FINANCIAL STATEMENTS

Fort Worth Osteopathic Hospital, Inc.

Years ended September 30, 2001 and 2000

0212-0372014

Fort Worth Osteopathic Hospital, Inc.

Financial Statements

Years ended September 30, 2001 and 2000

Contents

ERNST & YOUNG

Ernst & Young LLP
Suite 1100
201 Main Street
Fort Worth, Texas 76102-3161

Phone: (817) 335-1900
Fax Numbers–
Audit: (817) 348-6003
Tax: (817) 348-6024
www.ey.com

Report of Independent Auditors

The Board of Directors
Fort Worth Osteopathic Hospital, Inc.

We have audited the accompanying balance sheets of Fort Worth Osteopathic Hospital, Inc. as of September 30, 2001 and 2000, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 financial statements referred to above present fairly, in all material respects, the financial position of Fort Worth Osteopathic Hospital, Inc. at September 30, 2001 and 2000, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

December 21, 2001,
except for Note 2, as to which the date is
September 1, 2002

Fort Worth Osteopathic Hospital, Inc.

Balance Sheets

	September 30 2001	September 30 2000
Assets		
Current assets:		
Cash and cash equivalents	$ 100	$ 100
Assets limited as to use	2,184,231	2,364,715
Accounts receivable, less allowance for uncollectible accounts ($3,903,000 in 2001 and $3,093,000 in 2000)	23,514,523	22,934,503
Other receivables	11,392,665	2,291,291
Inventories	3,401,183	3,089,711
Prepaid expenses	42,520	42,520
Total current assets	40,535,222	30,722,840
Assets limited as to use:		
Held by trustees under bond agreements	9,171,576	11,186,753
Board designated depreciation reserve funds	6,085,769	8,014,054
Board designated self-insurance funds	53,801	56,328
	15,311,146	19,257,135
Less amount required to meet current obligations	2,184,231	2,364,715
	13,126,915	16,892,420
Notes receivable from affiliates	13,748,308	15,753,829
Property and equipment:		
Land and improvements	10,303,086	9,264,860
Buildings and improvements	53,100,769	52,605,334
Equipment	58,245,781	56,880,977
Construction in progress	823,505	480,143
	122,473,141	119,231,314
Less accumulated depreciation and amortization	63,524,213	58,280,980
Net property and equipment	58,948,928	60,950,334
Debt issuance costs, less accumulated amortization of $830,247 in 2001 and $696,182 in 2000	3,367,493	3,501,558
Other	38,742	37,778
Total assets	$129,765,608	$ 127,858,759

	September 30	
	2001	**2000**
Liabilities and Net Assets		
Current liabilities:		
Payable to bank under line of credit	**$ 3,900,000**	$ 3,900,000
Accounts payable	**9,181,204**	4,793,212
Accrued interest payable	**1,859,509**	1,891,760
Accrued salaries and employee benefits	**986,692**	734,205
Other accrued expenses	**522,089**	769,715
Current maturities of long-term debt	**1,741,569**	1,655,319
Total current liabilities	**18,191,063**	13,744,211
Long-term debt, less current maturities	**81,758,789**	83,385,747
Other long-term liabilities	**3,262,983**	3,372,983
Net unrestricted assets	**26,552,773**	27,355,818
Total liabilities and net assets	**$ 129,765,608**	$ 127,858,759

See accompanying notes.

Fort Worth Osteopathic Hospital, Inc.

Statements of Operations and Changes in Net Assets

	Year ended September 30	
	2001	**2000**
Revenue:		
Net patient service revenue	**$ 112,377,669**	$100,603,302
Other	**2,189,985**	3,842,820
Total revenue	**114,567,654**	104,446,122
Expenses:		
Salaries and wages	**35,151,804**	35,026,002
Employee benefits	**6,864,796**	6,556,849
Supplies and other	**45,842,607**	43,642,053
Provision for bad debts	**13,257,027**	13,326,541
Depreciation and amortization	**5,247,851**	5,558,868
Interest	**5,480,526**	5,513,054
Total expenses	**111,844,611**	109,623,367
Income (loss) from operations	**2,723,043**	(5,177,245)
Unrealized losses on investments, net	**(1,029,852)**	(816,373)
Gains on sale of fixed assets	**298,935**	469,120
Contribution income	**625,829**	151,047
Excess (deficit) of revenue over expenses	**2,617,955**	(5,373,451)

Continued on next page.

Fort Worth Osteopathic Hospital, Inc.

Statements of Operations and Changes in Net Assets (continued)

	Year ended September 30	
	2001	**2000**
Excess (deficit) of revenue over expenses	**$ 2,617,955**	$ (5,373,451)
Distributions to parent	**(3,421,000)**	(3,600,000)
Decrease in net assets	**(803,045)**	(8,973,451)
Net assets, beginning of year	**27,355,818**	36,329,269
Net assets, end of year	**$ 26,552,773**	$ 27,355,818

See accompanying notes.

Fort Worth Osteopathic Hospital, Inc.

Statements of Cash Flows

	Year ended September 30 2001	2000
Operating Activities		
Decrease in net assets	$ (803,045)	$ (8,973,451)
Distributions to parent	3,421,000	3,600,000
Excess (deficit) of revenue over expenses	2,617,955	(5,373,451)
Adjustments to reconcile excess (deficit) of revenue over expenses to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,247,851	5,558,868
Amortization of original issue discount	134,065	134,066
Unrealized loss on investments	1,029,852	816,373
Provision for bad debts	13,257,027	13,326,541
Gains on sale of fixed assets	(298,935)	(469,120)
Effect of changes in operating assets and liabilities:		
Accounts receivable	(13,837,047)	(18,979,859)
Other receivables	(9,101,374)	1,290,455
Inventories and prepaid expenses	(311,472)	(136,785)
Accounts payable	4,387,992	(1,369,981)
Accrued interest payable, accrued salaries and employee benefits, and other accrued expenses	(28,354)	1,463,643
Other long-term liabilities	(110,000)	(636,432)
Net cash provided by (used in) operating activities	2,987,560	(4,375,682)
Investing Activities		
(Acquisitions) disposals of property and equipment	(3,246,445)	864,258
Proceeds on sale of fixed assets	298,935	469,120
Net decrease in assets limited as to use	2,916,137	10,579,155
Loans to affiliates	(8,964,819)	(2,544,536)
Settlements of loans by affiliates	10,970,340	1,080,430
Net cash provided by investing activities	1,974,148	10,448,427
Financing Activities		
Payments of long-term debt	(1,540,708)	(1,722,745)
Decrease in short-term borrowings	–	(1,000,000)
Distributions to parent	(3,421,000)	(3,600,000)
Net cash used in financing activities	(4,961,708)	(6,322,745)
Net decrease in cash and cash equivalents	–	(250,000)
Cash and cash equivalents at beginning of year	100	250,100
Cash and cash equivalents at end of year	$ 100	$ 100

See accompanying notes.

0212-0372014

1. Accounting Policies (continued)

Assets Limited as to Use

Investments included in assets limited as to use are comprised principally of certificates of deposit, corporate bonds, commercial paper, a limited partnership interest (in 2000), United States Treasury notes, and other liquid short-term securities. The investments are subject to interest rate and credit risk normally associated with these types of security interests. The investments are reported at estimated fair value based on quoted market prices.

Property and Equipment

Property and equipment is stated at cost on the date of acquisition or estimated fair market value on the date of donation.

Construction in progress consists of renovation, remodeling, and related equipment expenditures for various ancillary and support service areas. Capitalized net interest charges applicable to construction projects are not significant.

Depreciation of property and equipment is provided by the straight-line method over the estimated useful life of each class of depreciable assets.

Debt Issuance Costs and Debt Discount

Costs related to the issuance of long-term debt have been deferred and are being amortized over the life of the debt. Original issue discount applicable to long-term borrowings is classified with the related debt and is being amortized over the life of the debt.

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

1. Accounting Policies (continued)

The Hospital is paid under the Medicare program at predetermined rates with final settlement determined after submission of an annual cost report by the Hospital and audit thereof by the Medicare fiscal intermediary. These retroactive settlements are estimated and recorded in the financial statements in the year in which they occur. The estimated settlements recorded at September 30, 2001 and 2000, of $9,185,000 and $2,244,000 (included in other receivables), respectively, could differ from actual settlements based on the results of cost report audits. The Hospital's Medicare cost reports have been settled by the Medicare fiscal intermediary through September 30, 1997. Management believes it has made adequate provision for adjustments, if any, which may result from the intermediary's audits of the cost reports for fiscal years subsequent to 1997.

During the years ended September 30, 2001 and 2000, approximately 24% and 26%, respectively, of net patient service revenue were for services provided to Medicare program beneficiaries. Net patient accounts receivable of approximately $7,260,000 and $9,629,000 are due from the Medicare program at September 30, 2001 and 2000, respectively. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change by a material amount in the near term. The 2001 and 2000 net patient service revenue increased approximately $7,000,000 and $1,100,000, due to changes in allowances previously estimated that are no longer necessary as a result of final settlements and appeals, recoveries from appeals, and years that are no longer subject to audits, reviews, and investigations.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge. The Hospital also considers certain amounts as charity care related to services which are subsequently determined to be uncollectible from Medicaid and other third-party payors, as well as amounts deemed to be uncollectible based on the patient's inability to pay.

1. Accounting Policies (continued)

Other Revenue

The Hospital reports all other revenue as operating income as it is either directly related to operations or results from activities that support or further the Hospital's mission. The major element of other revenue is interest income of approximately $757,000 in 2001 and $2,179,000 in 2000.

Functional Expenses

The Hospital provides general health care services to residents within its geographic region. General and administrative expenses are approximately $17,053,000 and $17,606,000 in 2001 and 2000, respectively.

Advertising Expenses

The Hospital expenses all advertising costs when incurred. The Hospital incurred advertising expenses of $220,000 and $334,000 in 2001 and 2000, respectively.

Contributions

Contributions are recognized as income in the period received or unconditionally pledged to the Hospital. The Hospital does not have a policy of applying time restrictions on long-lived donated assets and considers such assets unrestricted at the date placed in service. Expirations of donor-imposed restrictions are reported as reclassifications between temporarily restricted and unrestricted net assets. There were contributions of $626,000 and $151,000 made or pledged to the Hospital in 2001 and 2000, respectively. As of September 30, 2001 and 2000, assets that are restricted by donors totaled $39,000 and $38,000, respectively. These amounts are not material to the financial position of the Hospital and therefore are not presented separately as temporarily restricted assets in the accompanying financial statements.

Excess (Deficit) of Revenue over Expenses

Included in excess (deficit) of revenue over expenses in the accompanying statements of operations are all changes in unrestricted net assets other than equity transfers to or from related entities under common control.

1. Accounting Policies (continued)

Statements of Cash Flows

For purposes of the statements of cash flows, the Hospital considers all highly liquid and unrestricted investments with a short-term maturity (generally less than 90 days) to be cash equivalents.

Interest paid in cash for the years ended September 30, 2001 and 2000, totaled approximately $5,481,000 and $5,483,000, respectively. Capitalized interest for 2001 and 2000 totaled approximately $16,000 and $201,000, respectively.

Fair Value of Financial Instruments

The following methods and assumptions were used by the Hospital in estimating its fair value disclosures for financial instruments for both 2001 and 2000:

Cash and cash equivalents: The carrying amount reported in the balance sheets for cash and cash equivalents approximates its fair value.

Investment securities: The fair values of investment securities are based on quoted market prices. The carrying amounts reported in the balance sheets in 2001 and 2000 approximate fair value.

Long-term debt: The fair values of the Hospital's long-term debt are estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements. The fair values of the Hospital's long-term debt are $92,568,000 and $94,526,000 as of September 30, 2001 and 2000, respectively.

Reclassification

Certain reclassifications have been made to the prior year's financial statements to conform to the current year's presentation.

2. Indebtedness

Long-term debt at September 30 consists of the following:

	2001	2000
Tarrant County Health Facilities Development Corporation Hospital Revenue Bonds, Series 1997, stated interest rates 4.8% – 5.25%, payable in varying amounts to 2028, net of unamortized original issue discount of $110,000 at September 30, 2001 and $116,000 at September 30, 2000	**$ 13,710,000**	$ 13,901,000
Tarrant County Health Facilities Development Corporation Hospital Revenue Refunding and Improvement Bonds, Series 1996, stated interest rates 4.1% – 5.3%, payable in varying amounts to 2011, net of unamortized original issue discount of $206,000 at September 30, 2001 and $212,000 at September 30, 2000	**21,784,000**	22,078,000
Tarrant County Health Facilities Development Corporation Hospital Revenue Refunding and Improvement Bonds, Series 1993, stated interest rates 4.8% – 7.0%, payable in varying amounts to 2028, net of unamortized original issue discount of $1,463,000 at September 30, 2001 and $1,521,000 at September 30, 2000	**47,962,000**	49,004,000
Other notes	**45,000**	58,000
	83,501,000	85,041,000
Less current maturities	**1,742,000**	1,655,000
	$ 81,759,000	$ 83,386,000

In December 1997, the Hospital, through Tarrant County Health Facilities Development Corporation (the Development Corporation), issued $14,500,000 Series 1997 tax-exempt Hospital Revenue Bonds. The bonds were issued in conjunction with several capital projects to be completed by the Hospital.

2. Indebtedness (continued)

In December 1996, the Hospital, through the Development Corporation, issued \$23,120,000 Series 1996 tax-exempt Hospital Revenue Refunding and Improvement Bonds. A portion of the proceeds from this transaction was used to effectively retire \$7,060,000 of bonds issued in 1993 by depositing in an escrow fund amounts sufficient to provide for payment of principal and interest as they become due. At September 30, 2001, the outstanding principal balance of the 1993 bonds considered to be extinguished totaled \$7,060,000.

In January 1993, the Hospital, through the Development Corporation, issued \$62,120,000 Series 1993 tax-exempt Hospital Revenue Refunding and Improvement Bonds. A portion of the proceeds from this transaction was used to effectively retire \$18,610,000 of bonds issued in 1990 and \$33,745,000 of bonds issued in 1987 by depositing in an escrow fund amounts sufficient to provide for payment of principal and interest as they become due; simultaneously, the indenture and other instruments securing the 1990 and 1987 bonds were released and discharged. At September 30, 2001, the outstanding principal balance of the 1990 and 1987 bonds considered to be extinguished totaled \$42,495,000.

The Hospital has secured the Series 1997, 1996 and 1993 Bonds by the pledge and assignment of Hospital gross revenues. The master indenture contains certain covenants which, among other things, restrict the Hospital from incurring additional long-term debt and require the Hospital to meet a days cash on hand ratio. During 2001, the Hospital was in violation of its days cash on hand ratio as defined in the master indenture at certain reporting dates. The Hospital has obtained a forbearance agreement dated September 1, 2002, with respect to the days cash on hand ratio and the insurer has agreed to forebear from exercising remedies under the Master Indenture, the Loan Agreement and the Bond Indenture with respect to the days cash on hand covenant. The forbearance agreement places certain conditions on the Hospital. In addition the Health Care Foundation Inc. (See Note 8) is added to the obligated group under the Master Indenture. Management believes it is in compliance with these conditions and all other covenants in its debt agreements.

2. Indebtedness (continued)

Long-term debt maturities (excluding amortization of the original issue discount) are as follows for the years ending September 30:

2002	$ 1,742,000
2003	1,833,000
2004	1,920,000
2005	2,020,000
2006	2,140,000
Thereafter	75,625,000

The Hospital has a short-term line of credit totaling $5,000,000 in both 2001 and 2000, which provides for borrowings at the Hospital's discretion at the prime rate minus 3/4%. The Hospital had outstanding borrowings against its line of credit totaling $3,900,000 as of both September 30, 2001 and 2000.

3. Net Patient Service Revenue and Charity Care

Net patient service revenue for the years ended September 30 is as follows:

	2001	2000
Gross patient service revenue	**$278,943,000**	$257,392,000
Contractual adjustments, discounts, and allowances	**166,565,000**	156,789,000
	$112,378,000	$100,603,000

Charges foregone for charity care, excluded from revenue based on established rates, were approximately $2,235,000 and $2,125,000 in 2001 and 2000, respectively. The Hospital is in compliance with standards for charity care required of nonprofit, tax-exempt hospitals by the State of Texas.

Gross patient service revenue derived from services provided on behalf of patients under federal and state medical assistance programs was approximately $117,999,000 in 2001 and $93,453,000 in 2000. The future amount of this revenue is dependent upon federal and state governmental policies. Recently enacted legislation is expected to reduce the level of reimbursement for services under federal government assistance programs.

3. Net Patient Service Revenue and Charity Care (continued)

Contractual adjustments from these programs, which are shown as a reduction of gross patient service revenue, were approximately $76,694,000 in 2001 and $81,953,000 in 2000. Other contractual adjustments relate to managed care contracts and commercial insurance arrangements, which are also shown as a reduction of gross patient service revenue, and were approximately $89,871,000 in 2001 and $74,836,000 in 2000.

4. Assets Limited as to Use

Under the trust indentures relating to the bonds (see Note 2), certain trustee-held funds are required to be maintained. At September 30, 2001 and 2000, the balances in these funds, as well as other trustee-held amounts, were as follows:

	2001	2000
Held by trustees under bond agreements		
Principal account	**$ 569,000**	$ 531,000
Interest account	**1,616,000**	1,834,000
Bond reserve account	**6,987,000**	8,822,000
	9,172,000	11,187,000
Less estimated amounts required for current liabilities, reported as current assets	**2,184,000**	2,365,000
	$ 6,988,000	$ 8,822,000

The Hospital's Board of Directors has designated certain assets for internal use. At September 30, the internal designation of such assets is as follows:

	2001	2000
Board designated assets		
Depreciation reserve funds	**$ 6,086,000**	$ 8,014,000
Self-insurance funds (see Note 6)	**54,000**	56,000
	$ 6,140,000	$ 8,070,000

5. Investments

The cost or amortized cost, gross unrealized gains and losses, and market value of investments are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
September 30, 2001:				
Debt securities:				
U.S. Treasury	$ 1,958,000	$ 4,000	$ (23,000)	$ 1,939,000
Corporate	6,295,000	10,000	(12,000)	6,293,000
	8,253,000	14,000	(35,000)	8,232,000
Equity securities	1,915,000	23,000	(198,000)	1,740,000
Cash and cash equivalents	5,343,000	–	(4,000)	5,339,000
	$ 15,511,000	$ 37,000	$ (237,000)	$ 15,311,000
September 30, 2000:				
Debt securities:				
U.S. Treasury	$ 2,376,000	$ 9,000	$ (29,000)	$ 2,356,000
Corporate	800,000	4,000	(3,000)	801,000
	3,176,000	13,000	(32,000)	3,157,000
Equity securities	4,050,000	931,000	(23,000)	4,958,000
Cash and cash equivalents	11,149,000	1,000	(59,000)	11,091,000
Partnership interest	52,000	–	(1,000)	51,000
	$ 18,427,000	$ 945,000	$ (115,000)	$ 19,257,000

6. Contingencies

The Hospital has established a partially self-insured program for the risk of loss resulting from professional liability. The program is self-funded on a basis believed to be actuarially sound and designed to provide protection to the Hospital from professional liability. The Hospital has been named in legal actions alleging failure to exercise due professional care. The claims are in various stages of processing and some may ultimately be brought to trial. There are known incidents occurring through September 30, 2001, that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. The estimated professional liability reserves were discounted on an assumed interest rate of 5%. The Hospital has reserved $3,263,000 and $3,373,000 for its professional liability exposure at September 30, 2001 and 2000, respectively, and has set up a revocable trust fund to cover professional liability claims.

The ultimate costs of the litigation and claims may exceed recorded reserves. In that event, the Hospital's financial position may be adversely affected. In the opinion of Hospital management, adequate reserves for professional liability exposure have been recorded at September 30, 2001 and 2000.

7. Lease Commitments

The Hospital uses certain equipment under operating lease arrangements. Rent expense relating to operating lease arrangements for the years ended September 30, 2001 and 2000, was approximately $1,556,000 and $1,377,000, respectively.

A summary of operating lease commitments with initial or noncancelable terms in excess of one year as of September 30, 2001, is as follows for fiscal years ending September 30:

2002	$ 1,438,000
2003	1,361,000
2004	542,000
2005	262,000
2006	458,000

8. Related Party Transactions

Notes receivable from affiliates are comprised of various notes, primarily from the Parent. Principal and interest on these notes are payable monthly. The notes are partially collateralized by real estate. The Hospital charges the Parent a floating rate of interest, calculated according to the Hospital's rate of return on other investments. The interest rate was approximately 5% for 2001 and 2000. Total interest income recorded by the Hospital from these notes receivable was approximately $522,000 and $642,000 in 2001 and 2000, respectively, which is included in other revenue.

Several years ago, the former management agreement with the Parent was revised and, in lieu of management fees, the Hospital pays distributions to its Parent from its net assets. In 2001 and 2000, distributions of $3,421,000 and $3,600,000 were made to the Parent.

At September 30, 2001 and 2000, the Hospital was contingently liable as a guarantor of loans made to the Parent by a lending institution, amounting to approximately $1,226,000 and $1,317,000, respectively.

The Health Care Foundation, Inc. (the Foundation) was organized for the primary purpose of providing financial support to the Hospital. The Foundation's activities are not included in the accompanying financial statements. At September 30, 2001 and 2000, the Foundation's unaudited financial statements reflect total assets of $4,179,000 and $10,814,000 and total net liabilities of $(975,800) and $(1,408,000), respectively. The Foundation had restricted net assets of approximately $963,000 and $1,745,000 at September 30, 2001 and 2000, respectively. The Foundation contributed $502,000 and $4,000 to the Hospital during 2001 and 2000, respectively. The Foundation's assets at September 30, 2001 and 2000, consisted mainly of investments and the cash surrender value of life insurance acquired pursuant to a special program.

9. Employee Benefit Plans

The Hospital has a defined contribution plan (the Plan) covering substantially all employees. This Plan is available to all eligible employees based upon years of service and hours worked. The Plan authorizes a discretionary contribution to be made by the Hospital each year. No discretionary contribution was authorized by the Board for the years ended September 30, 2001 and 2000.

9. Employee Benefit Plans (continued)

The Plan is interrelated with the Hospital's Tax-Deferred Annuity Program (the Program). The Program was amended and restated effective October 1, 1992, for all eligible employees based upon years of service and hours worked. The Program is designed to accept tax-deferred employee contributions as determined by the employee. The Plan provides for maximum employer matching contributions of up to 100% of an eligible employee's contributions to the Program based upon years of service. The Hospital funded matching contributions in 2001 and 2000 of approximately $499,000 and $659,000, respectively.