The Methodist Hospitals, Inc.

Consolidated Financial Report
December 31, 2012

Contents

Plante & Moran, PLLC
Suite 200
2155 Point Blvd.
Elgin, IL 60123
Tel: 847.697.6161
Fax: 847.697.6176
plantemoran.com

Independent Auditor's Report

To the Board of Directors
The Methodist Hospitals, Inc.

We have audited the accompanying consolidated financial statements of The Methodist Hospitals, Inc. (The "Hospital"), which comprise the consolidated balance sheet as of December 31, 2012 and 2011 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Methodist Hospitals, Inc. as of December 31, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
The Methodist Hospitals, Inc.

Emphasis of Matter

As described in Note 1 to the consolidated financial statements, the Hospital adopted the provisions of Accounting Standards Update 2011-07, *Health Care Entities (Topic 954) Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities*, during 2012. Our opinion is not modified with respect to this matter.

Plante & Moran, PLLC

April 26, 2013

The Methodist Hospitals, Inc.

Consolidated Balance Sheet

	December 31, 2012	December 31, 2011
Assets		
Current Assets		
Cash and cash equivalents	$ 41,662,822	$ 19,345,002
Short-term investments (Note 5)	6,415,963	4,707,401
Accounts receivable - Net (Note 2)	33,332,579	30,813,413
Cost report settlements receivable (Note 3)	18,845,272	26,153,626
Current portion of assets limited as to use (Note 5)	639,302	2,489,027
Other current assets (Note 7)	12,635,716	11,023,071
Total current assets	113,531,654	94,531,540
Assets Limited as to Use - Net of current portion (Note 5)	129,912,791	127,288,581
Property and Equipment - Net (Note 8)	124,971,548	122,830,854
Other Assets	2,863,883	1,190,053
Total assets	**$ 371,279,876**	**$ 345,841,028**
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 10)	$ 3,926,053	$ 3,703,792
Accounts payable	12,598,765	8,971,752
Cost report settlements payable (Note 3)	8,290,096	7,398,859
Accrued liabilities and other (Note 9)	17,388,198	15,061,638
Total current liabilities	42,203,112	35,136,041
Long-term Debt - Net of current portion (Note 10)	79,820,196	83,748,010
Other Liabilities (Note 11)	47,040,009	43,716,666
Total liabilities	169,063,317	162,600,717
Net Assets		
Unrestricted	201,928,989	182,984,820
Temporarily restricted	262,570	230,491
Permanently restricted	25,000	25,000
Total net assets	202,216,559	183,240,311
Total liabilities and net assets	**$ 371,279,876**	**$ 345,841,028**

The Methodist Hospitals, Inc.

Consolidated Statement of Operations

	Year Ended December 31, 2012	Year Ended December 31, 2011
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue	$ 263,857,924	$ 246,792,771
Provision for bad debts	(14,933,707)	(10,872,378)
Net patient service revenue less provision for bad debts	248,924,217	235,920,393
Investment income (Note 5)	10,598,682	(412,993)
Other operating revenue	6,126,862	8,417,761
Medicaid disproportionate share revenue	64,622,805	48,552,178
Net assets released from restrictions used for operations	105,590	396,631
Total unrestricted revenue, gains, and other support	330,378,156	292,873,970
Operating Expenses		
Salaries and wages	117,536,043	106,996,138
Employee benefits and payroll taxes	28,288,863	26,761,229
Supplies	49,203,557	47,766,832
Outside services	45,733,062	44,420,464
Professional and other liability costs	1,511,364	2,185,528
Utilities	6,555,439	6,557,103
Repairs and maintenance	7,443,910	7,399,828
Medicaid assessment fee	16,481,865	-
Depreciation and amortization	18,694,642	17,891,380
Interest expense	5,825,872	5,938,159
Other	6,247,316	7,701,603
Total operating expenses (Note 16)	303,521,933	273,618,264
Operating Income	26,856,223	19,255,706
Nonoperating Income	1,360,216	-
Excess of Revenue Over Expenses	28,216,439	19,255,706
Pension-related Changes Other than Net Periodic Cost (Note 14)	(9,272,270)	(15,570,432)
Increase in Unrestricted Net Assets	**$ 18,944,169**	**$ 3,685,274**

The Methodist Hospitals, Inc.

Consolidated Statement of Changes in Net Assets

	Year Ended December 31, 2012	Year Ended December 31, 2011
Unrestricted Net Assets		
Excess of revenue over expenses	$ 28,216,439	$ 19,255,706
Pension-related changes other than net periodic cost	(9,272,270)	(15,570,432)
Increase in Unrestricted Net Assets	18,944,169	3,685,274
Temporarily Restricted Net Assets		
Restricted contributions	137,669	113,834
Net assets released from restriction	(105,590)	(396,631)
Increase (Decrease) in Temporarily Restricted Net Assets	32,079	(282,797)
Increase in Net Assets	18,976,248	3,402,477
Net Assets - Beginning of year	183,240,311	179,837,834
Net Assets - End of year	**$ 202,216,559**	**$ 183,240,311**

Consolidated Statement of Cash Flows

	Year Ended December 31, 2012	Year Ended December 31, 2011
Cash Flows from Operating Activities		
Increase in net assets	$ 18,976,248	$ 3,402,477
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Depreciation and amortization	18,694,642	17,891,380
Net change in unrealized net (gains) losses on investments	(6,392,235)	3,756,254
Realized gains on investments	(357,196)	(182,054)
Pension-related changes other than net periodic costs	9,272,270	15,570,432
(Gain) loss on disposal of property and equipment	(21,250)	31,646
Temporarily restricted contributions	(137,699)	(113,834)
Provision for bad debts	14,933,707	10,872,378
Changes in assets and liabilities that (used) provided cash:		
Accounts receivable	(17,452,873)	(23,362,967)
Other current assets	(1,612,645)	298,487
Cost report settlements receivable	7,308,354	(26,153,626)
Other assets	(1,673,830)	312,957
Accounts payable	1,176,537	1,596,597
Accrued liabilities	2,326,560	(68,007)
Cost report settlements payable	891,237	(386,603)
Other liabilities	(5,948,927)	(5,237,234)
Net cash provided by (used in) operating activities	39,982,900	(1,771,717)
Cash Flows from Investing Activities		
Purchase of property and equipment	(18,363,610)	(14,652,065)
Net change in assets limited as to use and investments	4,266,384	7,224,163
Net cash used in investing activities	(14,097,226)	(7,427,902)
Cash Flows from Financing Activities		
Principal payment on long-term debt	(3,510,000)	(3,330,000)
Payments on capital lease obligations	(195,553)	(2,395,503)
Temporarily restricted contributions	137,699	113,834
Net cash used in financing activities	(3,567,854)	(5,611,669)
Net Increase (Decrease) in Cash and Cash Equivalents	22,317,820	(14,811,288)
Cash and Cash Equivalents - Beginning of year	19,345,002	34,156,290
Cash and Cash Equivalents - End of year	**$ 41,662,822**	**$ 19,345,002**
Supplemental Cash Flow Information - Cash paid for interest	**$ 5,883,797**	**$ 5,993,098**

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, and Methodist Pathology, LLC.

During 2009, the Hospital established The Methodist Hospitals Foundation, Inc. (the "Foundation") to support and benefit the Hospital. The Foundation has been accounted for within the Hospital's financial statements.

Basis of Consolidation - The consolidated financial statements include the accounts of The Methodist Hospitals, Inc., The Methodist Hospitals Foundation, Inc., Methodist Cardiographics, LLC, Methodist Anesthesia, LLC, and Methodist Pathology, LLC; all intercompany accounts have been eliminated in consolidation.

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. The Hospital's cash balances are only insured up to the Federal Depository Insurance limit. As of December 31, 2012, there was approximately $25.2 million of uninsured cash.

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)

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheet.

Inventories - Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at cost, determined on a first-in, first-out basis or market.

Assets Limited as to Use - Assets limited as to use include assets designated by the governing board for future capital improvement, over which the board retains control and may, at its discretion, subsequently use for other purposes. Included in these investments are assets held by trustees under bond indenture agreements, and assets held in self-insurance trust arrangements. Restricted foundation investments consist of assets whose use by the Hospital has been restricted by the donor.

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. Repairs and maintenance costs are charged to expense as incurred.

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. The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

	Third-party Payors	Self-pay	Total All Payors
Patient service revenue (net of contractual allowances and discounts)	$ 263,294,536	$ 563,388	$ 263,857,924

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 of 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.

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 restriction.

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

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.

Professional and Other Liability Insurance - The Hospital accrues an estimate of the ultimate expense, including litigation and settlement expense, 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. Amounts receivable from insurance related to stop-loss provisions are recorded as a receivable and included in other assets.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions, and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients.

Accounting for Conditional Asset Retirement Obligation - Management has considered 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 within other liabilities.

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

Electronic Health Records Incentive Payments - The American Recovery and Reinvestment Act of 2009 (ARRA) established funding in order to provide incentive payments to hospitals and physicians that implement the use of electronic health record (EHR) technology by 2014. The Hospital may receive an incentive payment for up to four years, provided the Hospital demonstrates meaningful use of certified EHR technology for the EHR reporting period. The revenue from the incentive payments is recognized ratably over the EHR reporting period when there is reasonable assurance that the Hospital will comply with eligibility requirements during the EHR reporting period and an incentive payment will be received. In 2012 and 2011, approximately $2,100,000 and $5,100,1000, respectively, is recorded within other operating revenue as incentive payments are related to the Hospital's ongoing and central activities, yet not critical to the delivery of patient service.

Federal Income Tax - The Internal Revenue Service has ruled that the Hospital and its subsidiaries are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and accordingly, no tax provision is reflected in the consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and recognize a tax liability if the Hospital has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS or other applicable taxing authorities. Management has analyzed the tax positions taken by the Hospital and has concluded that as of December 31, 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the consolidated financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes it is no longer subject to income tax examinations for years prior to 2009.

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.

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

New Accounting Pronouncement - During 2011, the Financial Accounting Standards Board (FASB) adopted Accounting Standards Update (ASU) 2011-07, *Health Care Entities (Topic 954) Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, establishing accounting and disclosures for healthcare entities that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. The amendments in the ASU change the presentation of the consolidated statement of operations and add new disclosures that are not required under current GAAP for entities within the scope of this update. The provision for bad debts associated with patient service revenue for certain entities is required to be presented on a separate line as a deduction from patient service revenue (net of contractual allowances and discounts) in the consolidated statement of operations. The ASU is effective for the Hospital for the year ended December 31, 2012 and the provision has been applied retrospectively to the year ended December 31, 2011. As a result of the retrospective application, total unrestricted revenue, gains, and other support and total operating expenses decreased by $10,872,378, with no change to excess of revenue over expenses for the year ended December 31, 2011. The update requires new disclosures be provided on a prospective basis, and have therefore been presented for the year ended December 31, 2012 only.

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.

Subsequent Events - The consolidated financial statements and related disclosures include evaluation of events up through and including April 26, 2013, which is the date the consolidated financial statements were available to be issued.

Note 2 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2012	2011
Patient accounts receivable	$ 98,337,683	$ 104,744,638
Less allowance for uncollectible accounts	(17,459,647)	(18,008,370)
Less allowance for contractual adjustments	(47,545,457)	(55,922,855)
Net patient accounts receivable	$ 33,332,579	$ 30,813,413

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 as of December 31:

	Percentage	
	2012	2011
Medicare	32 %	34 %
Commercial and managed care	34	31
Medicaid	14	13
Self-pay	20	22
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.

Note 3 - Cost Report Settlements (Continued)

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

  The Indiana Hospital Association (IHA) and the Office of Medicaid Policy and Planning (OMPP) worked together to develop and implement a hospital assessment fee program as enacted by the 2011 Session of the Indiana General Assembly. In 2012, the Centers for Medicare and Medicaid Services (CMS) approved the state plan amendment necessary to implement these changes with a retroactive effective date of July 1, 2011. The program will continue through June 30, 2013. Under this program, OMPP will collect an assessment fee from eligible hospitals. The fee will be used in part to increase reimbursement to eligible hospitals for services provided in both fee-for-service and managed care programs, and as the state share of Disproportionate Share Hospital (DSH) payments. During 2012, the Hospital incurred $16,481,865 in Medicaid assessment fees under this program, which is reflected in total operating expenses in the accompanying consolidated statement of operations.

  Final reimbursement under the Medicare and Medicaid programs are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements. The effect of prior year settlements received in 2012 resulted in an increase in net revenue of approximately $2,812,000.

- **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, 2012 and 2011, the Hospital recorded approximately $18.8 million and $26.2 million, respectively, in amounts due from the State of Indiana under the DSH program. These amounts are reflected in cost report settlements receivable in the accompanying consolidated balance sheet. The amounts recorded represent estimated reimbursement due to the Hospital for services provided through the State fiscal year 2012. During the years ended December 31, 2012 and 2011, approximately $48 million and $22 million, respectively, was received in cash related to the DSH program.

Note 3 - Cost Report Settlements (Continued)

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.

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. The Hospital is unable to determine the extent of liability for overpayments, if any. The potential exists for significant overpayment of claims liability for the Hospital at a future date.

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. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses less bad debt expense divided by gross patient service revenue. The Hospital estimates that it provided approximately $14.5 million and $13.8 million of services to indigent patients during 2012 and 2011, respectively.

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 details of assets limited as to use are summarized in the following schedule at December 31:

	2012	2011
Funds held by trustees under bond indenture	$ 6,674,050	$ 8,523,776
Funds held in trust for payment of professional and other liability claims	7,538,483	7,579,594
Funds held by board for future capital improvements	116,314,560	113,649,238
Funds held by donors for specific purposes	25,000	25,000
Subtotal	130,552,093	129,777,608
Less amount for payment of current liabilities	(639,302)	(2,489,027)
Total assets limited as to use and permanently or temporarily restricted	$ 129,912,791	$ 127,288,581

Investments, including short-term investments, consist of the following at December 31:

	2012	2011
Money market investments	$ 13,929,062	$ 14,326,278
Government securities	3,694,051	4,793,829
Mutual funds	55,754,956	48,806,643
Corporate bonds	58,126,300	61,811,678
Pooled funds	5,463,687	4,746,581
Total	$ 136,968,056	$ 134,485,009
Classified as:		
Short-term investments	$ 6,415,963	$ 4,707,401
Current portion of assets limited as to use	639,302	2,489,027
Noncurrent portion of assets limited as to use	129,912,791	127,288,581
Total	$ 136,968,056	$ 134,485,009

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

Note 5 - Assets Limited as to Use (Continued)

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

	2012	2011
Interest and dividends	$ 3,849,251	$ 3,161,207
Change in net unrealized gains (losses)	6,392,235	(3,756,254)
Realized gains and losses - Net	357,196	182,054
Total	$ 10,598,682	$ (412,993)

Note 6 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Hospital's assets measured at fair value on a recurring basis at December 31, 2012 and 2011 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 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 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. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their 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.

Note 6 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2012

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2012
Short-term Investments -				
Money market investments	$ 6,415,963	$ -	$ -	$ 6,415,963
Assets Limited as to Use -				
Money market investments	9,196,511	-	-	9,196,511
Mutual funds:				
U.S. companies	25,614,362	-	-	25,614,362
International companies	22,602,212	-	-	22,602,212
Fixed income	5,015,921	-	-	5,015,921
Fixed income:				
U.S. Treasuries	-	4,309,569	-	4,309,569
Governmental agency bonds	-	1,787,166	-	1,787,166
Pooled funds	-	5,463,687	-	5,463,687
Asset-backed securities	-	18,146,725	-	18,146,725
Mortgage-backed securities	-	13,894,717	-	13,894,717
Corporate - Domestic	-	15,621,562	-	15,621,562
Corporate - International	-	7,578,375	-	7,578,375
Total assets limited as to use	62,429,006	66,801,801	-	129,230,807
Total	$ 68,844,969	$ 66,801,801	$ -	$ 135,646,770

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2012 included cash and cash equivalents of $1,321,286, which are not measured at fair value on a recurring basis and therefore are not in the table above.

Note 6 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2011

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2011
Short-term Investments -				
Money market investments	$ 4,707,401	$ -	$ -	$ 4,707,401
Assets Limited as to Use				
Money market investments	11,046,095	-	-	11,046,095
Mutual funds:				
U.S. companies	24,532,705	-	-	24,532,705
International companies	16,694,442	-	-	16,694,442
Fixed income	5,057,177	-	-	5,057,177
Fixed income:				
U.S. Treasuries	-	4,278,045	-	4,278,045
Governmental agency bonds	-	3,296,902	-	3,296,902
Pooled funds	-	4,746,581	-	4,746,581
Asset-backed securities	-	17,725,028	-	17,725,028
Mortgage-backed securities	-	16,381,235	-	16,381,235
Corporate - Domestic	-	19,416,698	-	19,416,698
Corporate - International	-	5,891,466	-	5,891,466
Total assets limited as to use	57,330,419	71,735,955	-	129,066,374
Total	$ 62,037,820	$ 71,735,955	$ -	$ 133,773,775

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2011 include cash and cash equivalents of $711,234, which are not measured at fair value on a recurring basis and therefore are not in the table above.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2012 and 2011, there were no significant transfers.

Note 7 - Other Current Assets

The details of other assets at December 31, 2012 and 2011 are as follows:

	2012	2011
Prepaid expenses	$ 2,707,299	$ 2,787,137
Inventory	8,437,788	6,990,069
Other	1,490,629	1,245,865
Total	$ 12,635,716	$ 11,023,071

Note 8 - Property and Equipment

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

	2012	2011	Depreciable Life - Years
Land	$ 3,745,499	$ 3,745,499	-
Buildings	240,826,771	236,672,426	2-40
Equipment	210,614,419	204,196,651	3-5
Construction in progress	10,868,772	2,595,927	-
Total cost	466,055,461	447,210,503	
Accumulated depreciation	(341,083,913)	(324,379,649)	
Net property and equipment	$ 124,971,548	$ 122,830,854	

Depreciation and amortization expense, including assets under capital lease, totaled approximately $18,695,000 and $17,891,000 in 2012 and 2011, respectively.

The Hospital holds buildings under capital leases with an original cost of approximately $22,100,000 at December 31, 2012 and 2011. Accumulated amortization for buildings under capital lease obligations was approximately $4,400,000 and $3,788,000 at December 31, 2012 and 2011, respectively.

Construction in progress consists primarily of costs incurred for the Southlake Emergency Room renovation, installation and implementation of software systems, and installation of various clinical equipment. Remaining costs to complete the project are approximately $8,320,000 as of December 31, 2012.

Note 9 - Accrued Liabilities and Other

The details of accrued liabilities at December 31 are as follows:

	2012	2011
Payroll and related items	$ 8,649,382	$ 7,612,306
Compensated absences	7,732,794	6,385,385
Interest	1,006,022	1,063,947
Total accrued liabilities	$ 17,388,198	$ 15,061,638

Note 10 - Long-term Debt

The following is a summary of long-term debt and capital lease obligations at December 31, 2012 and 2011:

	2012	2011
Indiana Health Facility Financing Authority Revenue Bonds, Series 1996, interest at 6.00 percent, due in installments through 2016	$ 8,870,000	$ 10,780,000
Indiana Health Facility Financing Authority Revenue Bonds, Series 2001, interest ranging from 4.30 percent to 5.50 percent, due in installments through 2031	53,565,000	55,165,000
Urgent care building capital lease obligation, expires October 31, 2020, collateralized by the leased building	1,255,296	1,334,320
Medical office building capital lease obligations, expire December 31, 2045, collateralized by leased medical office buildings	19,861,557	19,976,325
Total - Before unamortized discount	83,551,853	87,255,645
Less original issue discount	(194,396)	(196,157)
Less current portion	3,926,053	3,703,792
Long-term portion	$ 79,820,196	$ 83,748,010

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 term bonds payable in annual installments for 2013 through 2016, ranging from $2,025,000 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 with annual installments of $1,685,000 in 2013 and $1,775,000 in 2014 at interest rates ranging from 4.30 percent to 4.98 percent, and term bonds payable in annual installments beginning in 2015 through 2031, ranging from $1,870,000 to $4,365,000 at interest rates ranging from 5.375 percent to 5.50 percent.

Note 10 - Long-term Debt (Continued)

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 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, 2012:

Years Ending December 31		Long-term Debt	Capital Lease Obligations
2013		$ 3,710,000	$ 2,005,224
2014		3,925,000	2,005,224
2015		4,150,000	2,005,224
2016		4,385,000	2,005,224
2017		2,075,000	2,005,224
Thereafter		44,190,000	30,231,855
	Total	62,435,000	40,257,975
	Less amount representing interest under capital lease obligations	-	(19,141,122)
	Total debt and present value of minimum lease payments	$ 62,435,000	$ 21,116,853

The fair value of the Series 1996 Bonds, Series 2001 Bonds, and capital leases is $83,601,782 and $83,969,906 at December 31, 2012 and 2011, respectively. The Series 1996 and 2001 Bonds were estimated based on current traded values.

Note 11 - Other Liabilities

The detail of other liabilities is shown below:

	2012	2011
Accrued pension cost (Note 14)	$ 38,623,044	$ 35,342,417
Accrued professional and other liability claims (Note 15)	6,889,244	7,106,418
Other	1,527,721	1,267,831
Total other liabilities	$ 47,040,009	$ 43,716,666

Note 12 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately $1,776,000 and $1,451,000 for the years ended December 31, 2012 and 2011, 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
2013	$ 1,254,759
2014	840,191
2015	575,481
2016	528,759
2017	354,041
Thereafter	683,452
Total	$ 4,236,683

Note 13 - Defined Contribution Plan

The Hospital established a defined contribution pension plan effective January 1, 2006, which allows for employee contributions and requires a matching employer contribution of 50 percent of the first 6 percent of employees' earnings. Expense for the years ended December 31, 2012 and 2011 was approximately $1,601,000 and $1,520,000, respectively.

Note 14 - Pension Plan

The Methodist Hospitals, Inc. participates in a defined benefit pension plan covering certain employees.

Note 14 - Pension Plan (Continued)

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 benefits accrual based on 2006 compensation, and the early retirement reduction was calculated assuming a participant was 50 years or 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.

Obligations and Funded Status

	Pension Benefits	
	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 101,387,075	$ 89,723,836
Service cost	29,000	33,000
Interest cost	4,882,989	4,927,379
Actuarial loss	13,482,050	9,826,667
Benefits paid	(3,438,430)	(3,123,807)
Benefit obligation at end of year	116,342,684	101,387,075
Change in plan assets:		
Fair value of plan assets at beginning of year	66,044,658	64,418,918
Actual return on plan assets	9,113,412	(850,453)
Employer contributions	6,000,000	5,600,000
Benefits paid	(3,438,430)	(3,123,807)
Fair value of plan assets at end of year	77,719,640	66,044,658
Funded status at end of year	$ (38,623,044)	$ (35,342,417)

Note 14 - Pension Plan (Continued)

Components of net periodic benefit cost and other amounts recognized are as follows:

	Pension Benefits	
	2012	2011
Net Periodic Benefit Cost		
Service cost	$ 29,000	$ 33,000
Interest cost	4,882,989	4,927,379
Expected return on plan assets	(4,903,632)	(4,893,312)
Amortization of net loss	1,561,720	342,485
Total	$ 1,570,077	$ 409,552

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic pension cost:

	Pension Benefits	
	2012	2011
Net gain	$ 9,272,270	$ 15,570,432

Assumptions

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

	Pension Benefits	
	2012	2011
Discount rate	4.10 %	4.90 %

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31 are as follows:

	Pension Benefits	
	2012	2011
Discount rate	4.90 %	5.60 %
Expected long-term return on plan assets	7.25	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.

Note 14 - Pension Plan (Continued)

Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the Hospital, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and assures timely payment of retirement benefits. Pension funds are invested in growth-oriented securities up to 65 percent in equities, including international equities.

The target allocation range of percentages for plan assets is 65 percent equity securities and 35 percent debt securities as of December 31, 2012 and 2011.

The fair values of the Hospital's pension plan assets at December 31, 2012 and 2011 by major asset categories are as follows:

Fair Value Measurements at December 31, 2012

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Asset Category				
Equity securities:				
U.S. companies	$ 25,952,327	$ 25,952,327	$ -	$ -
International companies	23,186,690	23,186,690	-	-
Debt securities	26,173,627	-	26,173,627	-
Fixed income - Pooled funds	2,296,633	-	2,296,633	-
Total	$ 77,609,277	$ 49,139,017	$ 28,470,260	$ -

Fair Value Measurements at December 31, 2011

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Asset Category				
Equity securities:				
U.S. companies	$ 26,227,015	$ 26,227,015	$ -	$ -
International companies	16,552,924	16,552,924	-	-
Debt securities	20,279,082	-	20,279,082	-
Fixed income - Pooled funds	2,891,827	-	2,891,827	-
Total	$ 65,950,848	$ 42,779,939	$ 23,170,909	$ -

Note 14 - Pension Plan (Continued)

The pension plan assets shown above included cash and cash equivalents of $110,363 and $93,810 at December 31, 2012 and 2011, respectively. Cash and cash equivalents are not measured at fair value on a recurring basis and therefore are not included in the table above.

The above tables present information about the pension plan assets measured at fair value at December 31, 2012 and 2011 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 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 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.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their 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 plan asset.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2012 and 2011, there were no significant transfers.

Note 14 - Pension Plan (Continued)

Cash Flow

Contributions

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years Ending December 31	Pension Benefits
2013	$ 3,574,942
2014	3,733,493
2015	3,899,530
2016	4,098,546
2017	4,327,636
2018-2022	26,740,834

Note 15 - Professional Liability Self-insurance

On April 2, 1983, the Hospital became qualified under the Indiana Medical Malpractice Act (the "Act"). The Act limits the amount of individual claims to $1,250,000 ($7,500,000 annual aggregate) of which $1,000,000 would be paid by the State of Indiana Patient Compensation Fund and $250,000 by the Hospital. 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.

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 16 - Functional Expenses

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

Expenses related to providing these services are as follows:

	2012	2011
Healthcare services	$ 270,893,325	$ 243,024,480
General and administrative	32,628,608	30,593,784
Total	$ 303,521,933	$ 273,618,264

Note 17 - Subsequent Event

In February 2013, the Hospital acquired certain assets of a surgery center for a purchase price of $3,715,000. The agreement terms includes a promissory note of $2,574,496, bearing interest at 5 percent per year and three principal payments of $945,377, beginning on the first anniversary of the agreement, February 2014, and continuing until maturity in February 2016.