)

Heartland Home Health Care, Inc. is an Illinois for-profit corporation wholly owned by MHSC. Its purpose is to operate retail pharmacies and a small retail store located on the campus of The Methodist Medical Center of Illinois. It has one subsidiary, Methodist Physician Services, Inc.

Methodist Physician Services, Inc. (MPS)

Methodist Physician Services, Inc. is an Illinois for-profit corporation wholly owned by HHHC. Its purpose is to provide management services to physician offices.

Basis of Presentation

The consolidated financial statements include the accounts and transactions of all wholly owned and controlled subsidiaries, which include both taxable and tax-exempt entities. The equity method of accounting is used for investments in joint ventures, partnerships, and companies where control is participatory with others or where ownership is 50% or less. All significant intercompany balances and transactions have been eliminated in consolidation.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates are made, actual results could differ from the estimates recorded and/or disclosed.

Cash and Cash Equivalents

Investments in highly liquid instruments, which are not limited as to use, with a maturity of three months or less at the time of acquisition are reflected as cash equivalents.

Patient Accounts Receivable and Allowance for Uncollectible Accounts

The Corporation evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, historical collection experience of the payor, an assessment of business and economic conditions, and trends in health care coverage. The Corporation follows established guidelines for placing certain past-due patient balances with collection agencies. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible in accordance with the Corporation's collection policies.

Inventories

Inventories, consisting primarily of drugs and supplies, are stated at the lower of cost or market, and are determined by the first-in, first-out method.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Short-Term Investments

Substantially all short-term investments are invested and managed by professional investment managers and are held in custody by financial institutions. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Investment return (including realized and unrealized gains and losses on investments, interests, and dividends) is included in revenues (less than) in excess of expenses unless the income or loss is restricted by donors, in which case the investment return is recorded directly to either temporarily or permanently restricted net assets.

Investments in alternative investments, primarily hedge fund of funds, invest in marketable securities and derivative products. These investments are reported using the equity method. The values provided by the respective fund managers are based on historical costs, appraisals, and other estimates that require varying degrees of judgment. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in nonoperating investment income.

Prior to January 3, 2007, the Corporation's investments were classified as other than trading. As such, unrealized gains and losses that were considered temporary were excluded from revenues in excess of expenses. On January 3, 2007, the Corporation changed investment managers and liquidated its short-term investment portfolio. Management designated the new portfolio, effective January 3, 2007, as trading securities. Accordingly, under the trading securities designation, changes in unrestricted unrealized gains and losses in the fair value of such investments subsequent to January 3, 2007, are included in revenues (less than) in excess of expenses in the accompanying consolidated statements of operations and changes in net assets.

Assets Held by Trustee

Assets held by trustee for the self-insurance trust are invested and managed by professional investment managers and are held in a trust by financial institutions. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Investment return (including realized gains and losses on investments, interests, and dividends) is included in investment income.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Prior to January 3, 2007, the self-insurance trust investments were classified as other than trading. As such, unrealized gains and losses that were considered temporary were excluded from revenues (less than) in excess of expenses. On January 3, 2007, the self-insurance trust changed investment managers and liquidated its self-insurance investment portfolio. Management designated the new portfolio, effective January 3, 2007, as trading securities. Accordingly, under the trading securities designation, changes in unrestricted unrealized gains and losses in the fair value of such investments subsequent to January 3, 2007, are included in nonoperating income (loss) in revenues (less than) in excess of expenses in the accompanying consolidated statements of operations and changes in net assets. Subsequent to January 3, 2007, as a result of this change, investment return (including realized and unrealized gains and losses on investments, interests, and dividends) is included in nonoperating as investment income (loss). Prior to January 3, 2007, investment return (other than unrealized gains and losses) was included in other operating revenue.

Assets held by trustee for the deferred compensation agreements are investments that are invested and self-directed by the employee and are held in a trust by a financial institution. Investments in mutual funds are measured at fair value based on quoted market prices for those or similar investments. Investment return (including realized and unrealized gains and losses on investments, interests, and dividends) is included in other operating revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor 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 consolidated statements of operations and changes in net assets as net assets released from restrictions.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Restricted Net Assets

Temporarily restricted net assets are assets of which use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of amounts held in perpetuity as designated by donors. The Corporation's temporarily restricted net assets are primarily restricted for various programs related to the provisions of health care and pastoral care. The Corporation's permanently restricted net assets represent endowment funds for which the investments are to be held in perpetuity. In accordance with the donor's restrictions, a portion of the related investment income is temporarily restricted for specific purposes, and a portion is to be reinvested with the principal in perpetuity.

Property, Plant, and Equipment

Property, plant, and equipment are stated on the basis of cost. Depreciation is provided over the estimated useful life of the assets, which ranges from 3 to 40 years and is computed using the straight-line method.

Deferred Financing Costs

Bond issuance costs are amortized over the period the bonds are outstanding, using the effective interest method. Amortization expense is included in depreciation and amortization expense in the accompanying consolidated statements of operations and changes in net assets.

Derivative Financial Instruments

As part of its Capital Management Strategy, the Corporation has entered into interest rate swap transactions. The Corporation accounts for its derivative instruments under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, and Statement of Position (SOP) 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations*. SOP 02-2 requires that not-for-profit health care organizations apply the provisions of SFAS No. 133 in the same manner as for-profit enterprises. SFAS No. 133 requires that derivative instruments be recognized as either assets or liabilities in the consolidated financial statements at fair value. Management has not designated any of its interest rate swaps as hedging instruments. Accordingly, all changes in the fair value of the interest rate swaps are reflected as other nonoperating income (losses) in the accompanying consolidated statements of operations and changes in net assets.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Investment in Nonconsolidated Affiliates

The Corporation accounts for its investments in less than majority-owned and controlled affiliates using the equity method of accounting.

Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments to the Corporation at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Income Taxes

Methodist Health Services Corporation, The Methodist Medical Center of Illinois, The Methodist Medical Center Foundation, and Methodist Services, Inc. are tax-exempt organizations as defined in Section 501(c)(3) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. Provider Resource Management, Inc., Heartland Home Health Care, Inc., and Methodist Physician Services, Inc. are for-profit corporations.

In June 2006, Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (FIN 48), was issued and effective January 1, 2007. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Uncertainty in Income Taxes*, and prescribes a recognition threshold and measurement attribute for the financial statement recognition, measurement of a tax position taken or expected to be taken in a tax return, and guidance on derecognition, classification, interest, and penalties, accounting for interim periods, disclosure, and transition. Compliance with this standard had no material impact on the consolidated financial statements of the Corporation.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Revenues (Less Than) in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenues (less than) in excess of expenses. Transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as operating revenues and expenses. Transactions incidental to the provision of health care services are reported as nonoperating gains and losses. Items that are excluded from revenues (less than) in excess of expenses include certain changes in pension obligations, the adoption of new accounting standards related to pension accounting (2007), contributions of long-lived assets, and prior to January 3, 2007, under the other-than-trading designation, unrealized gains and temporary losses on investments.

New Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, *Disclosures About Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133*. The new standard requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. SFAS No. 161 is effective for the Corporation's financial statements beginning January 1, 2009. The Corporation is currently evaluating the impact that the adoption of this statement will have on its disclosures.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which 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 and establishes a framework for measuring fair value. SFAS No. 157 establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

SFAS No. 157 expands disclosures about instruments measured at fair value. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, and accordingly, SFAS No. 157 does not require any new fair value measurements. In November 2007, the FASB issued a FASB Staff Position (FSP) that would defer the effective date of SFAS No. 157 for one year for all nonfinancial assets and liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The impact of the adoption of SFAS No. 157 on the Corporation's financial position and results of operations is shown in Note 13.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115*, which among other things, provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. As a result of adopting SFAS No. 159, the Corporation did not elect fair value accounting for any assets or liabilities that were not previously required to be measured at fair value.

Charity Care and Community Benefit

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The amount of charity care provided is determined based on qualifying criteria, as defined in the Corporation's charity care policy, and applications completed by patients and their families or beneficiaries. Charges foregone for services and supplies provided to the community by the Corporation for patients whose charity applications were approved were \$16,409,000 and \$11,955,000 in 2008 and 2007, respectively.

In addition, the Corporation is involved in many community benefit activities. These activities are wide-ranging and include health education, school health services, health screenings, and other sponsorships. These activities are conducted free of charge or below the cost of providing the service. The estimated costs of these activities were approximately \$2,974,000 and \$1,901,000 in 2008 and 2007, respectively.

Fair Value of Financial Instruments

Financial instruments include cash and cash equivalents, short-term investments, patient and other receivables, assets held by trustee, accounts payable and accrued expenses, amounts due to third-party payors, lines of credit, long-term debt, and interest rate swaps. The carrying values of cash and cash equivalents, patient accounts and other receivables, assets held by trustee, accounts payable and accrued expenses, and amounts due to third-party payors approximate their fair values as reported in the consolidated balance sheets and, in the opinion of management, represent highly liquid assets or short-term obligations not subject to being discounted. The fair values for short-term investments, assets held by trustees, lines of credit, long-term debt, and interest rate swaps are described in Notes 3 and 5.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Reclassifications

Certain amounts in the 2007 consolidated financial statements have been reclassified to conform to the 2008 presentation.

2. Contractual Arrangements With Third-Party Payors

The Corporation provides care to certain patients under payment arrangements with Medicare, Medicaid, Blue Cross, and various health maintenance and preferred provider organizations. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs, as defined. Reported costs and/or services provided under certain of the arrangements are subject to retroactive audit and adjustment by the administering agencies. The results of these audits, as well as changes in Medicare and Medicaid programs and reduction of funding levels, could have an adverse effect on the future amounts recognized as net patient service revenue.

Provision has been made in the consolidated financial statements for contractual adjustments, representing the difference between the standard charges for services and actual or estimated payments. Changes in estimates that relate to prior years' payment arrangements resulted in an increase in revenues (less than) in excess of expenses in the amount of \$492,000 and \$2,499,000 for 2008 and 2007, respectively.

The Corporation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party arrangements. Assignment of benefits payable under patients health insurance programs and plans (e.g., Medicare, Medicaid, health maintenance organizations, and commercial insurance policies) is routinely obtained and consistent with industry practice.

Management views the Corporation's concentration of credit risk relating to accounts receivable to be limited due to the diversity of patients and payors. At December 31, 2008 and 2007, approximately 30% and 31%, respectively, of gross patient accounts receivable were due from the Medicare program. At December 31, 2008 and 2007, approximately 22% and 16%, respectively, of gross patient accounts receivable were due from the Medicaid program.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Contractual Arrangements With Third-Party Payors (continued)

Laws and regulations governing the Medicare and Medicaid programs, which account for 63% of the Corporation's gross patient service charges in 2008 and 2007 are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. There can be no assurance that regulatory authorities will not challenge the Corporation's compliance with those laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Corporation.

In 2008, the State of Illinois (the State) sought and received approval from the Centers for Medicare and Medicaid Services (CMS) to institute a hospital tax assessment program to be administered by the Illinois Department of Public Aid. The program was approved for the State's 2009–2013 fiscal years. This program supersedes the program that was in place for the State's 2006–2008 fiscal years. The Corporation is to receive an annual provider payment of \$20,809,612, and the Corporation will remit \$9,137,674 back to the State in the form of an assessment tax as stipulated by the program for the 2009–2013 period.

The Corporation recognized gross amounts of \$16,591,962 and \$12,374,310 in 2008 and 2007, respectively, as an increase in revenue and \$8,688,899 and \$8,199,290 in 2008 and 2007, respectively, as an operating expense on the consolidated statements of operations and changes in net assets related to the program,

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (Including Assets Held by Trustee) and Other Financial Instruments

The composition of investments at December 31 is set forth in the following tables:

	<u>2008</u>	<u>2007</u>
Short-term investments:		
Equity securities	\$ 29,044,236	\$ 49,257,670
Fixed income	29,775,193	82,626,866
Hedge funds	13,705,097	–
Accrued interest	150,943	314,689
Total short-term investments	<u>\$ 72,675,469</u>	<u>\$ 132,199,225</u>
Assets held by trustee:		
Deferred compensation:		
Mutual funds	\$ 1,574,412	\$ 1,631,061
Self-insurance trust:		
Equity securities	1,423,589	2,398,131
Fixed income	3,268,375	7,042,100
Hedge funds	1,191,747	–
Accrued interest	15,246	29,406
Total assets held by trustee	<u>\$ 7,473,369</u>	<u>\$ 11,100,698</u>

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**3. Investments (Including Assets Held by Trustee) and Other Financial Instruments
(continued)**

The composition of investment return on the Corporation's investment portfolio for the years ended December 31 is as follows:

	<u>2008</u>	<u>2007</u>
Interest and dividend income	\$ 3,204,404	\$ 2,942,302
Net realized gains and losses	(7,683,357)	20,270,603
Net change in unrealized gains and losses on trading portfolio	(30,546,277)	(3,087,165)
Net change in unrealized gains and losses on other than trading portfolio		– (14,716,122)
Total investment return	<u>\$ (35,025,230)</u>	<u>\$ 5,409,618</u>

Investment returns are included in the accompanying consolidated statements of operations and changes in net assets for the years ended December 31 as follows:

	<u>2008</u>	<u>2007</u>
Other operating revenue	\$ (680,651)	\$ 933,100
Nonoperating (losses) income – investment income	(29,458,246)	18,088,780
Other changes in unrestricted net assets:		
Net change in unrealized gains and losses		– (14,716,122)
Temporarily restricted net assets – investment income	(4,598,698)	1,026,657
Permanently restricted net assets – investment income	(287,635)	77,203
	<u>\$ (35,025,230)</u>	<u>\$ 5,409,618</u>

The carrying values of short-term investments and assets held by trustee approximate their fair values at December 31, 2008 and 2007. The Corporation has determined the estimated fair values using quoted market prices, or if quoted market prices are not available, fair values are based on quoted prices of comparable instruments.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Property, Plant, and Equipment

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

	2008	2007
Land	\$ 36,147,825	\$ 26,120,028
Land improvements	3,333,039	3,333,039
Buildings and leasehold improvements	182,210,665	172,483,776
Fixed and major movable equipment	230,305,765	221,562,016
Construction-in-progress	19,786,735	6,159,861
Information technology assets	8,575,862	8,952,920
	480,359,891	438,611,640
Less accumulated depreciation	268,251,423	256,023,710
	\$ 212,108,468	\$ 182,587,930

Construction-in-progress represents several facility expansions and other projects. Information technology projects in progress relate to various upgrades and the replacement of certain hardware and software to enhance the Corporation's systems. At December 31, 2008, outstanding commitments related to these projects were approximately \$17,464,000.

5. Long-Term Debt

On June 9, 1998, the Illinois Health Facilities Authority, on behalf of the Medical Center, issued \$86,960,000 of Illinois Health Facilities Authority Series 1998A Revenue Bonds (the Bonds) with an original issue premium of approximately \$735,000. The bond proceeds were used to pay off the 1990 Series Bonds and to advance refund the 1991A Series Bonds, 1991 Series Bonds, and the 1985G Series Bonds. The Bonds bear interest, which is paid semiannually, at varying rates and are subject to redemption through November 15, 2021. Various agreements related to the long-term debt place restrictions on the Medical Center and require the Medical Center to maintain certain financial ratios.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

Effective October 6, 2005, the Corporation entered into a fixed annuity basis interest rate swap agreement (the swap agreement) with an initial notional amount of \$90,000,000, which amortizes to zero, as adjusted on an annual basis, until termination of the swap agreement on November 15, 2030. Under the terms of the swap agreement, the Corporation receives quarterly payments based upon 68% of the variable LIBOR-BBA interest rate plus 59.2 fixed basis points and makes quarterly payments based upon 100% of the variable BMA Municipal Swap Index interest rate.

Effective December 13, 2007, the Corporation amended and restated the swap agreement that originated on October 6, 2005. Under the terms of the amendment, for the period from February 15, 2008 to November 15, 2010, the Corporation will receive fixed quarterly payments of \$117,000 in lieu of the floating rate options.

The notional amount of the swap agreement was \$90,000,000 at December 31, 2008. Net interest paid or received under the swap agreement is included in interest expense. The swap agreement does not qualify for hedge accounting; therefore, the change in fair value of the swap agreement is recorded as a nonoperating income (loss) and was \$(9,243,531) and \$1,201,827 for the years ended December 31, 2008 and 2007, respectively. The fair value of the swap agreement approximates \$(8,162,957) and \$1,080,574 at December 31, 2008 and 2007, respectively, and is recorded as amount due under interest rate swap agreements.

Effective December 20, 2007, the Corporation entered into another fixed annuity basis interest rate swap agreement with an initial notional amount of \$150,000,000, which amortizes to zero, as adjusted on an annual basis, until termination of the swap agreement on November 15, 2044. The effective date of this future swap agreement is between June 1, 2009 and January 1, 2010. Under the terms of the swap agreement, the Corporation will receive monthly payments based upon 68% of the variable LIBOR-BBA interest rate and will make monthly payments based upon the annual fixed rate of 3.538%.

The notional amount of the swap agreement was \$150,000,000 at December 31, 2008. Net interest paid or received under the swap agreement is included in interest expense. The swap agreement does not qualify for hedge accounting; therefore, the decrease in fair value of the swap agreement is recorded as a nonoperating loss of \$(36,402,610) and \$(1,805,951) for 2008 and 2007, respectively. The fair value of the swap agreement approximates \$(38,208,561) and \$(1,805,951) at December 31, 2008 and 2007, respectively, and is recorded as an amount due under interest rate swap agreements.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

The swap agreements require collateral to be posted when mark-to-mark value is less than \$(10,000,000). As of December 31, 2008, the Corporation has posted \$39,631,734 in collateral. The collateral is treated as restricted cash and is held in a Corporation owned account established by the trustee. The Corporation earns interest on the account.

A summary of long-term debt at December 31 is as follows:

	<u>2008</u>	<u>2007</u>
Fixed-rate revenue refunding bonds (Series 1998A), inclusive of unamortized premium of \$301,035 and \$330,147 at December 31, 2008 and 2007, respectively, with annual interest ranging from 4.35% to 5.50%, payable annually through November 2021; secured by municipal bond insurance	\$ 61,341,035	\$ 64,585,147
Fixed-rate promissory note, due in monthly installments through December 30, 2008; with interest of 7.05%; secured by real estate		– 271,451
Lines of credit draws	30,500,000	11,578,987
	91,841,035	76,435,585
Less current portion of lines of credit draws		– 3,000,000
Less current portion of debt	3,365,000	3,486,451
	<u>\$ 88,476,035</u>	<u>\$ 69,949,134</u>

Maturities of long-term debt for the next five years are as follows:

	<u>Line of Credit</u>	<u>Revenue Refunding Bonds</u>	<u>Total</u>
2009	\$ –	\$ 3,365,000	\$ 3,365,000
2010	6,000,000	3,540,000	9,540,000
2011	6,000,000	3,740,000	9,740,000
2012	6,000,000	3,945,000	9,945,000
2013	6,000,000	4,165,000	10,165,000

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

The estimated fair value of the Corporation's Series 1998A bonds was \$61,096,000 and \$65,917,000 at December 31, 2008 and 2007, respectively. Fair value was estimated using quoted market prices based upon the Corporation's current borrowing rates for similar types of long-term securities.

The Corporation has established lines of credit with two banks for \$22,500,000 and \$8,000,000. During 2008, \$18,921,013 was the total amount drawn on the lines of credit. \$15,291,237 was drawn for collateral for the interest rate swap and \$3,629,776 was to reimburse the Corporation for capital purchases. The Corporation has recorded this draw in noncurrent liabilities. There are no unused remaining amounts on the lines of credit. Both lines expire during 2009; however, the Corporation intends to refinance these lines into long-term obligations. The interest rate for one line of credit is the lesser of one month LIBOR plus 0.75% or prime rate. The interest rate for the second line of credit is the lesser of one month LIBOR plus 0.75%, three-month LIBOR, or federal funds plus 0.90%. The fair market value of the lines of credit approximates their recorded balance.

The Corporation has recorded lines of credit as a long-term obligation. The Corporation intends to refinance the outstanding balance with a long-term financing agreement. The financing agreement is anticipated to be a five-year term and executed in the second quarter of 2009.

6. Pension Plan

The Corporation offers retirement benefits through a defined-benefit plan and a defined-contribution plan. Defined-benefit pension benefits are based on years of service and compensation of employees (as defined) and are actuarially determined. The funding policy is to annually contribute the contribution required to comply with ERISA regulations.

The Corporation froze the defined-benefit pension plan for new participants and began offering a defined-contribution plan as of January 1, 2007. Curtailment costs associated with the plan freeze were taken during 2006. In addition, active employees as of January 1, 2007, were given a choice of remaining in the current plan or freezing their participation in the defined-benefit plan and enrolling in the new defined-contribution plan. The defined-contribution plan is a retirement plan that is employer only funded based on service time. The percentage contributed by the Corporation ranges from 2.5% to 9% of the employee's annual earnings based on years of service. The Corporation recorded defined-contribution expense of \$1,527,000 and \$1,403,000 in 2008 and 2007, respectively. The contribution is funded in the first quarter of the following year.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Pension Plan (continued)

Effective December 31, 2007, the Corporation adopted the recognition and disclosure requirements of SFAS No. 158, *Employers' Accounting for Defined-Benefit Pension and Other Postretirement Plans – an Amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS No. 158 requires an entity to recognize in its balance sheet an asset for a defined-benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined-benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined-benefit, postretirement plan in changes in unrestricted net assets in the year in which the changes occur. In 2007, the effect of the Corporation adopting SFAS No. 158 increased the accrued pension obligations and decreased unrestricted net assets in the amount of \$18,554,000.

The following table sets forth the changes in the projected benefit obligation and plan assets and the resulting funded status of the Corporation's defined-benefit pension plan as of and for the years ended December 31, 2008 and 2007. The date of data collection was January 1 for 2008 and 2007 (rolled forward to year-end and adjusted for changes in employment status). A measurement date of December 31 is utilized.

	<u>2008</u>	<u>2007</u>
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 148,729,766	\$ 148,224,051
Service cost	4,318,504	4,451,145
Interest cost	9,350,679	8,713,297
Actuarial gains	(2,728,561)	(8,700,079)
Benefits paid	(4,294,630)	(3,958,648)
Projected benefit obligation at end of year	<u>\$ 155,375,758</u>	<u>\$ 148,729,766</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 122,825,403	\$ 114,375,734
Actual return on plan assets	(28,834,089)	5,882,317
Employer contributions	3,427,979	6,526,000
Benefits paid	(4,294,630)	(3,958,648)
Fair value of plan assets at end of year	<u>\$ 93,124,663</u>	<u>\$ 122,825,403</u>

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Pension Plan (continued)

	<u>2008</u>	<u>2007</u>
Funded status at December 31	<u>\$ (62,251,095)</u>	<u>\$ (25,904,363)</u>
Accumulated adjustments to unrestricted net assets:		
Net actuarial loss	63,043,020	26,872,624
Prior service cost	<u>452,868</u>	<u>552,321</u>
Net accumulated difference between historical contributions and net pension expense	<u>\$ 63,495,888</u>	<u>\$ 27,424,945</u>

Accumulated benefit obligation for the years ended December 31 are as follows:

	<u>2008</u>	<u>2007</u>
Accumulated benefit obligations	<u>\$(136,492,976)</u>	<u>\$(130,795,069)</u>
Accumulated benefit obligation in excess of fair value of plan assets	<u>\$ (43,368,313)</u>	<u>\$ (7,969,666)</u>

The adoption of SFAS No. 158 had no effect on the Corporation's consolidated revenue (less than) in excess of expenses for the year ended December 31, 2007, and it will not affect the Corporation's operating results in future periods.

Included in unrestricted net assets at December 31, 2008, are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service costs of \$452,868 and unrecognized actuarial losses of \$63,043,020. The prior service costs and actuarial losses included in unrestricted net assets and expected to be recognized in the net periodic pension cost during the year ended December 31, 2009, are \$99,444 and \$4,506,000, respectively.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Pension Plan (continued)

Employer contributions were paid from employer assets for both years presented. All benefits paid under the defined-benefit pension plan were paid from plan assets.

	<u>2008</u>	<u>2007</u>
Net pension expense comprises the following:		
Service cost	\$ 4,318,504	\$ 4,451,145
Interest cost	9,350,679	8,713,297
Expected return on plan assets	(10,973,030)	(10,316,789)
Amortization of:		
Unrecognized net actuarial loss	908,162	1,588,723
Unrecognized prior service cost	99,444	99,444
	<u>\$ 3,703,759</u>	<u>\$ 4,535,820</u>

Weighted-average assumptions used to determine net periodic benefit costs for the fiscal year ended December 31 are as follows:

	<u>2008</u>	<u>2007</u>
Assumptions as of December 31:		
Discount rate	6.50 %	6.00%
Expected return on plan assets	9.00	9.00
Weighted-average rate of compensation increase	3.25	3.25

The Corporation's target and actual pension asset allocation are as follows:

Asset Category	Strategic Target	Actual Asset Allocation at December 31	
		2008	2007
Equities			
Midcap value	8%	6%	13%
International	12	12	16
Large cap	30	30	31
Total equities	<u>50</u>	<u>48</u>	<u>60</u>
Alternative investment	25	25	-
Fixed income			
Fixed income	25	27	40
Total investments	<u>100%</u>	<u>100%</u>	<u>100%</u>

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Pension Plan (continued)

Weighted-average assumptions used to determine benefit obligations as of December 31 are as follows:

	<u>2008</u>	<u>2007</u>
Discount rate	6.50%	6.50%
Weighted-average rate of compensation increase	3.25	3.25

Certain expected cash flow:

Expected employer contributions in 2009	\$ 4,000,000
Expected employee benefit payments:	
2009	4,491,192
2010	4,692,850
2011	5,047,413
2012	5,681,765
2013	6,118,091
2014–2018	47,687,382

Effective August 5, 2001, the Corporation began sponsoring a defined-contribution plan. The Corporation matches 1/2 of 1% for each 1% up to 3% contributed by the employee. Amounts contributed by the Corporation approximated \$1,172,000 and \$1,070,000 in 2008 and 2007, respectively, and are included in salaries and benefits expense.

7. Professional Liability Insurance

The Corporation is self-insured for the purpose of providing professional and general liability insurance. The self-insurance program combines various levels of self-insured retention with excess commercial insurance coverage. The Corporation is an owner of American Excess Insurance Exchange (AEIX), an entity sponsored by Premier, Inc., to provide excess professional liability insurance coverage to Premier's hospital owners. Professional insurance consultants have been retained to determine funding requirements, as well as to assist in the estimation of outstanding professional liabilities. The amounts funded have been placed in an irrevocable self-insurance trust account, which is being administered by a trustee. The self-insurance trust account is reported in assets held by trustee in the accompanying consolidated balance sheets.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Professional Liability Insurance (continued)

The Corporation is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Corporation and are currently in various stages of litigation. Although the outcome of the litigation cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material effect on the Corporation's financial condition. The Corporation accrues for the ultimate cost of malpractice claims, including estimates for claims incurred, but not reported. The accrual for estimated malpractice losses calculated by outside consulting actuaries (using trend factors for number of claims of 0% for 2008 and 1% for 2007, severity of claims of 6% for 2008 and 7% for 2007, and annual discount rate of 5.0% and 6.5% at December 31, 2008 and 2007, respectively) amounted to \$8,033,000 and \$12,081,000 at December 31, 2008 and 2007, respectively. The discount rate resulted in a discount of \$1,600,000 and \$2,780,000 at December 31, 2008 and 2007, respectively. The accrual is reported net of estimated excess insurance coverage recoveries. These amounts are included as a component of noncurrent liabilities in the accompanying consolidated balance sheets.

8. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at December 31:

	<u>2008</u>	<u>2007</u>
Net assets available for future periods:		
Purchases of equipment	\$ 486,892	\$ 883,867
Medical education and other health care programs	7,247,053	4,250,971
	<u>\$ 7,733,945</u>	<u>\$ 5,134,838</u>

Permanently restricted net assets generate investment income, which is used to benefit the following purposes or periods at December 31:

	<u>2008</u>	<u>2007</u>
Purchases of equipment	\$ 327,311	\$ 386,602
Medical education and other health care programs	3,465,405	10,304,915
	<u>\$ 3,792,716</u>	<u>\$ 10,691,517</u>

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Group Health Insurance Program

The Corporation, on January 1, 2007, began offering a fully insured HMO option for employee group health insurance coverage. In 2007, for those employees who chose not to participate in the HMO option, the Corporation continued to offer the self-insured employee group health insurance coverage. In 2008, the fully insured plan was the only option for employees, as the self-insured plan was terminated fully on December 31, 2007.

During the years ended December 31, 2008 and 2007, employee health insurance expense totaled approximately \$10,131,000 and \$10,058,000, respectively. The Corporation has established a reserve for open claims and claims incurred, but not reported, which amounted to \$57,668 and \$577,215 at December 31, 2008 and 2007, respectively.

10. Commitments and Contingencies

Operating Leases

The Corporation has various operating lease agreements for the lease of clinical and information technology equipment. Total lease expense under these leases totaled \$2,194,000 in 2008 and \$2,460,000 in 2007. Certain of these operating leases contain purchase options. Future minimum lease commitments for all noncancelable operating leases with original terms of more than one year are as follows at December 31, 2008:

2009	\$ 2,250,592
2010	990,774
2011	692,339
Total	<u>\$ 3,933,705</u>

11. Investments in Nonconsolidated Affiliates

Included in the investments in nonconsolidated affiliates disclosure are certain investments that the Corporation accounts for under the equity method of accounting.

A subsidiary of the Corporation owns a 50% interest in RTS. RTS provides inpatient and outpatient therapy services. A subsidiary of the Corporation owns a 49% interest in Central Illinois Work Injury Resource Center Corp. (CIWIRC). CIWIRC provides a comprehensive range of workers' compensation and employer-related occupational health and related services.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Investments in Nonconsolidated Affiliates (continued)

Summarized financial information relating to these equity investments is as follows:

	<u>2008</u>	<u>2007</u>
Assets	\$ 5,184,580	\$ 4,225,944
Liabilities	994,825	1,165,814
Net income	1,255,297	1,329,283

12. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to this and general and administrative functions for are as follows:

	<u>2008</u>	<u>2007</u>
Health care services	\$ 262,908,362	\$ 254,834,425
General and administrative	58,822,737	57,425,169
	<u>\$ 321,731,099</u>	<u>\$ 312,259,594</u>

13. Fair Value of Financial Instruments

As mentioned in Note 1, the Corporation adopted SFAS No. 157, which establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Fair Value of Financial Instruments (continued)

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following table presents the financial instruments carried at fair value as of December 31, 2008, by caption, on the consolidated balance sheet by SFAS No. 157 valuation hierarchy defined above (in thousands).

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Assets:				
Cash and cash equivalents	\$ 24,794	\$ –	\$ –	\$ 24,794
Cash held by trustee as collateral	39,632	–	–	39,632
Short-term investments:				
Equity securities	29,044	–	–	29,044
Fixed income	29,926	–	–	29,926
Self-insurance trust:				
Equity securities	1,423	–	–	1,423
Fixed income	3,284	–	–	3,284
Interest in trust:				
Cash and cash equivalents	248	–	–	248
Equity securities	1,582	–	–	1,582
Fixed income	2,102	–	–	2,102
Mutual funds	1,084	–	–	1,084
Deferred compensation	1,574	–	–	1,574
Total assets at fair value	<u>\$ 134,693</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 134,693</u>
Liabilities:				
Interest rate swaps	<u>\$ –</u>	<u>\$ 46,372</u>	<u>\$ –</u>	<u>\$ 46,372</u>
Total liabilities at fair value	<u>\$ –</u>	<u>\$ 46,372</u>	<u>\$ –</u>	<u>\$ 46,372</u>

Cash and cash equivalents – A majority of the Corporation's cash equivalents are bank and sweep accounts. The fair value is equal to the account balances. The cash and cash equivalents are classified as Level 1.

Cash held by trustee as collateral – The total of cash held by trustee as collateral is cash held in an interest bearing account. The fair value is equal to the account balance. The cash held by trustee as collateral is classified as Level 1.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Fair Value of Financial Instruments (continued)

Equity securities – A substantial portion of the Corporation’s investment portfolio is comprised of equity securities for which identical quotes exist on active exchanges. These securities are classified as Level 1.

Fixed income – A substantial portion of the Corporation’s investment portfolio is comprised of fixed income investments for which identical quotes exist on active exchanges. These securities are classified as Level 1.

Mutual funds – A portion of the interest in the trust is comprised of mutual fund investments for which identical quotes exist on active exchanges. These securities are classified as Level 1.

Deferred compensation – Comprised of equity securities and fixed income investments for which identical quotes exist on active exchanges. These securities are classified as Level 1.

Interest rate swaps – Derivative financial instruments consist solely of interest rate swap agreements with interest rate terms that are observable based upon forward interest rate curves and are therefore considered Level 2 inputs.

14. Endowments

SFAS No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to the Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, became effective for fiscal years ending after December 15, 2008. While preparing for the implementation of SFAS No. 117-1, management determined that the interest in the Barker Trust had been recorded as a permanently restricted net asset in error in previous years. The Corporation receives an annual distribution each year from the trust, and a portion or all of that distribution can come from the corpus of the fund based on previous years’ market return. Therefore, as the trust agreement allows distribution out of the fund’s corpus, the funds should be classified as temporarily restricted net assets.

The Corporation’s endowment consists of approximately nine individual funds established for a variety of purposes. The endowments include donor-restricted endowment funds.

Methodist Health Services Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Endowments (continued)

At December 31, 2008, the endowment net asset composition by type of fund consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment fund	\$ —	\$ —	\$ 3,792,716	\$ 3,792,716
Total funds	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,792,716</u>	<u>\$ 3,792,716</u>

Changes in endowment net assets for the fiscal year ended December 31, 2008, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of year	\$ —	\$ —	\$ 10,691,517	\$ 10,691,517
Reclassification of net assets	—	—	(7,163,193)	(7,163,193)
Total investment return	—	—	(287,635)	(287,635)
Transfers from unrestricted assets	—	—	165,686	165,686
Contributions	—	—	386,341	386,341
Endowment net assets at end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,792,716</u>	<u>\$ 3,792,716</u>

Details of Consolidation

Report of Independent Auditors on Details of Consolidation

The Board of Directors
Methodist Health Services Corporation and Subsidiaries
Peoria, Illinois

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying details of consolidation are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Ernst & Young LLP

March 31, 2009

Methodist Health Services Corporation and Subsidiaries

Details of Consolidated Balance Sheet

December 31, 2008

	Methodist Health Services Corporation (Parent Consolidated)	The Methodist Medical Center of Illinois	Methodist Services, Inc.	The Methodist Medical Center Foundation	Eliminations	Consolidated Totals
Assets						
Current assets:						
Cash and cash equivalents	\$ 3,133,484	\$ 19,517,339	\$ 38,145	\$ 2,105,434	\$ –	\$ 24,794,402
Cash held by trustee as collateral	–	39,631,734	–	–	–	39,631,734
Short-term investments	46,618	61,547,047	–	11,081,804	–	72,675,469
Receivables:						
Patient accounts receivable, net	102,207	55,382,889	–	–	–	55,485,096
Inventory	377,931	3,545,249	–	–	–	3,923,180
Prepaid expenses	–	2,365,476	3,056	4,111	–	2,372,643
Due from affiliates	5,766	8,614,007	–	–	(8,619,427)	346
Other	10,200	14,788,928	227,266	15,564	–	15,041,958
Total current assets	3,676,206	205,392,669	268,467	13,206,913	(8,619,427)	213,924,828
Assets held by trustee:						
Self-insurance trust	–	5,898,957	–	–	–	5,898,957
Deferred compensation	–	1,574,412	–	–	–	1,574,412
Total assets held by trustee	–	7,473,369	–	–	–	7,473,369
Property, plant, and equipment, net	42,690	138,770,392	73,295,386	–	–	212,108,468
Other long-term assets:						
Interest in perpetual trust	–	5,016,776	–	–	–	5,016,776
Investment in nonconsolidated affiliates	366,190	3,963,327	–	–	–	4,329,517
Deferred financing costs, net	–	775,497	–	–	–	775,497
Other	201,030	955,525	–	147,695	–	1,304,250
Investment in foundation	–	12,983,418	–	–	(12,983,418)	–
Total other long-term assets	567,220	23,694,543	–	147,695	(12,983,418)	11,426,040
	<u>\$ 4,286,116</u>	<u>\$ 375,330,973</u>	<u>\$ 73,563,853</u>	<u>\$ 13,354,608</u>	<u>\$ (21,602,845)</u>	<u>\$ 444,932,705</u>

Methodist Health Services Corporation and Subsidiaries

Details of Consolidated Balance Sheet (continued)

	Methodist Health Services Corporation (Parent Consolidated)	The Methodist Medical Center of Illinois	Methodist Services, Inc.	The Methodist Medical Center Foundation	Eliminations	Consolidated Totals
Liabilities and net assets						
Current liabilities:						
Accounts payable and accrued expenses	\$ 315,242	\$ 52,584,902	\$ 577,482	\$ 72,013	\$ –	\$ 53,549,639
Due to affiliates	193,618	48,362	8,420,043	–	(8,619,428)	42,595
Amounts due to third-party payors	–	19,210,960	–	–	–	19,210,960
Current portion of long-term debt	–	3,365,000	–	–	–	3,365,000
Total current liabilities	508,860	75,209,224	8,997,525	72,013	(8,619,428)	76,168,194
Noncurrent liabilities:						
Long-term debt, less current portion	–	88,476,035	–	–	–	88,476,035
Accrued pension cost	–	62,251,095	–	–	–	62,251,095
Estimated self-insurance liabilities	–	8,032,809	–	–	–	8,032,809
Amount due under interest rate swap agreement	–	46,371,518	–	–	–	46,371,518
Other liabilities	–	3,798,091	–	299,178	–	4,097,269
Total noncurrent liabilities	–	208,929,548	–	299,178	–	209,228,726
Total liabilities	508,860	284,138,772	8,997,525	371,191	(8,619,428)	285,396,920
Net assets:						
Unrestricted	3,777,256	79,665,540	64,566,328	6,632,926	(6,632,926)	148,009,124
Temporarily restricted	–	7,733,945	–	2,577,775	(2,577,775)	7,733,945
Permanently restricted	–	3,792,716	–	3,772,716	(3,772,716)	3,792,716
Total net assets	3,777,256	91,192,201	64,566,328	12,983,417	(12,983,417)	159,535,785
	\$ 4,286,116	\$ 375,330,973	\$ 73,563,853	\$ 13,354,608	\$ (21,602,845)	\$ 444,932,705

Methodist Health Services Corporation and Subsidiaries

Details of Consolidated Statement of Operations

Year Ended December 31, 2008

	Methodist Health Services Corporation (Parent Consolidated)	The Methodist Medical Center of Illinois	Methodist Services, Inc.	The Methodist Medical Center Foundation	Eliminations	Consolidated Totals
Unrestricted revenues, gains, and other support						
Net patient service revenue	\$ 609,177	\$ 312,071,445	\$ -	\$ -	\$ (876,992)	\$ 311,803,630
Medicaid assessment	-	16,591,962	-	-	-	16,591,962
	609,177	328,663,407	-	-	(876,992)	328,395,592
Other revenue:						
Other operating revenue	8,090,742	10,099,411	4,771,172	299,767	(11,932,169)	11,328,923
Unrestricted gifts and bequests	-	21,447	-	977,823	-	999,270
Net assets released from restrictions and used for operations	-	477,286	-	249,675	-	726,961
Total operating revenue	8,699,919	339,261,551	4,771,172	1,527,265	(12,809,161)	341,450,746
Expenses						
Salaries and benefits	8,570,789	149,537,823	-	226,956	-	158,335,568
Supplies and other	234,728	120,851,405	2,799,380	580,947	(12,809,161)	111,657,299
Depreciation and amortization	3,914	16,162,769	2,380,659	-	-	18,547,342
Interest	-	3,150,607	10,622	-	-	3,161,229
Provision for uncollectible accounts	8,516	21,332,246	-	-	-	21,340,762
Medicaid assessment	-	8,688,899	-	-	-	8,688,899
Total expenses	8,817,947	319,723,749	5,190,661	807,903	(12,809,161)	321,731,099
Operating (loss) income	(118,028)	19,537,802	(419,489)	719,362	-	19,719,647
Nonoperating income						
Investment (loss) income	(2,349,235)	(24,531,977)	1,059	(2,578,093)	-	(29,458,246)
Interest rate swap valuation	-	(45,646,141)	-	-	-	(45,646,141)
Total nonoperating (loss) income, net	(2,349,235)	(70,178,118)	1,059	(2,578,093)	-	(75,104,387)
Revenues less than expenses	\$ (2,467,263)	\$ (50,640,316)	\$ (418,430)	\$ (1,858,731)	\$ -	\$ (55,384,740)

Methodist Health Services Corporation and Subsidiaries (Parent Only)

Details of Consolidated Balance Sheet

December 31, 2008

	Methodist Health Services Corporation (Parent Only)	Provider Resource Management Services, Inc.	Heartland Home Health Care, Inc.	Methodist Physicians Services, Inc.	Eliminations	Consolidating Totals
Assets						
Current assets:						
Cash and cash equivalents	\$ 247,949	\$ 37,771	\$ 2,491,310	\$ 356,454	\$ –	\$ 3,133,484
Short-term investments	46,618	–	–	–	–	46,618
Receivables:						
Patient accounts receivable, net	–	–	102,207	–	–	102,207
Due from affiliates	–	–	5,766	–	–	5,766
Inventory	–	–	377,931	–	–	377,931
Other	–	–	10,200	–	–	10,200
Total current assets	<u>294,567</u>	<u>37,771</u>	<u>2,987,414</u>	<u>356,454</u>	<u>–</u>	<u>3,676,206</u>
Property, plant, and equipment, net	–	–	42,690	–	–	42,690
Other long-term assets:						
Investments in nonconsolidated affiliates	275,000	49,940	41,250	–	–	366,190
Investments	3,277,730	–	73,132	–	(3,350,862)	–
Other	–	–	79,328	121,702	–	201,030
Total other long-term assets	<u>3,552,730</u>	<u>49,940</u>	<u>193,710</u>	<u>121,702</u>	<u>(3,350,862)</u>	<u>567,220</u>
	<u>\$ 3,847,297</u>	<u>\$ 87,711</u>	<u>\$ 3,223,814</u>	<u>\$ 478,156</u>	<u>\$ (3,350,862)</u>	<u>\$ 4,286,116</u>

Methodist Health Services Corporation and Subsidiaries (Parent Only)

Details of Consolidated Balance Sheet (continued)

	Methodist Health Services Corporation (Parent Only)	Provider Resource Management Services, Inc.	Heartland Home Health Care, Inc.	Methodist Physicians Services, Inc.	Eliminations	Consolidating Totals
Liabilities and net assets/stockholders' equity						
Current liabilities:						
Accounts payable and accrued expenses	\$ 6,858	\$ –	\$ 34,180	\$ 274,204	\$ –	\$ 315,242
Due to affiliates	63,183	(385)	–	130,820	–	193,618
Total current liabilities	70,041	(385)	34,180	405,024	–	508,860
Total liabilities	70,041	(385)	34,180	405,024	–	508,860
Stockholders' equity:						
Common stock	–	292,395	354,492	100	(646,987)	–
Retained (deficit) earnings	–	(204,299)	2,835,142	73,032	(2,703,875)	–
Total stockholders' equity	–	88,096	3,189,634	73,132	(3,350,862)	–
Net assets:						
Unrestricted	3,777,256	–	–	–	–	3,777,256
Total net assets	3,777,256	–	–	–	–	3,777,256
	<u>\$ 3,847,297</u>	<u>\$ 87,711</u>	<u>\$ 3,223,814</u>	<u>\$ 478,156</u>	<u>\$ (3,350,862)</u>	<u>\$ 4,286,116</u>

Methodist Health Services Corporation and Subsidiaries (Parent Only)

Details of Consolidated Statement of Operations

Year Ended December 31, 2008

	Methodist Health Services Corporation (Parent Only)	Provider Resource Management Services, Inc.	Heartland Home Health Care, Inc.	Methodist Physicians Services, Inc.	Eliminations	Consolidating Totals
Unrestricted revenues, gains, and other support						
Net patient service revenue	\$ -	\$ -	\$ 609,177	\$ -	\$ -	\$ 609,177
Other revenue:						
Other operating revenue	-	548	20,645	8,069,549	-	8,090,742
Total operating revenue	-	548	629,822	8,069,549	-	8,699,919
Expenses						
Salaries and benefits	-	-	537,442	8,033,347	-	8,570,789
Supplies and other	64,608	13,850	120,118	36,152	-	234,728
Depreciation and amortization	-	-	3,914	-	-	3,914
Provision for uncollectible accounts	-	-	8,516	-	-	8,516
Total expenses	64,608	13,850	669,990	8,069,499	-	8,817,947
Operating (loss) income	(64,608)	(13,302)	(40,168)	50	-	(118,028)
Nonoperating income						
Investment income	(2,381,077)	-	31,842	-	-	(2,349,235)
Other nonoperating gains	(21,577)	-	50	-	21,527	-
	(2,402,654)	-	31,892	-	21,527	(2,349,235)
Revenues in excess of (less than) expenses	\$ (2,467,262)	\$ (13,302)	\$ (8,276)	\$ 50	\$ 21,527	\$ (2,467,263)

Other Financial Information

Report of Independent Auditors on Other Financial Information

The Board of Directors
Methodist Health Services Corporation

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The following other financial information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Ernst & Young LLP

March 31, 2009

Methodist Health Services Corporation and Subsidiaries

Statement of Operations of the Methodist College of Nursing

Year Ended December 31, 2008

Operating revenues

Student revenue	\$ 174,396
Tuition waiver	1,337,705
Foundation grants	<u>165,827</u>
Total operating revenues	<u>1,677,928</u>

Operating expenses

Salaries and wages	2,056,730
Employee benefits	147,353
Supplies and other expenses	419,061
Purchased services and professional fees	170,669
Depreciation and amortization	<u>206,744</u>
	<u>3,000,557</u>
Excess of expenses over revenues	<u><u>\$ (1,322,629)</u></u>