The Methodist Hospitals, Inc.

Consolidated Financial Report
December 31, 2008

The Methodist Hospitals, Inc.

Contents

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Independent Auditor's Report

To the Board of Directors
The Methodist Hospitals, Inc.

We have audited the accompanying consolidated balance sheet of The Methodist Hospitals, Inc. (the "Hospital") as of December 31, 2008 and 2007 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Methodist Hospitals, Inc. at December 31, 2008 and 2007 and the consolidated results of its operations, changes in net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

May 22, 2009

The Methodist Hospitals, Inc.

Consolidated Balance Sheet

	December 31, 2008	December 31, 2007
Assets		
Current Assets		
Cash and cash equivalents	$ 4,860,654	$ 28,665,821
Short-term investments (Note 5)	8,043,456	311,741
Accounts receivable (Note 2)	22,839,151	29,744,383
Cost report settlements receivable (Note 3)	21,749,278	70,857,449
Current portion of assets limited as to use (Note 5)	301,757	798,283
Other current assets	9,203,280	11,448,815
Total current assets	66,997,576	141,826,492
Assets Limited as to Use - Net of current portion (Note 5)	115,380,831	101,063,652
Property and Equipment - Net (Note 7)	146,027,960	148,823,513
Other Assets	2,340,159	1,792,902
Total assets	**$ 330,746,526**	**$ 393,506,559**
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 9)	$ 3,132,683	$ 3,717,253
Accounts payable	17,854,239	12,751,673
Cost report settlements payable (Note 3)	6,691,667	6,850,000
Accrued liabilities and other (Note 8)	12,153,277	14,947,549
Total current liabilities	39,831,866	38,266,475
Long-term Debt - Net of current portion (Note 9)	96,506,258	100,338,640
Other Liabilities (Note 10)	48,966,294	36,547,341
Total liabilities	185,304,418	175,152,456
Net Assets		
Unrestricted	144,709,217	217,606,047
Temporarily restricted	707,891	723,056
Permanently restricted	25,000	25,000
Total net assets	145,442,108	218,354,103
Total liabilities and net assets	**$ 330,746,526**	**$ 393,506,559**

The Methodist Hospitals, Inc.

Consolidated Statement of Operations

	Year Ended December 31, 2008	Year Ended December 31, 2007
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue	$ 254,839,621	$ 240,128,490
Investment income (Note 5)	(14,037,787)	9,242,860
Other revenue	5,658,103	5,187,057
Medicaid disproportionate share revenue	34,151,029	72,782,552
Net assets released from restrictions used for operations	58,717	92,446
Total unrestricted revenue, gains, and other support	280,669,683	327,433,405
Expenses		
Salaries and wages	102,746,962	116,615,898
Employee benefits and payroll taxes	23,482,925	22,671,966
Supplies	49,041,220	45,314,995
Outside services	55,929,888	35,892,082
Professional and other liability costs	5,370,911	4,695,305
Depreciation and amortization	21,278,785	20,475,287
Provision for bad debts	25,861,767	23,051,248
Interest expense	6,924,297	6,984,944
Voluntary early retirement (Note 12)	-	25,420,449
Loss on impairment (Note 7)	15,223,921	-
Restructuring (Note 16)	2,233,661	4,847,632
Other	26,734,648	17,424,144
Total expenses (Note 14)	334,828,985	323,393,950
Minority Interest in the Loss of Consolidated Subsidiary	-	347,375
Excess of Revenue (Under) Over Expenses	(54,159,302)	4,386,830
Pension-related Changes Other than Net Periodic Cost	(18,952,117)	-
Minimum Pension Liability Adjustment (Note 12)	-	5,256,172
Net Assets Released from Restriction	214,589	192,611
(Decrease) Increase in Unrestricted Net Assets	**$ (72,896,830)**	**$ 9,835,613**

The Methodist Hospitals, Inc.

Consolidated Statement of Changes in Net Assets

	Year Ended December 31, 2008	Year Ended December 31, 2007
Unrestricted Net Assets		
Excess of revenue (under) over expenses	$ (54,159,302)	$ 4,386,830
Pension-related changes other than net periodic cost	(18,952,117)	-
Minimum pension liability adjustment	-	5,256,172
Net assets released from restriction	214,589	192,611
(Decrease) Increase in Unrestricted Net Assets	(72,896,830)	9,835,613
Temporarily Restricted Net Assets		
Restricted contributions	258,141	282,458
Net assets released from restriction	(273,306)	(285,057)
Decrease in Temporarily Restricted Net Assets	(15,165)	(2,599)
(Decrease) Increase in Net Assets	(72,911,995)	9,833,014
Net Assets - Beginning of year	218,354,103	208,521,089
Net Assets - End of year	**$ 145,442,108**	**$ 218,354,103**

The Methodist Hospitals, Inc.

Consolidated Statement of Cash Flows

	Year Ended December 31, 2008	Year Ended December 31, 2007
Cash Flows from Operating Activities		
(Decrease) increase in net assets	$ (72,911,995)	$ 9,833,014
Adjustments to reconcile (decrease) increase in net assets to net cash from operating activities:		
Depreciation and amortization	21,278,785	20,475,287
Net change in unrealized net gains and losses on investments	19,629,772	4,055,382
Realized gains and losses on investments	(1,369,094)	(8,575,825)
Pension-related changes other than net periodic costs	18,952,117	(5,256,172)
(Gain) loss on disposal of property and equipment	(27,316)	151,687
Abandonment of software costs	15,223,921	-
Temporarily restricted contributions	(258,141)	(282,458)
Provision for bad debts	25,861,767	23,051,248
Changes in assets and liabilities that (used) provided cash:		
Accounts receivable	(18,956,535)	(21,833,737)
Other current assets	2,245,535	(1,759,027)
Cost report settlements receivable	49,108,171	(10,386,706)
Other assets	(784,402)	732,518
Accounts payable	5,102,566	3,510,620
Accrued liabilities	(2,794,272)	602,558
Cost report settlements payable	(158,333)	(1,193,576)
Other liabilities	(6,533,164)	15,122,675
Net cash provided by operating activities	53,609,382	28,247,488
Cash Flows from Investing Activities		
Purchase of property and equipment	(33,679,837)	(12,867,526)
Net change in assets limited as to use	(39,813,046)	12,581,452
Net cash used in investing activities	(73,492,883)	(286,074)
Cash Flows from Financing Activities		
Principal payment on long-term debt	(4,041,445)	(3,177,632)
Payments on capital lease obligations	(138,362)	(1,075,367)
Temporarily restricted contributions	258,141	282,458
Net cash used in financing activities	(3,921,666)	(3,970,541)
Net (Decrease) Increase in Cash and Cash Equivalents	(23,805,167)	23,990,873
Cash and Cash Equivalents - Beginning of year	28,665,821	4,674,948
Cash and Cash Equivalents - End of year	**$ 4,860,654**	**$ 28,665,821**
Supplemental Cash Flow Information - Cash paid for interest	**$ 6,950,464**	**$ 6,996,237**

Note 1 - Nature of Business and Significant Accounting Policies

Organization - The Methodist Hospitals, Inc. (the "Hospital") is an Indiana nonprofit corporation operating a 302-bed general acute-care facility in Gary, Indiana (Northlake Campus), and a 313-bed general acute-care facility in Merrillville, Indiana (Southlake Campus). The Hospital also provides physician services to patients through the following wholly owned limited liability companies: Methodist Cardiographics, LLC, Methodist Anesthesia, LLC, Northwest Emergency Associates, LLC, and Methodist Pathology, LLC. The accounts of these limited liability companies have been consolidated in the accompanying financial statements. All significant intercompany transactions and balances have been eliminated in the consolidation.

During 2008, the Hospital purchased the minority interest of Merrillville Surgery Center, LLC (MSC), and owns 100 percent of MSC as of December 31, 2008. The accounts of MSC have been consolidated in the accompanying financial statements for the year ended December 31, 2008. Minority interests in MSC of approximately $300,000 were included in other long-term liabilities as of December 31, 2007.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Accounts Receivable - Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

In previous years, investments held by the Hospital were classified as available-for-sale securities with unrealized gains and losses that were considered temporary excluded from excess of revenue over expenses. During 2008, the Hospital determined that substantially all its investment portfolio was more appropriately classified as trading, with unrealized gains and losses included in excess of revenue over expenses, effective as of the beginning of the fiscal year. Therefore, certain amounts in the accompanying consolidated financial statements have been reclassified to reflect this change in classification. These reclassifications did not impact the increase in net assets previously reported; however, the excess of revenue over expenses for 2007 decreased by $4,055,382 as a result of the reclassification.

Assets Limited as to Use - Assets limited as to use include assets set aside by the governing board for future capital improvement, over which the board retains control, and may, at its discretion, subsequently use for other purposes, assets held by trustees under bond indenture agreements, and assets held in self-insurance trust arrangements.

Property and Equipment - Property and equipment amounts are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements.

Classification of Net Assets - Net assets of the Hospital are classified as permanently restricted, temporarily restricted, or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the Hospital's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Permanently restricted net assets result from donor-imposed restrictions that limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

Excess of Revenue Over Expenses - The consolidated statement of operations includes excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets and pension-related changes other than periodic benefit costs.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Net Patient Service Revenue - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its 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. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

The Medicare program has initiated a recovery audit contractor (RAC) initiative, whereby claims subsequent to October 1, 2007 will be reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential significant overpayments. The RAC program is scheduled for Indiana in 2009. The Hospital is unable to determine if it will be audited and, if so, the extent of liability for overpayments, if any. If selected for audit, the potential exists for significant overpayment of claims liability for the Hospital at a future date.

Contributions - The Hospital reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of changes in net assets as net assets released from restrictions.

The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Professional and Other Liability Insurance - The Hospital accrues an estimate of the ultimate expense, including litigation and settlement expense, net of applicable reinsurance coverage, for incidents of potential improper professional service and other liability claims occurring during the year as well as for those claims that have not been reported at year end.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Tax Status - The Hospital and its subsidiaries are nonprofit, tax-exempt organizations; accordingly, no tax provision is reflected in the consolidated financial statements.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

***Accounting for Conditional Asset Retirement Obligation* (FIN 47)** - Financial Accounting Standards Board Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligation*, clarified when an entity is required to recognize a liability for a conditional asset retirement obligation. Management has considered FIN 47, specifically as it related to its legal obligation to report asset retirement activities, such as asbestos removal, on its existing properties. Over the past 20 years, management has systematically renovated, replaced, or constructed the majority of the physical plant facilities, resulting in a relatively small portion of the facility with any remaining hazardous material. Management has calculated the present value of the retirement obligation and the amount has been recognized as a liability on the consolidated balance sheet.

Note 2 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2008	2007
Patient accounts receivable	$ 93,968,590	$ 90,026,385
Less allowance for uncollectible accounts	(25,718,135)	(23,899,473)
Less allowance for contractual adjustments	(45,464,618)	(36,382,529)
Net patient accounts receivable	22,785,837	29,744,383
Other	53,314	-
Total accounts receivable	$ 22,839,151	$ 29,744,383

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percentage	
	2008	2007
Medicare	29	28
Commercial and managed care	30	28
Medicaid	15	18
Self pay	26	26
Total	100	100

Note 3 - Cost Report Settlements

A significant portion of the Hospital's net patient service revenue is received from the Medicare and Medicaid programs. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.

- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge or per procedure.

Note 3 - Cost Report Settlements (Continued)

- **Other Third-party Payors** - The Hospital has also entered into agreements with certain commercial carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement to the Hospital under these agreements is discounts from established charges, prospectively determined rates per discharge, and prospectively determined daily rates.

The Hospital qualifies as a Medicaid Disproportionate Share (DSH) provider under Indiana law and, as such, is eligible to receive DSH payments linked to the State of Indiana's fiscal year, which is June 30. The Hospital records DSH program revenue and receivables when the related amounts are determinable and when collectibility is reasonably assured.

At December 31, 2008 and 2007, the Hospital recorded approximately $21.8 million and $70.9 million, respectively, in amounts due from the State of Indiana under the DSH program. These amounts are included as part of third-party payor settlements. The amounts recorded represent estimated reimbursement due to the Hospital for services provided through state fiscal year 2009.

Subsequent to December 31, 2008, the Hospital has been notified by the State of Indiana that it will be receiving approximately $22 million in tentative settlement and advances from the State of Indiana by May 30, 2009.

The Hospital also received Medicaid lump-sum payments in lieu of hospital care for indigent payments. At December 31, 2008 and 2007, the Hospital recorded approximately $0 and $5,451,000, respectively, as amounts due from the State under the hospital care for the indigent program, which is included in the amounts due from the State noted above.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare and Medicaid programs that are subject to audit by fiscal intermediaries. Laws and regulations governing the Medicare and Medicaid programs 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.

Note 4 - Charity Care

In support of its mission, the Hospital's policy is to treat patients in need of medical services without regard to their ability to pay for such services. Charity care covers services provided to persons who cannot afford to pay. The amount reflects the cost of free or discounted health services, net of contributions and other revenues received, as direct assistance for the provision of charity care. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The following is a summary of the Hospital's charity care for the years ended December 31, 2008 and 2007:

	2008	2007
Traditional charity care	$ 27,470,000	$ 13,450,000

In addition, the Hospital performs many activities of community benefit, including programs provided to persons with inadequate healthcare resources or for other groups within the community that need special services and support. Examples include programs related to the poor, elderly, substance abuse, child abuse, and others with specific particular healthcare needs. They also include broader populations who benefit from health community initiatives such as health promotion, education, and health screening.

The Hospital also participates in the Medicare and Medicaid programs. At present, the reimbursement rates for both programs do not fully cover the cost of providing care to these patients. This represents the estimated "shortfall" created when a facility receives payments below the costs of treating Medicare and Medicaid beneficiaries. These uncompensated costs are not included above.

Note 5 - Assets Limited as to Use

The detail of assets limited as to use is summarized in the following schedule:

	2008	2007
Funds held by trustees under bond indenture	$ 9,570,124	$ 9,823,429
Funds held in trust for payment of professional and other liability claims	8,230,166	5,383,959
By board for future capital improvements	97,857,298	85,906,491
By donors for specific purposes	25,000	748,056
Subtotal	115,682,588	101,861,935
Less amount for payment of current liabilities	(301,757)	(798,283)
Total assets limited as to use and permanently or temporarily restricted	$ 115,380,831	$ 101,063,652

Note 5 - Assets Limited as to Use (Continued)

Investments, including short-term investments, consist of the following:

	2008	2007
Money market investments	$ 48,870,000	$ 12,934,000
Government securities	17,944,000	4,477,000
Mutual funds	30,060,000	45,542,000
Corporate bonds	23,706,000	36,818,000
Pooled funds	3,146,000	2,403,000
Total	$ 123,726,000	$ 102,174,000

Funds held by the trustee under bond indenture are held for the purpose of making future bond principal and interest payments. Investment income accrues to the funds as earned.

Investment income and gains and losses are comprised of the following for the years ended December 31, 2008 and 2007:

	2008	2007
Interest and dividends	$ 4,223,000	$ 4,722,000
Change in net unrealized losses on investments	(19,630,000)	(4,055,000)
Realized gains and losses	1,369,000	8,576,000
Total	$ (14,038,000)	$ 9,243,000

Note 6 - Fair Value

As of January 1, 2008, the Hospital adopted Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures for fair value measurements. The standard applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The provisions of SFAS 157 are effective prospectively for periods beginning January 1, 2008 for financial assets and liabilities and for periods beginning January 1, 2008 for nonfinancial assets and liabilities as a result of the deferral of the effective date of SFAS 157 provided by FSP FAS 157-2. The implementation of the provisions of SFAS 157 for financial assets and liabilities as of January 1, 2008 did not have a material impact on the Hospital's consolidated financial statements.

Note 6 - Fair Value (Continued)

The following table presents information about the Hospital's assets measured at fair value on a recurring basis at December 31, 2008, and the valuation techniques used by the Hospital to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Hospital has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in the entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Disclosures concerning assets measured at fair value on a recurring basis are as follows (dollars in thousands):

Fair Value Measurements at December 31, 2008

	Balance at December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets - Investments - Trading securities	$ 123,726,000	$ 78,930,000	$ 44,796,000	$ -

Note 7 - Property and Equipment

The cost of property, plant, and equipment and depreciable lives are summarized as follows:

	2008	2007	Depreciable Life - Years
Land	$ 3,748,538	$ 3,748,538	-
Buildings	237,057,092	235,805,686	2-10
Equipment	174,394,583	198,541,579	3-5
Construction in progress	18,134,132	7,571,269	-
Total cost	433,334,345	445,667,072	
Accumulated depreciation	(287,306,385)	(296,843,559)	
Net property and equipment	$ 146,027,960	$ 148,823,513	

Depreciation and amortization expense on property and equipment totaled approximately $21,236,000 and $20,430,000 in 2008 and 2007, respectively. Accumulated amortization for equipment under capital lease obligations was approximately $10,290,000 and $4,780,000 at December 31, 2008 and 2007, respectively.

Construction in progress consists primarily of costs incurred for the installation and implementation of a new information technology system and installation of various clinical equipment.

During 2008, the Hospital began evaluating whether the information technology system for both clinical and financial applications that was in process of being installed was in fact going to be the long-term solution for the Hospital. Subsequent to year end, the Hospital had concluded that the current system would not meet its needs and the Hospital will begin a transition to a new system in 2009.

Because of the decision to abandon the information technology system, the Hospital has recognized a loss on the impairment of the assets related to the information technology system for approximately $15 million as of December 31, 2008.

Note 8 - Accrued Liabilities and Other

The details of accrued liabilities at December 31, 2008 and 2007 are as follows:

	2008	2007
Payroll and related items	$ 5,052,231	$ 5,976,454
Compensated absences	5,868,191	5,090,252
Voluntary early retirement liability (Note 12)	-	2,621,821
Interest	1,232,855	1,259,022
Total accrued liabilities	$ 12,153,277	$ 14,947,549

Note 9 - Long-term Debt

A summary of long-term debt and capital lease obligations at December 31, 2008 and 2007 follows:

	2008	2007
Indiana Health Facility Financing Authority Revenue Bonds, Series 1996, interest at 6.00 percent, due in installments through 2016	$ 14,605,000	$ 14,830,000
Indiana Health Facility Financing Authority Revenue Bonds, Series 2001, interest ranging from 4.30 percent to 5.55 percent, due in installments through 2031	60,550,000	62,925,000
Indiana Health and Educational Facility Financing Authority equipment loan, interest at 7.0 percent, due in monthly installments through 2008	-	1,441,445
Urgent care and ambulatory surgery center capital lease obligation, expires June 30, 2030, collateralized by the leased buildings	2,249,868	2,252,073
Computer software capital lease obligation, expires December 31, 2011, collateralized by leased software	246,254	495,608
Urgent care building capital lease obligation, expires on October 31, 2020, collateralized by the leased building	1,516,579	1,555,746

Note 9 - Long-term Debt (Continued)

	2008	2007
Medical office building capital lease obligations, expires on December 31, 2045, collateralized by leased medical office buildings	$ 20,269,798	$ 20,352,818
Total - Before unamortized discount	99,437,499	103,852,690
Less original issue discount	(201,442)	(203,203)
Less current portion	3,132,683	3,717,253
Long-term portion	$ 96,506,258	$ 100,338,640

The Indiana Health Facility Financing Authority (the IHFFA) has issued bonds on behalf of The Methodist Hospitals, Inc. Obligated Group (the "Obligated Group") and has loaned the proceeds to the Obligated Group under the terms of the master indenture.

Hospital Obligated Group Bonds Payable, Series 1996, consist of hospital revenue bonds issued by the IHFFA. The bonds consist of serial bonds payable of $320,000 in 2009, at an interest rate of 6 percent and term bonds payable in annual installments beginning in 2010 through 2016 ranging from $1,700,000 to $2,415,000 at an interest rate of 6 percent.

Hospital Obligated Group Bonds Payable, Series 2001, consist of hospital revenue bonds issued by the IHFFA. The bonds consist of serial bonds payable in annual installments ranging from $2,415,000 in 2009 to $1,685,000 in 2013, at interest rates ranging from 4.30 percent to 4.98 percent, and term bonds payable in annual installments beginning in 2014 through 2031 ranging from $1,775,000 to $4,365,000 at interest rates ranging from 5.375 percent to 5.50 percent.

The Series 1996 and 2001 Bonds have been issued under a master trust indenture and are secured by the gross revenue of the Hospital. In connection with the bond indenture and loan agreements, the Obligated Group is subject to certain financial covenants related to, among others, transfer of assets, restrictions on additional indebtedness, and maintenance of certain financial covenants, including a minimum debt service coverage ratio and minimum debt service reserve funds.

The IHFFA equipment loan consists of variable rate debt issued through the Indiana Health and Education Facility Financing Authority, due in monthly installments of $87,088. The loan was paid off during 2008.

Note 9 - Long-term Debt (Continued)

The Hospital has entered into a series of capital lease arrangements for a medical office building on the Merrillville hospital campus. The Hospital is leasing the underlying land to the developer under terms of a ground lease. The medical office building houses physician offices, laboratory and diagnostic facilities, and an ambulatory surgery center. The lease agreements have terms from 25 to 40 years.

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows as of December 31, 2008:

Years Ending December 31	Long-term Debt	Capital Lease Obligations
2009	$ 2,735,000	$ 2,690,750
2010	3,145,000	2,444,496
2011	3,330,000	2,444,496
2012	3,510,000	2,444,496
2013	3,710,000	2,444,496
Thereafter	58,725,000	64,563,406
Total	75,155,000	77,032,140
Less amount representing interest under capital lease obligations	-	(52,749,641)
Total debt and present value of minimum lease payments	$ 75,155,000	$ 24,282,499

Note 10 - Other Liabilities

The detail of other liabilities is shown below:

	2008	2007
Accrued pension cost (Note 12)	$ 37,121,820	$ 23,476,632
Accrued professional and other liability claims (Note 13)	8,120,536	8,577,948
Minority interest in unconsolidated subsidiary	-	301,343
Other	3,723,938	4,191,418
Total other liabilities	$ 48,966,294	$ 36,547,341

Note 11 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately $1,967,000 and $1,232,900 for the years ended December 31, 2008 and 2007, respectively.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year:

Years Ending December 31		Amount
2009		$ 1,452,456
2010		995,040
2011		759,842
2012		489,608
2013		463,092
Thereafter		150,697
	Total	$ 4,310,735

Note 12 - Defined Benefit Pension Plan

The Methodist Hospitals, Inc. participates in a defined benefit pension plan covering substantially all of its employees.

The board of trustees of the Hospital elected to freeze the employees' participation in the future accrual of benefits under the existing defined benefit plan effective December 31, 2005.

Effective June 1, 2007, the plan was amended to provide early retirement window benefits to participants who had attained age 50 and completed 10 or more years of service on or before June 30, 2007. Under the terms of the amendment, eligible participants who elected to participate received three years of additional benefit accrual based on 2006 compensation, and the early retirement reduction was calculated assuming a participant was five years older. Participants were allowed to take their full benefit as a lump sum. A significant portion of participants eligible for the early retirement program elected to participate in the program.

The voluntary early retirement program was accounted for as a settlement under Financial Accounting Standards No. 88 in the amount of approximately $20 million. The related voluntary early retirement cost of approximately $25 million, which includes the settlement costs and other related expenses, has been recorded on the Hospital's consolidated statement of operations for the year ended December 31, 2007.

Note 12 - Defined Benefit Pension Plan (Continued)

The following table sets forth the funded status and amounts recognized in The Methodist Hospitals, Inc.'s consolidated balance sheet for the defined benefit plan:

	2008	2007
Plan assets at fair market value	$ 41,116,924	$ 52,388,949
Projected and accumulated benefit obligation for services rendered to date	78,238,744	75,865,581
Funded status	$ (37,121,820)	$ (23,476,632)
Accrued pension liability	$ 37,121,820	$ 23,476,632
Net periodic pension cost, including settlement costs	693,071	18,929,495
Employer contribution	6,000,000	3,750,000
Changes other than periodic benefit costs and minimum pension liability adjustment	(18,952,117)	5,256,172
Benefits paid	3,094,769	44,570,128

	Percentage	
	2008	2007
Actuarial assumptions used to determine benefit obligations at December 31 - Weighted average discount rate	6.25	6.40
Actuarial assumptions used to determine net periodic benefit cost for the years ended December 31:		
Weighted average discount rate	6.40	5.90
Expected rate of return on plan assets	7.40	7.40

In selecting the expected long-term rate of return on assets, the Hospital considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of this plan. This included considering the allocation of trust assets and the expected returns likely to be earned over the life of the plan.

Plan Assets - The Hospital's pension plan weighted average asset allocation at December 31, 2008 and 2007, by asset category, is as follows:

	Percentage	
	2008	2007
Asset category:		
Equity securities	62	56
Debt securities	38	34
Other	-	10
Total	100	100

Note 12 - Defined Benefit Pension Plan (Continued)

Investment Policies and Strategies - Pension funds will be invested in growth-oriented securities up to 65 percent in equities, including international equities.

Contributions - The Hospital expects to contribute $4,650,000 to the plan in 2009.

Estimated Future Benefit Payments - Benefits expected to be paid by the plan during the ensuing five years and thereafter are as follows:

2009	$ 2,903,957
2010	3,002,514
2011	3,118,716
2012	3,260,182
2013	3,448,523
2014-2017	20,435,363

During the year ended December 31, 2007, the Hospital adopted the provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statement Nos. 87, 88, 106, and 123(R). FAS 158 changes the accounting for defined benefit pension and postretirement plans by requiring that the full over- or underfunded status of a defined benefit plan be recognized as an asset or liability. For defined benefit pension plans, the funded status of the plan is the difference between the projected benefit obligation (PBO) and the fair value of plan assets. The adoption of FAS 158 as of December 31, 2007 did not result in any change to net assets because the plan had previously been frozen.

The Hospital established a defined contribution pension plan effective January 1, 2006, which allows for employee contributions and requires a matching employer contribution of up to 3 percent of employees' earnings. Expense for the years ended December 31, 2008 and 2007 was $3,880,000 and $4,700,000, respectively.

Note 13 - Professional Liability Self-insurance

On April 2, 1983, the Hospital became qualified under the Indiana Medical Malpractice Act (the "Act") to adopt the policy of self-insuring its professional liability risks for individual losses up to $250,000 per claim and $7,500,000 annually. In addition, the self-insurance plan has specified annual aggregate limits. The Hospital carries commercial insurance coverage for incidents that would exceed coverages specified by the self-insurance program. Prior to April 2, 1983, the Hospital carried commercial insurance for professional liability risks on an occurrence basis. The Hospital's liability for medical malpractice self-insurance is actuarially determined based upon the Hospital's estimated claims reserves and various assumptions, and includes an estimate for claims incurred but not yet reported.

Note 13 - Professional Liability Self-insurance (Continued)

In connection with the self-insurance program, the Hospital established a trust. Under the trust agreement, the trust assets can only be used for payment of professional liability losses, related expenses, and the costs of administering the trust. The assets of the trust are included in unrestricted funds and income from the trust assets and administrative costs are included in the consolidated statement of operations.

Note 14 - Functional Expenses

The Hospital provides general healthcare services to residents within its geographical location.

Expenses related to providing these services are as follows:

	2008	2007
Healthcare services	$ 294,241,259	$ 261,522,302
General and administrative	40,587,726	61,871,648
Total	$ 334,828,985	$ 323,393,950

Note 15 - Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents - The carrying amount approximates fair value because of the short maturity of those instruments.

Investments - Fair values, which are the amounts reported in the consolidated balance sheet, are based on quoted market prices.

Accounts Receivable, Accounts Payable, and Accrued Liabilities - The carrying amount reported in the consolidated balance sheet for accounts receivable, accounts payable, and accrued liabilities approximates its fair value.

Estimated Third-party Payor Settlements - Net - The carrying amount reported in the consolidated balance sheet for estimated third-party payor settlements - net approximates its fair value.

Long-term Debt - The fair value of the Hospital's bonds is estimated based on current traded value. The fair value of the Hospital's remaining debt is estimated using discounted cash flow analysis, based on current investment borrowing rates for similar types of borrowing arrangements.

Note 15 - Fair Value of Financial Instruments (Continued)

The estimated fair value of the Hospital's long-term debt is as follows:

	Carrying Amount	Fair Value
2008 - Long-term debt	$ 75,155,000	$ 55,884,000
2007 - Long-term debt	$ 78,993,242	$ 75,500,000

Note 16 - Restructuring

During 2008 and 2007, the Hospital incurred various costs related to an overall restructuring and expense reduction plan. The implementation of this plan commenced in February 2007 with the assistance from a management consulting firm engaged for this purpose.