SEARS METHODIST RETIREMENT SYSTEM, INC.

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

SEARS METHODIST RETIREMENT SYSTEM, INC.
TABLE OF CONTENTS
YEARS ENDED DECEMBER 31, 2012 AND 2011

CliftonLarsonAllen LLP
CLAconnect.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Sears Methodist Retirement System, Inc.
Austin, Texas

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Sears Methodist Retirement System, Inc. (the System), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets (deficit), and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Southwest Assurance Company, Ltd., a wholly-owned subsidiary, which statements reflect total assets of $1,952,743 as of December 31, 2012 and income of $13,191, for the year then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Southwest Assurance Company, Ltd., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 auditors' 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, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sears Methodist Retirement System, Inc. as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter Regarding Going Concern

The accompanying consolidated financial statements have been prepared assuming that the entity will continue as a going concern. As discussed in Note 21 to the consolidated financial statements, the System has incurred continued losses from operations that has resulted in the System being in a negative net asset position, has a lack of liquidity to cover its on-going operations and debt service, and has defaulted on the bond covenant requirements and bond payments. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 21. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Report on Consolidating and Combining Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating and combining information in the supplementary schedules is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating and combining information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating and combining information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Dallas, Texas
March 14, 2014

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2012 AND 2011

	2012	2011
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 2,093,816	$ 2,279,388
Accounts Receivable, Net	6,741,838	8,825,718
Current Portion of Assets Limited as to Use	6,229,150	28,745,544
Other Current Assets	1,121,973	1,098,843
Total Current Assets	16,186,777	40,949,493
ASSETS LIMITED AS TO USE, Net of Current Portion	10,108,307	211,584
PROPERTY AND EQUIPMENT, NET	148,353,539	149,029,637
OTHER ASSETS		
Deferred Financing Costs, Net	5,261,696	5,477,172
Deferred Marketing Costs, Net	2,091,731	2,368,049
Other Investments	681,937	681,937
Other Assets	1,327,623	1,941,420
Total Other Assets	9,362,987	10,468,578
Total Assets	$ 184,011,610	$ 200,659,292
LIABILITIES AND NET ASSETS (DEFICIT)		
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	$ 51,360,240	$ 147,318,426
Accounts Payable	2,806,160	3,192,307
Construction Payable	167,835	611,573
Accrued Expenses	6,737,106	6,323,775
Deferred Income	525,748	602,655
Resident Security Deposits	304,739	833,594
Total Current Liabilities	61,901,828	158,882,330
LONG-TERM DEBT, Net of Current Maturities	102,994,172	13,374,180
OTHER LIABILITIES		
Deferred Revenue from Residency Fees	37,066,254	32,797,445
Entrance Fee Deposits	664,559	775,598
Deferred Compensation	947,614	820,882
Charitable Gift Annuities Payable	138,736	182,038
Interest Rate Swap Agreement	97,488	160,766
Other Liabilities	7,974,728	8,172,225
Total Other Liabilities	46,889,379	42,908,954
Total Liabilities	211,785,379	215,165,464
NET ASSETS (DEFICIT)		
Unrestricted:		
Unrestricted Deficit	(32,547,910)	(18,769,278)
Noncontrolling Interest	1,064,106	(286,883)
Total Unrestricted	(31,483,804)	(19,056,161)
Temporarily Restricted	1,942,600	2,782,554
Permanently Restricted	1,767,435	1,767,435
Total Net Assets (Deficit)	(27,773,769)	(14,506,172)
Total Liabilities and Net Assets (Deficit)	$ 184,011,610	$ 200,659,292

See accompanying Notes to Consolidated Financial Statements.

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
OPERATING REVENUE		
Resident Service	$ 71,901,431	$ 67,393,978
Amortization of Residency Fees	1,688,975	1,328,905
Net Assets Released from Restriction	839,954	27,812
Other Operating Revenue	1,986,431	1,233,901
Total Operating Revenue	76,416,791	69,984,596
OPERATING EXPENSE		
Nursing	27,328,305	25,511,187
Dietary	7,332,131	6,904,965
Activity Services	817,410	827,591
Social Services	417,048	429,766
Environmental Services and Utilities	9,289,552	9,500,400
Consultant Services	169,832	188,000
General and Administrative	12,161,458	11,470,471
Risk Management and Training	491,121	406,773
Marketing and Admissions	1,057,669	1,311,173
Employee Benefits	7,811,916	7,573,290
Interest Expense	9,860,394	10,611,182
Depreciation and Amortization	6,473,455	5,429,193
Total Operating Expense	83,210,291	80,163,991
OPERATING LOSS	(6,793,500)	(10,179,395)
OTHER INCOME (EXPENSE)		
Unrealized Gain on Investments	256,793	6,607
Realized Loss on Investments	(14,968)	(40,321)
Investment Income	308,068	494,884
Contributions	637,453	1,435,184
Other Expenses	(533,386)	(204,772)
Loss on Extinguishment of Long-Term Debt	-	(2,020,889)
Impairment Loss on Long Lived Assets	(2,270,000)	-
Change in Fair Value of Interest Rate Swap	63,278	(110,797)
Total Other Expense	(1,552,762)	(440,104)
DEFICIT OF REVENUE OVER EXPENSE	(8,346,262)	(10,619,499)
Federal Income Tax Expense	(652,431)	(40,803)
DECREASE IN UNRESTRICTED NET ASSETS (DEFICIT) FROM CONTINUING OPERATIONS	(8,998,693)	(10,660,302)
Loss from Discontinued Operations	(3,428,950)	(3,272,802)
DECREASE IN UNRESTRICTED NET ASSETS (DEFICIT)	$ (12,427,643)	$ (13,933,104)

See accompanying Notes to Consolidated Financial Statements.

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (DEFICIT)
YEARS ENDED DECEMBER 31, 2012 AND 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
NET ASSETS (DEFICIT) - DECEMBER 31, 2010	$ (5,123,057)	$ 2,774,991	$ 1,767,435	$ (580,631)
CHANGE IN NET ASSETS (DEFICIT)				
Deficit of Revenue Over Expense	(10,619,499)	-	-	(10,619,499)
Federal Income Tax Expense	(40,803)	-	-	(40,803)
Contributions	-	35,375	-	35,375
Net Assets Released from Restriction	-	(27,812)	-	(27,812)
CHANGE IN NET ASSETS (DEFICIT) FROM CONTINUING OPERATIONS	(10,660,302)	7,563	-	(10,652,739)
Loss from Discontinued Operations	(3,272,802)	-	-	(3,272,802)
CHANGE IN NET ASSETS (DEFICIT)	(13,933,104)	7,563	-	(13,925,541)
NET ASSETS (DEFICIT) - DECEMBER 31, 2011	(19,056,161)	2,782,554	1,767,435	(14,506,172)
CHANGE IN NET ASSETS (DEFICIT)				
Deficit of Revenue Over Expense	(8,346,262)	-	-	(8,346,262)
Federal Income Tax Expense	(652,431)	-	-	(652,431)
Net Assets Released from Restriction	-	(839,954)	-	(839,954)
CHANGE IN NET ASSETS (DEFICIT) FROM CONTINUING OPERATIONS	(8,998,693)	(839,954)	-	(9,838,647)
Loss from Discontinued Operations	(3,428,950)	-	-	(3,428,950)
CHANGE IN NET ASSETS (DEFICIT)	(12,427,643)	(839,954)	-	(13,267,597)
NET ASSETS (DEFICIT) - DECEMBER 31, 2012	$ (31,483,804)	$ 1,942,600	$ 1,767,435	$ (27,773,769)

See accompanying Notes to Consolidated Financial Statements.

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets (Deficit) from Continuing Operations	$ (9,838,647)	$ (10,652,739)
Loss from Discontinued Operations	(3,428,950)	(3,272,802)
Adjustments to Reconcile Change in Net Assets (Deficit) to Net Cash Used by Operating Activities:		
Depreciation and Amortization	6,473,455	5,429,193
Depreciation and Amortization in Discontinued Operations	10,640	591,195
Amortization of Deferred Income	(1,688,975)	(1,328,905)
Change in Fair Value of Interest Rate Swap	(63,278)	110,797
Unrealized Gain on Investments	(256,793)	(6,607)
Realized Loss on Investments	14,968	40,321
Loss on Extinguishment of Long-Term Debt	-	2,020,889
Loss on Sale and Impairment of Property	2,466,687	640,411
Change in Current Assets and Liabilities:		
Accounts Receivable	2,363,580	(1,115,576)
Other Assets	568,241	(67,465)
Accounts Payable	(591,327)	770,253
Resident Security Deposits	(665,164)	304,107
Accrued Expenses	217,380	1,413,857
Net Cash Used by Operating Activities	(4,418,183)	(5,123,071)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property, Plant and Equipment, Net	(5,816,039)	(22,465,406)
Proceeds from Sale of Property	-	13,712,511
Change in Assets Limited as to Use	10,591,496	3,937,270
Net Cash Provided (Used) by Investing Activities	4,775,457	(4,815,625)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from Notes Payable	75,038	22,894,094
Repayments of Long-Term Debt	(6,086,821)	(27,533,995)
Proceeds Received from Entrance Fees and Deposits	9,036,839	14,417,851
Refunds to Residents for Entrance Fees and Deposits	(3,310,204)	(1,575,855)
Deferred Financing Cost	(257,698)	(1,003,932)
Payment of Deferred Marketing Costs	-	(298,526)
Net Cash Provided (Used) by Financing Activities	(542,846)	6,899,637
DECREASE IN CASH AND CASH EQUIVALENTS	(185,572)	(3,039,059)
Cash and Cash Equivalents at Beginning of Year	2,279,388	5,318,447
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 2,093,816	$ 2,279,388

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

Nature of Organization

Sears Methodist Retirement System, Inc. (the System) operates as the parent corporation and is exempt from income tax under 501(c)(3) of the Internal Revenue Code. The System is organized and operates through the following entities:

Sears Methodist Centers, Inc.

Sears Methodist Centers, Inc. (SMC) is a 501(c)(3) non-profit corporation, which is organized and operates through the following divisions:

Sears Methodist Center

Sears Methodist Center operated a community with 20 independent cottages, 75 assisted living units and 117-bed licensed nursing care center in Abilene, Texas. This community was sold in 2009 (see Note 2).

Windcrest Alzheimer's Care Center

Windcrest Alzheimer's Care Center (Windcrest) operated a 120 licensed nursing care beds for residents with Alzheimer's or other debilitating dementia needs in Abilene, Texas. This community was sold in 2011 (see Note 2).

Sears Home Health

Sears Home Health (Home Health) operated a home health agency with operations in Abilene and Wichita Falls, Texas. The operations in Wichita Falls were sold in 2010, and the remaining Home Health operations were closed in 2011 (see Note 2).

Sears Methodist Hospice

Sears Methodist Hospice (Hospice) operated an in-home hospice service to seniors in Abilene, Texas. During 2011, the System agreed to sell the operating license of Hospice to an unrelated party, which closed in February 2012 (see Note 2).

Sears Specialty Services

Sears Specialty Services (Specialty Services) offered private duty services to individuals living independently, in assisted living, or nursing home communities in Abilene and Amarillo, Texas. The operations in Amarillo, Texas were sold in 2010, and the System ceased operating in Abilene, Texas in 2011, and all remaining working capital was transferred to Home Health (see Note 2).

Wesley Court Methodist Retirement Community

Wesley Court Methodist Retirement Community (Wesley Court) is a continuum of care retirement community located in Abilene, Texas. This senior living community provides a full continuum of living options, consisting of 49 executive homes, 78 apartment homes, 19 assisted living apartments and 30 private nursing care rooms. Rehabilitative services are also available as needed. An expansion program for up to 16 new executive homes was started in 2010. During 2012 and 2011, six and eight additional homes were completed and placed into service, respectively.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Sears Methodist Centers, Inc. (Continued)

Southwest Therapy Associates

Southwest Therapy Associates (Southwest Therapy) provided rehabilitation services to Craig Methodist Retirement Community (Craig), Parks Methodist Retirement Village (Parks), Garrison Geriatric Education and Care Center (Garrison), Mesa Springs Retirement Village (Mesa Springs), and Wesley Court, as well as other health care communities and home health agencies within the state of Texas. Services provided to Home Health in Wichita Falls were discontinued in 2010. Services provided to Windcrest, Wesley Woods Alzheimer's Care Center (Wesley Woods), and Home Health in Abilene were discontinued in 2011. In January 2013, the System closed operations of Southwest Therapy (see Note 2).

Sears Methodist Foundation

Sears Methodist Foundation (the Foundation), a non-profit 501(c)(3) Corporation, solicits donor support for the charitable needs of the residents of the System. The Foundation contains donor restricted and board designated investments for benevolent care and capital needs of the System.

Sears Panhandle Retirement Corporation

Sears Panhandle Retirement Corporation (Sears Panhandle), a non-profit 501(c)(3) Corporation, is the parent company of Craig. Craig is a continuum of care campus, comprised of 173 independent living cottages and apartments, 40 assisted living units and a 106-bed long-term care skilled nursing and Alzheimer's specialty care community. During 2012, Sears Panhandle completed the conversion of 28 semi-private rooms to 14 private rooms, reducing the number of beds from 120 to 106.

Sears Permian Retirement Corporation

Sears Permian Retirement Corporation (Sears Permian), a non-profit 501(c)(3) Corporation, owns and operates Parks in Odessa, Texas. Parks has 55 independent living apartments and cottages, 23 assisted living units and operates an 85-bed nursing center. During 2012, Sears Permian converted 10 semi-private rooms to 5 private rooms.

Odessa Methodist Housing, Inc.

Odessa Methodist Housing, Inc. (Odessa), a non-profit 501(c)(3) Corporation, owns and operates Desert Haven a 40-unit one bedroom HUD subsidized apartment complex in Odessa, Texas.

Sears Brazos Retirement Corporation

Sears Brazos Retirement Corporation (Sears Brazos), a non-profit 501(c)(3) Corporation, owned and operated a 120-bed nursing facility doing business as Wesley Woods in Waco, Texas. During 2011, Wesley Woods was sold (see Note 2).

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Senior Dimensions, Inc.

Senior Dimensions, Inc. (SDI), a for-profit corporation, aides in the development of various projects and operates three Texas Veteran Homes throughout Texas on behalf of the State Land Board (the Land Board). The homes are located in Big Spring, El Paso and McAllen, Texas.

Sears Plains Retirement Corporation

Sears Plains Retirement Corporation (Sears Plains), a non-profit 501(c)(3) Corporation, owns and operates Garrison. Garrison is a geriatric learning center and nursing facility in Lubbock, Texas. The facility has 106 nursing care beds and one executive home and is used for a training ground for Texas Tech University students. During 2012, Sears Plains completed the conversion of 28 semi-private beds to 14 private suites, reducing the number of beds from 120 to 106.

Sears Tyler Methodist Retirement Corporation

Sears Tyler Methodist Corporation (Sears Tyler), a nonprofit 501(c)(3) corporation, owns and operates Meadow Lake Retirement Community (Meadow Lake). Meadow Lake is a newly developed community consisting of 33 executive homes, 80 independent living apartments, 20 assisted living units, 34 memory support units and a 30-bed health center. Meadow Lake has a total potential capacity of 54 executive homes and is currently in the process of constructing additional executive homes.

Sears Caprock Retirement Corporation

Sears Caprock Retirement Corporation (Sears Caprock), a non-profit 501(c)(3) Corporation, owns and operates Mesa Springs in Abilene, Texas. Mesa Springs consists of 16 independent living executive homes, 34 independent living garden homes, 10 independent living apartments and a 75-bed skilled nursing facility.

Sears Methodist Senior Housing, LLC

Sears Methodist Senior Housing, LLC (Senior Housing), was established as a limited liability corporation with SMRS being the sole member. Senior Housing acts as the general partner for Canyons Senior Living, L.P. (the Partnership) and owns a .01% interest. An independent third party acts as the limited liability partner and owns the remaining 99.99%. This ownership is shown as a noncontrolling interest in the financial statements (see Note 5).

Canyons Senior Living, L.P.

The Partnership was formed for the purpose of developing and operating a retirement community. Senior Housing as the General Partner of the Partnership, is required to include the financial statements of the Partnership in the accompanying consolidated financial statements. The interest of the limited partners is reported as noncontrolling interest on the consolidated balance sheets as of December 31, 2012 and 2011. The Partnership financed the development of this project through $11.8 million of available funding from the Texas Department of Housing and Community Affairs (TDHCA) and the U.S. Department of Housing and Urban Development (HUD), and a combination of lenders to renovate the Canyons Retirement Community (Canyons) under a tax credit rehabilitation program.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Senior Living Assurance, Inc.

Senior Living Assurance, Inc. (SLAI) was formed to provide administrative and risk management services to Southwest Assurance Company, Ltd. (SWAC).

Southwest Assurance Company, Ltd.

SWAC is a wholly owned subsidiary of the System, and was incorporated on June 16, 2011 under the laws of the Cayman Islands. SWAC was granted an Unrestricted Class "B" insurance license pursuant to the Insurance Law of the Cayman Islands on June 30, 2011, and provides general and professional liability insurance for the System and its subsidiaries. SWAC is exempt from taxes on income and gains under Cayman Islands tax concession laws.

Texas Senior Management

Texas Senior Management (TSM) is a for-profit corporation that was established to provide third party management services.

Principles of Consolidation

The accompanying consolidated financial statements include all accounts of Sears Methodist Retirement System, Inc., Sears Methodist Foundation, and wholly owned subsidiaries, Sears Methodist Centers, Inc., Sears Panhandle Retirement Corporation, Sears Permian Retirement Corporation, Sears Brazos Retirement Corporation, Senior Dimensions, Inc., Sears Plains Retirement Corporation, Sears Tyler Methodist Retirement Corporation, Sears Caprock Retirement Corporation, Sears Methodist Senior Housing, LLC, Texas Senior Management, Senior Living Assurance, Inc., and Southwest Assurance Company, Ltd. that are under common control. Canyons Senior Living, L.P. has been included in these consolidated financial statements due to Sears Methodist Senior Housing, LLC being the general partner. The interest of the limited partners is reported as noncontrolling interest.

All inter-company transactions and balances have been eliminated in the consolidation.

Sears Methodist Retirement System, Inc. (SMRS) generates revenue through management fees charged to the above entities to cover expenses of operating the entire system. For all bonds payable which are the debt of the Obligated Group, the three other facilities within the Obligated Group make debt service payments to SMRS for their portion of the principal and interest for the underlying Obligated Group bonds.

Obligated Group

Sears Methodist Retirement System, Inc., Sears Methodist Foundation, Sears Methodist Centers, Inc., Sears Panhandle Retirement Corporation, Sears Permian Retirement Corporation, and Sears Brazos Retirement Corporation are the members of the Obligated Group under a Master Trust Indenture (see Note 6) which secures a major portion of the System’s debt. Each member of the Obligated Group is required to secure the related debt by a pledge of gross revenues and a security interest in any fund or account in which gross revenues are deposited subsequent to a default. In addition, each member of the Obligated Group is jointly and severally liable for all debt under the indenture.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Discontinued Operations

The operations of Sears Methodist Center, Windcrest, Wesley Woods, Home Health, Hospice, Sears Specialty Services and Southwest Therapy have been reported as discontinued operations in these consolidated financial statements.

Tax Status

SMRS and all subsidiaries, with the exception of SDI, Senior Housing, the Partnership, TSM, SLAI and SWAC are incorporated as nonprofit corporations under the laws of the State of Texas and are exempt from federal income tax under Section 501(c)(3) of the federal Internal Revenue Code. SWAC is exempt from taxation under Section 6 of the Cayman Islands tax concession law.

The System's income tax returns are subject to review and examination by federal authorities. The System is not aware of any activities that would jeopardize its tax-exempt status. The System is not aware of any activities that are subject to tax on unrelated business income or excise or other taxes. The tax returns for the years 2009 to 2011 are open to examination by federal authorities.

The Partnership is taxed as a partnership for federal income tax purposes. Accordingly, the System does not pay federal income taxes and no provision for federal income taxes is included in these consolidated financial statements. The members are liable for individual federal income taxes on their proportionate share of the partnership's income.

SDI, TSM and SLAI have recorded deferred tax assets and liabilities in the accompanying consolidated balance sheets to reflect temporary book and tax differences. Deferred tax assets and liabilities are computed annually for differences between the financial statement and income tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to offset taxable income.

Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense (benefit) is the income tax payable (receivable) for the year and the change during the year in deferred tax assets and liabilities.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Financial Statement Presentation

Contributions received are recorded as an increase in unrestricted, temporarily restricted or permanently restricted support, depending on the existence or nature of any donor restrictions. Accordingly, net assets of the System and changes therein are classified and reported as follows:

Unrestricted –Those resources over which the board of directors has discretionary control. Designated amounts represent those assets which the board has set aside for a particular purpose.

Temporarily Restricted –Those resources subject to donor imposed restrictions which will be satisfied by actions of the System or passage of time.

Permanently Restricted –Those resources subject to a donor imposed restriction that they be maintained permanently by the System. The donors of these resources permit the System to use all or part of the income earned, including capital appreciation of related investments for unrestricted or temporarily restricted purposes.

Unconditional promises to give cash and other assets are accrued at estimated fair value at the date each promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied, net assets are released and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same reporting period as received are recorded as unrestricted contributions.

Resident Services Revenue

The System provides care to residents covered by various third-party payors such as Medicare, Medicaid and private insurance companies. Medicare and Medicaid agreements provide for rate payments which are updated annually by the federal and applicable state governments, respectively. Many of the residents served by the System are elderly and many have limited resources to pay for care without assistance from the Medicare and Medicaid programs.

Provisions for estimated third-party payor settlements are provided in the period the related services are rendered. Differences between the amounts accrued and subsequent settlements are recorded in revenue in the year of settlement.

Third-Party Reimbursement Agreements

Medicaid

The System participates in the Texas Medicaid program administered by the Texas Health and Human Services Commission (THHSC). The System is reimbursed based upon prospective rates.

The System is required to file annual Medicaid cost reports for those participating facilities, which are subject to audit by the THHSC. Adjustments to these reports may retroactively affect payment rates.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Third-Party Reimbursement Agreements (Continued)

Medicare

The System owns licensed nursing facilities and home health and hospice agencies that participate in the Medicare program. The Medicare program is administered by the Centers for Medicare and Medicaid Services (CMS). The Medicare program pays on a Prospective Payment System (PPS), a per diem price based system. Cost reports must be filed annually with no cost settlement provision.

Nursing facilities licensed for participation in the Medicare and Medical Assistance programs are subject to annual licensure renewal. If it is determined that a nursing facility is not in substantial compliance with the requirements of participation, CMS may impose sanctions and penalties during the period of noncompliance. Such a payment ban would have a negative impact on the revenues of the nursing facilities.

Veterans' Land Board

The System has multiple contracts with the Land Board of the State of Texas. The System, in the name of and on behalf of the Land Board, bills Medicare, Medicaid and other third-party payor plans for collection of fees for services rendered to residents. The Land Board then provides per-diem reimbursement to the System once payment is received by the Land Board from third-party payors. In addition to the per diem fees, the Land Board also pays the System an annual management fee. The System currently manages three homes for the Land Board with one-year contracts that automatically renew. The current contracts for the three homes are in effect until June 2014.

Occupancy Percentages

During the years ended December 31, 2012 and 2011, the occupancy percentages and the percentage of resident days covered under the Medicaid and Medicare program for all of the System's skilled nursing facilities were as follows:

	2012				
Campuses	Location	Licensed Beds	Occupancy	Medicaid	Medicare
Craig Methodist Retirement Community	Amarillo, TX	106	85%	42%	14%
Parks Methodist Retirement Village	Odessa, TX	85	82%	42%	18%
Garrison Geriatric Education and Care Center	Lubbock, TX	106	83%	38%	22%
Mesa Springs Retirement Village	Abilene, TX	75	89%	38%	21%
Wesley Court Methodist Retirement Community	Abilene, TX	30	97%	-	18%
Meadow Lake Retirement Community	Tyler, TX	30	61%	-	78%
Total		432			

	2011				
Campuses	Location	Licensed Beds	Occupancy	Medicaid	Medicare
Craig Methodist Retirement Community	Amarillo, TX	120	89%	38%	13%
Parks Methodist Retirement Village	Odessa, TX	90	76%	47%	18%
Garrison Geriatric Education and Care Center	Lubbock, TX	120	83%	34%	22%
Mesa Springs Retirement Village	Abilene, TX	75	87%	43%	18%
Wesley Court Methodist Retirement Community	Abilene, TX	30	97%	-	11%
Meadow Lake Retirement Community	Tyler, TX	30	22%	-	47%
Total		465			

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Occupancy Percentages (Continued)

The skilled nursing facility at Meadow Lake began operating in 2011. The occupancy percentages for Windcrest and Wesley Woods were excluded from the 2011 table as the System no longer operates these facilities after the sale in November 2011.

During the years ended December 31, 2012 and 2011, the occupancy percentages for the senior living units were as follows:

Assisted Living	2012 Units	2011 Units	2012 Occupancy	2011 Occupancy
Wesley Court Methodist Retirement Community	19	19	98%	94%
Craig Methodist Retirement Community	40	40	82%	87%
Parks Methodist Retirement Village	23	23	95%	96%
Meadow Lake Retirement Community	54	54	52%	8%
Total	136	136		

Independent Living	2012 Units	2011 Units	2012 Occupancy	2011 Occupancy
Wesley Court Methodist Retirement Community	127	121	99%	97%
Desert Haven	40	40	98%	97%
Mesa Springs Retirement Village	60	60	92%	88%
Craig Methodist Retirement Community	173	173	92%	94%
Parks Methodist Retirement Village	55	55	92%	83%
Canyons Retirement Community	108	108	66%	47%
Meadow Lake Retirement Community	107	107	64%	50%
Total	670	664		

The assisted living (including the memory support units) and independent living at Meadow Lake Retirement Community began operating in 2011.

Cash and Cash Equivalents

The System considers all highly liquid debt instruments and certificates of deposit with a maturity of three months or less to be cash equivalents.

The System places its temporary cash investments with financial institutions. The System also has cash held at an unrelated foundation, Texas Methodist Foundation (TMF). At times such investments may be in excess of the FDIC insurance limit. As of December 31, 2012 and 2011, cash held by TMF was $1,733,732 and $1,019,373, respectively.

Accounts Receivable

Accounts receivable are primarily from Medicaid, Medicare, third party insurance plans, private pay residents and the Land Board.

The System accounts for uncollectible accounts by using management’s judgment. Resident services are provided on an unsecured basis and payment is required upon receipt of the invoice. Accounts that are past due more than 90 days are individually analyzed for collectibility. In addition, an allowance is estimated for other accounts based on historical experience of the System. The allowance for uncollectible accounts was approximately $670,000 and $1,120,000 at December 31, 2012 and 2011, respectively.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Accounts Receivable (Continued)

Accounts receivable are partially collateralized under the Capital One Bank NA (Capital One) Line of Credit (see Note 6).

Assets Limited as to Use

Assets limited as to use include assets set aside by the board of directors for benevolent care needs, deferred compensation, future capital improvements and other purposes, over which the board retains control and may, at its discretion, subsequently use for other purposes; assets held by trustees under the bond agreements and required HUD reserves and assets limited as to use by donors.

Under the HUD regulatory agreement, Odessa and the Partnership are required to deposit monthly amounts into a reserve for replacement account and other restricted escrow accounts, and Odessa is required to deposit any surplus cash from operations into a residual receipts account. All disbursements from these accounts require the prior written approval of HUD. Odessa and Canyons also hold in trust security deposit amounts received by the tenants of the projects upon move-in.

Assets limited as to use are invested in cash and cash equivalents, and guaranteed investment contracts are measured at cost. Other investments such as fixed income securities, equity securities, and corporate and government obligations with readily determinable fair values are measured at fair value on the balance sheet.

The System also participates in the Texas Methodist Foundation’s pooled investment funds. Each participant is allocated their pro-rata share of investment earnings (losses) and expenses in the program. The assets in the pooled investment funds are invested in cash and cash equivalents and measured at fair value in the accompanying consolidated balance sheet.

Investment income or loss from assets limited as to use (including realized gains and losses on investments, interest and dividends) are included in net revenue over expense unless the income or losses is restricted by donor or law.

Property and Equipment

Property and equipment are recorded at cost for purchased assets or fair market value at the date of receipt for donated assets. Depreciation is computed using the straight-line method over the estimated useful lives of the asset. Leasehold improvements are amortized over the shorter of the lease term or estimated useful life of the asset.

Construction in progress costs have been deferred until the projects have been completed. When the planned projects are completed, the construction in progress costs are capitalized and depreciated over the estimated life of the project including interest costs from borrowed funds.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Property and Equipment (Continued)

The System reviews its property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In the event that facts and circumstances indicate that the cost of construction in progress may be impaired, an evaluation of recoverability is performed.

Interest Capitalization

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets, and depreciated over their estimated useful lives by the straight-line method of depreciation. There was no capitalized interest expense as of December 31, 2012 and 2011.

Deferred Financing Costs

Costs incurred of $7,537,914 and $7,285,157 as of December 31, 2012 and 2011, respectively, in connection with the issuance of debt are capitalized and amortized over the term of the related indebtedness on a straight line basis, which approximates the effective interest rate method. Amortization expense for the years ended December 31, 2012 and 2011 was $455,437 and $403,618, respectively.

Deferred Marketing Costs

Advertising and marketing costs incurred in connection with acquiring initial continuing-care contracts are capitalized during the start up phase of the retirement community. One year following the completion of construction or when occupancy is stabilized, whichever occurs first, these capitalized marketing cost will be amortized to expense on a straight-line basis over the average expected remaining lives of the residents under contract at Meadow Lake. Total marketing costs capitalized, net of accumulated amortization, as of December 31, 2012 and 2011, totaled $2,091,731 and $2,368,049, respectively. Amortization expense recognized for the years ended December 31, 2012 and 2011 was $276,318 and $-0-, respectively.

Refundable Residency Fees and Deferred Revenue from Residency Fees

The cottages, apartments and executive homes located at Craig, Wesley Court, Parks, Mesa Springs and Garrison are for persons who are 55 years of age and older. Residents of these senior housing facilities enter into a personal and non-assignable agreement. When entrance fees are received under a 90% refundable plan, 90% is amortized over the remaining life of the applicable unit and 10% is amortized monthly over the life expectancy of the resident. The contract states that the 10% non-refundable portion is contributed to the Foundation and used for future benevolent care; therefore all amortization revenue calculated on the non-refundable portion is reflected in the consolidated statement of operations of the Foundation. Certain facilities adjust the standard average life expectancy to account for time spent in assisted living and the nursing center.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Refundable Residency Fees and Deferred Revenue from Residency Fees (Continued)

Upon termination of such agreement, either by resident, by the System or by reason of death and under the terms of these agreements, the respective organization is required to refund 90% of the residency fee to residents upon resale of the residence and collection of all entrance fees from the new resident and occupancy by the new resident. All refunds are paid without interest. Residents pay a monthly fee while living in these residences. These fees cover operating expenses and capital costs, and do not include any health care benefits.

A 48-month amortizing plan has been made available on one campus. Residents pay an entrance fee at closing. The available refund to the resident amortizes over time with a 4% initial reduction and a 2% reduction for each month of occupancy.

The apartments and executive homes (Independent Living Residences) located at Meadow Lake are for persons who are 55 years of age and older (ILU Residents). Entrance fees for Independent Living Residences consist of a lump-sum one-time payment, the amount of which is based on the type of independent living unit to be reserved and subsequently occupied by the ILU Resident (the Entrance Fee). In addition, to reserve a residence, an ILU Resident must execute a residency agreement and make an initial payment equal to 10% of the Entrance Fee (the Entrance Fee Deposit) prior to or upon execution of the residency agreement. The resident typically pays the remaining 90% of the Entrance Fee on or before the date of occupancy. Meadow Lake offers a 90% Refundable Entrance Fee Plan for the Independent Living Residences. When the resident occupies their unit, 90% of their entrance fee is amortized over the life of the applicable residence and 10% is amortized monthly over the life expectancy of the resident. ILU Residents pay a monthly service fee for services provide by Meadow Lake.

As a marketing incentive, Meadow Lake made arrangements with several residents that were experiencing problems in selling their previous residents to generate the necessary funds to pay the applicable Entrance Fees to move into their respective units. Meadow Lake worked with a local financial institution to make bridge loans to these residents while their homes were on the market to sale. Meadow Lake agreed to pay the interest cost on the resident bridge loans until their homes are sold. There were two residents that were provided with this incentive.

Prior to occupancy, prospective ILU Residents who have paid an initial entrance fee may terminate the residency agreement and receive a refund plus interest and less an administrative fee of $2,500, by providing 10-days written notice of termination to Meadow Lake. After occupancy, the residency agreement may be terminated at any time by providing 90 days written notice to the Organization. Upon termination, Meadow Lake will refund 90% (less financial assistance provided by Meadow Lake) of the entrance fee paid by the departing ILU Resident (or 100% in the case of the ILU Residents who elected the 100% refundable entrance plan fee) within 30 days after the residence is reoccupied and Meadow Lake receives an entrance fee from the new resident occupying the unit.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Resident Deposits and Community Fees

The System maintained a program of required guaranty deposits in amounts ranging from $500 to $5,000 for each resident entering an independent or assisted living facility within the System. These deposits in the case of non-rental units were credited to the residents' accounts upon execution of the occupancy agreement. In the case of rental units, the deposits were treated as security deposits and refunded at the time the units are vacated. These deposits are shown in resident security deposits on the balance sheet. In 2012, the System changed the program for incoming independent and assisted living residents from a refundable guaranty deposit program to a non-refundable community fee payable upon entry. These fees are included in resident services revenue in the financial statements.

Deferred Revenue

In addition to the resident contracts for cottages and executive homes, the System received $500,000 from the Development Corporation of Abilene in 2005 for future development costs in exchange for maintaining the corporate offices in Abilene, Texas. The term of the agreement is 10 years, and the associated deferred revenue is being amortized over 10 years. The balance of the deferred revenue from this contract as of December 31, 2012 and 2011 was $141,666 and $191,666, respectively.

Charitable Gift Annuities Payable

The System has established a gift annuity program whereby donors may contribute assets to the System in exchange for the right to receive a fixed dollar annual return during their lifetime. A portion of the transfer is considered to be a charitable contribution. The difference between the amount provided for the gift annuity and the present value of the liability for future payments is recognized as a temporarily restricted contribution at the date of the gift as specified by the donor. The System uses published mortality rate tables adopted by the United States Internal Revenue Service. The annuity liability is revalued annually based upon computed present values and discounted at rates between 3.0% and 10.0%. Total charitable gift annuities payable as of December 31, 2012 and 2011 was $177,252 and $237,889, respectively. The current portion of gift annuities payable as of December 31, 2012 and 2011 was $38,516 and $55,851, respectively, and are included in other current liabilities. The corresponding assets associated with these liabilities are in assets limited as to use.

Performance Indicator

The consolidated statements of operations includes a line entitled the “decrease in unrestricted net assets from continuing operations” which is the performance indicator for the System. Changes in unrestricted net assets which are excluded from the performance indicator, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, discontinued operations, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Performance Indicator (Continued)

The performance indicator is influenced by the start-up of new projects. For each of the years ended December 31, 2012 and 2011, the System has been in various stages of redeveloping existing properties, and developing, constructing and opening new senior living projects and new business divisions. The System expenses all of the pre-opening start up costs during the development and stabilization of these projects. Once the project is open for occupancy, the interest cost and depreciation is also expensed, even though the project is not fully occupied. In 2012 and 2011, the System incurred expense in excess of revenue of approximately $5,270,000 and $6,944,000, respectively, for these projects.

Charity Care

The System provided care to residents who meet criteria under its charitable care policy without charge or at amounts less than its established charge rates. In addition, the System also provides care under the Medicaid program for which the costs to provide such care exceeds reimbursement. The total charitable care provided under these programs was $5,455,735 and $6,083,220 for the years ended December 31, 2012 and 2011, respectively. The System also provides a number of other services to its residents and on behalf of the community where costs exceed revenues.

Fair Value of Financial Instruments

Fair value measurement applies to reported balances that are required or permitted to be measured at fair value under an existing accounting standard. The System emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability and establishes a fair value hierarchy. The fair value hierarchy consists of three levels of inputs that may be used to measure fair value as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the System has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Subsequent to initial recognition, the System may remeasure the carrying value of assets and liabilities measured on a nonrecurring basis to fair value. Adjustments to fair value usually results when certain assets are impaired. Such assets are written down from their carrying amounts to their fair value.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Fair Value of Financial Instruments (Continued)

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The System also adopted the policy of valuing certain financial instruments at fair value. This accounting policy allows entities the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on an instrument-by-instrument basis. The System has elected to measure investments at fair value, with the exception of investments in the captive insurance companies and guaranteed investment contracts, which are recorded at cost. The System may elect to measure newly acquired financial instruments at fair value in the future.

The System has elected the fair value option for investments to simplify record keeping. This election effectively moves the classification of investments from available for sale to trading which has no impact on the balance sheet presentation. The impact on the consolidated statement of operations pertaining to this election is that unrealized gains and losses on investments are shown within the performance indicator.

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange. Level 2 inputs include fixed income securities, corporate obligations and US. Government backed securities that are traded by dealers or brokers in active over-the-counter markets. Level 3 inputs include investments in pooled funds.

Investments in equity and fixed income securities and government and corporate obligations with readily determinable fair values are measured at fair value on the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in net revenue over expense unless the income or loss is restricted by donor or law.

Other Operating Revenue

Other operating revenue consists primarily of non-resident rental income, laundry, barber and beauty, cafeteria sales and other miscellaneous revenue.

Contributed Services

The System receives a substantial amount of services donated by volunteers. No amounts have been reflected in the financial statements for these services.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Risks and Uncertainties

The System has investments in a variety of investment holdings. In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility risk. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the investments will occur in the near term and that such changes could materially affect account balances reported on the balance sheet of the System.

Advertising

Advertising costs, other than those costs incurred in connection with acquiring initial continuing-care contracts during the start up phase of a retirement community, are charged to operations when incurred. Advertising expense was $282,866 and $563,047 for the years ended December 31, 2012 and 2011, respectively.

Reclassifications

Amounts in the consolidated balance sheet as of December 31, 2011, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended have been reclassified to conform to the 2012 classification. These reclassifications had no effect on the overall assets, liabilities and changes in net assets (deficit) for the year ending December 31, 2011.

Subsequent Events

In preparing these consolidated financial statements, the System has considered events and transactions for potential recognition or disclosure through March 14, 2014, the date the consolidated financial statements were available to be issued.

NOTE 2 DISCONTINUED OPERATIONS

During 2012, the System developed plans to cease operating Southwest Therapy, which was closed in January 2013. At that time, the System contracted with an outside therapy company to provide therapy services to the System's communities that had been served by Southwest Therapy.

In 2011, the System sold the assets and ceased operating Windcrest and Wesley Woods. These properties were sold for $14,200,000, which was used to pay down the Series 1998, 1999 and 2003 bonds of $8,690,000, with the remaining net proceeds paid to the System to pay transaction costs and to provide additional cash to the System. For the Series 2003 bond paydown, $4,270,000 was placed in an escrow fund that will provide the funds available to redeem these bonds upon the next available redemption date in April 2013. These bonds were deemed to be defeased at the time of funding of the escrow.

NOTE 2 DISCONTINUED OPERATIONS (CONTINUED)

In addition, in 2011, the System reached an agreement to sell the operating license of Hospice, and ceased the operations of Specialty Services. The operations of Home Health were agreed to be ceased in 2011, and ceased operating in 2012. The operating license of Hospice was sold in February 2012. This license was sold in 2012 for a potential price of $900,000, of which $450,000 was received upon the closing date. An additional $300,000 was placed into an escrow and $150,000 was a holdback that would be paid to the System, net of any reductions as described in the purchase agreement within one year following the closing. During 2012, the System received $280,000 of the escrow account. The remaining $150,000 was received by the System in February 2013, resulting in total sales proceeds of $880,000 from the Hospice transaction.

On July 1, 2009, the System sold the assets of Sears Methodist Center (SMC) for $6,250,000. In addition to the purchase price, the buyer also assumed $1,030,000 of the liability to residents of the cottages located at SMC. A portion of the proceeds were used to retire Series 1998 Bonds in the amount of $3,725,000. In addition, SMC agreed to retain up to $500,000 of entrance fee liabilities to be applicable solely to the residents residing in the cottages as of the sale date. This $500,000 shall be repaid to the residents of the cottages as of the sale date in future periods when they move out. As of December 31, 2012 and 2011, $300,429 and $377,852, respectively, related to these entrance fee liabilities are included in the long-term debt on the consolidated balance sheets.

In accordance with the accounting standard Accounting for the Impairment or Disposal of Long-Lived Assets, the operating activity for SMC, Windcrest, Wesley Woods, Home Health, Hospice, Specialty Services, and Southwest Therapy are presented as discontinued operations in the consolidated statements of operations for the years ended December 31, 2012 and 2011. The amounts included in discontinued operations include:

	2012	2011
Total Operating Revenues	$ 392,300	$ 12,826,064
Total Operating Expenses	(3,616,933)	(15,374,679)
Other Expense	(7,634)	(83,776)
Loss on Sale of Assets	(196,683)	(640,411)
Loss from Discontinued Operations	$ (3,428,950)	$ (3,272,802)

NOTE 3 ASSETS LIMITED AS TO USE

The System is required to hold funds in various accounts based upon terms in the indenture of trust of the various bond issuances, restricted deposits and funded reserves based upon the regulatory agreements for Odessa, and also have designated funds from the board of directors and donors. Assets limited as to use that are available for obligations classified as current liabilities are reported in current assets. The System maintains the following accounts:

Board Designated – Funds have been established for the purposes restricted by the board of directors for benevolent care, expansion projects and other purposes.

Permanently and Temporarily Restricted – Funds have been set aside to fulfill the restrictions established by donors. These funds are held for the specified purpose as designated by donors.

Held by Bond Trustee – These funds are held by the bond trustees in accordance with the bond and master trust indenture agreements. There are various funds established which are utilized to pay debt service as it becomes due, provide a reserve for payment of debt service, pay interest during the construction and start up of new projects, pay construction related costs for new projects, pay working capital costs, hold entrance fee funds that will be utilized for project costs and redemption of long-term debt, to repay related party notes, provide funding for the working capital fund and other costs, and other escrow funds as required by the indenture agreements.

Restricted Deposits and Funded Reserves – Various escrow and reserve funds have been established under the loan agreements with HUD. The funds accumulate in accordance with the HUD Regulatory and loan agreements for payment of real estate taxes, insurance, building and equipment repairs and replacements, and surplus cash of the HUD projects. Withdrawals from the reserve for replacement and residual receipts require HUD approval.

NOTE 3 ASSETS LIMITED AS TO USE (CONTINUED)

The balances of assets limited as to use and the respective composition of related investments at December 31, 2012 and 2011 are as follows:

	2012	2011
BOARD DESIGNATED		
Expansion Projects	$ 417,222	$ 391,704
Other Board Designated	1,682,838	2,607,177
Subtotal	2,100,060	2,998,881
PERMANENTLY AND TEMPORARILY RESTRICTED		
By Donors or Grantors for Specific Purposes	1,767,435	2,607,389
RESTRICTED BY DEBT AGREEMENTS		
Under Bond Indenture Agreement	4,519,589	13,502,114
Cash Held as Security	4,000,000	4,000,000
Restricted Land	1,830,000	4,100,000
Entrance Fee Deposits	1,210,945	775,598
Subtotal	11,560,534	22,377,712
RESTRICTED DEPOSITS AND FUNDED RESERVES		
Replacement Reserves	30,681	10,453
Resident Trust Funds	685,277	766,253
Operating Deficit Reserve Fund	110,829	110,829
Working Capital Escrow	69,769	72,746
Residual Receipts	12,872	12,865
Subtotal	909,428	973,146
Total Assets Limited as to Use	16,337,457	28,957,128
Less: Current Portion of Assets Limited as to Use	6,229,150	28,745,544
Assets Limited as to Use, Net of Current Portion	$ 10,108,307	$ 211,584

The estimated fair value and cost of assets limited as to use at December 31, 2012 and 2011 were as follows:

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
Cash and Cash Equivalents	$ 9,958,762	$ 9,958,762	$ 13,373,924	$ 13,373,924
Guaranteed Investment Contracts	2,498,441	2,498,441	5,227,178	5,227,178
Equities	-	-	526,788	526,788
Fixed Income Securities	318,879	316,522	4,328,294	4,280,310
Land	4,100,000	1,830,000	4,100,000	4,100,000
Funds Held by Texas Methodist Foundation	1,733,732	1,733,732	1,019,373	1,019,373
Other	-	-	429,555	429,555
Totals	$ 18,609,814	$ 16,337,457	$ 29,005,112	$ 28,957,128

NOTE 4 PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2012 and 2011:

	2012	2011
Land and Improvements	$ 12,044,889	$ 11,568,914
Building and Improvements	159,241,315	156,087,743
Furniture and Equipment	17,865,056	16,999,114
Leasehold Improvements	160,887	181,277
Construction in Progress	2,522,667	2,362,446
Total Property and Equipment	191,834,814	187,199,494
Less: Accumulated Depreciation	(43,481,275)	(38,169,857)
Property and Equipment, Net	$ 148,353,539	$ 149,029,637

Total depreciation expense for the years ended December 31, 2012 and 2011 was $5,683,537 and $5,490,138, respectively, including depreciation expense included in loss from discontinued operations.

Construction in progress consisted of numerous on-going projects as follows:

Parks

Parks is in the process of renovating the executive and patio homes on its campus, as well as expanding the nursing facility through the converting of 10 semi-private rooms in the nursing facility to private rooms. The cost of these construction projects are being paid through internal funds of the System and is expected to be completed in 2013. Construction in progress at December 31, 2012 and 2011 related to these projects was $1,485,297 and $597,830, respectively.

Meadow Lake

Meadow Lake is a newly developed community in Tyler, Texas that was completed in 2010 and into 2011. Construction in progress costs for Sears Tyler at December 31, 2012 and 2011 relate to the continued build out of additional executive homes on the surrounding campus. At December 31, 2012 and 2011, construction in progress related to this project was $163,633 and $84,507, respectively.

Wesley Court

In 2010, Wesley Court began the construction of up to 16 additional executive homes. Site cost for all 16 lots have been incurred, 9 homes were placed into service in 2011, and the remaining executive homes were placed into service in 2012. The project is partially financed with the Capital One Line of Credit. As of December 31, 2012 and 2011, there was $-0- and $340,115, respectively, included in construction in progress related to this project.

NOTE 4 PROPERTY AND EQUIPMENT (CONTINUED)

Other

The System has also incurred construction costs related to the planned development of new building projects, as well as planned renovations and remodeling of existing nursing facilities and senior housing projects.

NOTE 5 INVESTMENT IN LIMITED PARTNERSHIP

On August 7, 2007, Senior Housing, entered into an agreement with an independent development company to own and operate the Partnership. Senior Housing is the General Partner of the Partnership. Profits and losses of the Partnership are allocated based on percentages of ownership.

As the General Partner maintains controlling interest in the Partnership, the Partnership totals have been included in the consolidated financial statements. The equity attributable to the limited partner of the Partnership has been reflected on the consolidated balance sheets as "noncontrolling interest."

Under the partnership agreement, the Partnership shall dissolve upon the earliest to occur of any of the following events; (i) December 31, 2046 (ii) bankruptcy, incompetency, or withdrawal of the General Partner unless the Limited Partners select a successor General Partner within 30 days of the General Partner's incompetency or withdrawal and elect to continue the partnership; (iii) the passage of six months after the sale or other disposition of the property and all other assets of the Partnership; (iv) unanimous vote of the General Partner and the Limited Partners.

NOTE 6 LONG-TERM DEBT

The System's long-term debt at December 31, 2012 and 2011 is summarized below:

Description		2012	2011
HFDC of Central Texas, Inc. Series 2009A and 2009B Revenue Bonds, Due from November 15, 2019, to November 15, 2044. Secured by the Underlying Mortgage on the Property.	See (1)	$ 37,655,000	$ 39,190,000
HFDC of Central Texas, Inc. Series 2011A and 2011B Revenue Bonds, Due from November 15, 2013 to November 15, 2044. Secured by the Underlying Mortgage on the Property.	See (1)	5,395,000	5,395,000
Abilene Health Facilities Development Corporation Retirement Facility Series 2003 Revenue Bonds, Due through April 15, 2033. Secured by deed of trust and gross revenues of the Obligated Group.	See (2)	36,020,000	36,260,000
Abilene Health Facilities Development Corporation Series 1998 Bonds, Maturing through November 15, 2028. Secured by deed of trust and gross revenues of the Obligated Group.	See (3)	30,435,000	32,005,000
Abilene Health Facilities Development Corporation Retirement Facility Series 1999 Revenue Bonds, Due through November 15, 2029. Secured by deed of trust and gross revenues of the Obligated Group.	See (4)	7,840,000	8,110,000
Note Payable (American State Bank), due October 1, 2016, with monthly payments of $57,392, including interest ranging from 3.5 - 4.25%, secured by deed of trust.	See (5)	8,623,369	8,969,067
HFDC of Central Texas, Inc. Series 2008 Variable Rate Demand Retirement Facility Revenue Bonds, Due November 1, 2037. Secured by Letter of Credit.	See (6)	7,415,000	7,545,000
Note Payable to Capital One Bank, due August 15, 2015, with monthly payments of $99,281, including interest at 3.75%, secured by deed of trust and account pledge of the Obligated Group.	See (7)	14,154,713	14,793,236
Revolving Promissory Note to Capital One Bank, due August 31, 2012. Interest payments due monthly beginning October 1, 2010 at 3.75%. Secured by deed of trust and account pledge of the Obligated Group.	See (7)	4,000,000	5,537,433

NOTE 6 LONG-TERM DEBT (CONTINUED)

Description		2012	2011
Note Payable to Prudential Huntoon Paige Associates LTD, due April 1, 2052. Interest payments due monthly beginning November 1, 2010, at 4.82%. Commencing May 1, 2012, monthly payments of interest and principal of $17,705. Secured by deed of trust.		3,617,035	3,637,300
Asset Purchase Agreement Payable for Sears Caprock, due April 2015.	See (8)	465,000	465,000
Asset Purchase Agreement Payable for Sears Methodist Center Resident Refunds (see Note 2).		300,429	377,852
Notes Payable to Austin Bank, due March 1, 2015, with monthly payments of $2,243 including interest of 4.75%, secured by vehicles purchased.		57,282	-
Notes Payable to Austin Bank, due March 1, 2015, with monthly payments of $2,243 including interest of 4.75%, secured by vehicles purchased.		23,907	44,941
Capital Leases Payable require monthly payments of $2,920 and expire in 2013. As of December 31, 2011, the equipment owned by the Obligated Group and associated with the leases had cost and accumulated depreciation of $131,676 and $79,005, respectively. Unsecured.		22,717	54,935
Notes Payable with interest rates of 5.0% - 8.0% due through April 2012. Secured by equipment.		-	62,390
Subtotal - Long-Term Debt		156,024,452	162,447,154
Less: Current Maturities		(51,360,240)	(147,318,426)
Less: Unamortized Discount on Bonds		(1,670,040)	(1,754,548)
Total Long-Term Debt		$ 102,994,172	$ 13,374,180

The Obligated Group consists of the Series 1998, 1999 and 2003 revenue bonds, as well as the notes payable to Capital One Bank, and the capital leases. The amount of long-term debt outstanding for the Obligated Group as of December 31, 2012 and 2011 was $92,046,234 and $97,200,846, respectively. As of December 31, 2012 and 2011, the Obligated Group was in default of their bond covenants as included in the master trust indenture that covers the Series 1998, 1999 and 2003 bonds, and the agreement with Capital One Bank, as of December 31, 2011 the Obligated Group debt was included in current maturities of long-term debt. In May 2013 the Obligated Group restructured the outstanding debt. Based upon the restructuring of the debt completed in May 2013, the debt is classified as non-current in the accompanying December 31, 2012 consolidated balance sheet.

NOTE 6 LONG-TERM DEBT (CONTINUED)

At December 31, 2012 and 2011, Sears Caprock was not in compliance with the reimbursement and credit agreement that secures these bonds. In May 2013, Sears Caprock amended and restated its reimbursement and credit agreement through April 2014. Based upon the restructuring of the debt completed in May 2013, the debt is classified as non-current in the accompanying consolidated balance sheets.

In May and November 2012, Sears Tyler was in default on the Series 2009 and 2011 bonds due to the notice provided to the trustee that the bond payments to be made on May 1, 2012 and November 1, 2012 would not be paid in full, and to direct the trustee to draw upon the debt service reserve fund to make the required payment to the bondholders on May 15, 2012 and November 15, 2012. Management is in the process of negotiating a forbearance agreement with the existing bondholders (see Note 21). Based upon the event of default, the debt and its corresponding assets limited as to use are classified as current on the consolidated balance sheets.

Garrison did not meet its required debt service coverage ratio as of December 31, 2012. Based upon the event of default, the debt and its corresponding assets limited as to use are classified as current on the consolidated December 31, 2012 balance sheet.

The unamortized discount and premium on revenue bonds relates to the Series 1998, 1999, 2003, 2008, 2009 and 2011 Series Revenue Bonds and are being amortized over the term of the bonds using straight-line amortization.

Bonds Payable

(1) On November 1, 2009, Sears Tyler through HFDC of Central Texas, Inc. issued $8,545,000 Series 2009A Term Retirement Facility Revenue Bonds, $27,555,000 Series 2009A Term Retirement Facility Revenue Bonds and $7,850,000 Series 2009B Term Retirement Facility Revenue Bonds. The proceeds of the Series 2009A and 2009B bonds were used to finance the construction and equipping of, and the start up costs in connection with the construction of Meadow Lake. The bonds are secured by the underlying mortgage on the property.

The Series 2009 Bonds were issued at a discount of $921,200, which is being amortized on the effective interest method over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011 was approximately $32,000.

On March 8, 2011, Sears Tyler through HFDC of Central Texas, Inc. issued $3,895,000 Series 2011A and $1,500,000 Series 2011B Retirement Facility Revenue Bonds. The proceeds of these bonds were utilized to provide additional funding to complete construction of Meadow Lake, and to provide funding for the debt service reserve fund and pay costs of issuance.

The Series 2011 bonds were issued at a discount of $53,985, which is being amortized on the effective interest method over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011 was $2,000.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

Operating Support Agreement

In conjunction with the issuance of the Series 2009 Bonds, Sears Tyler entered into an operating support agreement (the Support Agreement) on November 1, 2009, with SDI. Under this agreement, SDI agrees to deposit all of its excess cash flow from its Veterans Land Board Contracts (the VLB Contracts) into a trustee held fund called the Operating Support Fund. The Support Agreement further calls for SDI to grant the System a continuing security interest in and to all, right, title and interest of SDI in its right to receive payments of money under the VLB Contracts.

Repayments of funded amounts from SDI to Sears Tyler are defined in the Master Trust Indenture and shall not be released and repaid until after the Series 2009B Bonds have been redeemed and Sears Tyler is in compliance with the required covenants of the Master Trust Indenture. Any funds deposited by SDI and not repaid pursuant to the above criteria shall be added to the outstanding note payable between SDI and Sears Tyler under the same repayment terms. If the note has been repaid or no longer exist at the termination of the Support Agreement, then a new note bearing the same terms shall be executed. Through December 31, 2012 and 2011, approximately $1,216,000 of funds have been received by Sears Tyler under the Support Agreement.

(2) On April 10, 2003, the System issued $43,060,000 Series 2003A Retirement Facility Revenue Bonds $2,500,000 Series 2003B-1 Extended Rate Adjustable Securities and $2,500,000 Series 2003B-2 Extendable Rate Adjustable Securities under the Abilene Health Facilities Development Corporation. The proceeds of the bonds were used (i) to construct, furnish and equip certain facilities of the Obligated Group located in Waco and Abilene, Texas, (ii) refinance certain indebtedness of the System, (iii) reimburse the System for certain other capital expenditures relating to project costs of the Garrison facility; (iv) to fund capitalized interest on bond proceeds allocated to Wesley Woods and Wesley Court; (v) to purchase new equipment; (vi) to fund start up and marketing expenses for Wesley Woods and Wesley Court; (vii) to fund a deposit to the debt service reserve fund with respect to the Series 2003 Bonds and (viii) to pay a portion of the costs of issuance of the Series 2003 Bonds. Interest on the 2003A Bonds is payable semi-annually at rates from 5.15% to 7.00%. The 2003A Bonds required annual principal payments and are due in full November 15, 2033. The Series 2003B-1 and 2003B-2 bonds have been fully redeemed.

In 2011, due to the sale of Obligated Group campuses Windcrest and Wesley Woods, the System was required to repay $5,300,000 of the Series 2003 bonds from proceeds received on the sale. At December 31, 2011, $4,270,000 of these funds were held in an escrow account that will be used to redeem these bonds at the next redemption date of April 2013 in conjunction with the issuance of the Series 2013 bonds. Due to the escrow of these funds, these bonds are considered to be defeased.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

Subsequent to year-end, the System discovered an error in the calculation of the allocable portion of the Series 2003A as previously issued. As a result, the System calculated that an additional $1,200,000 of Series 2003A bonds should have been defeased at the time of the sale of Wesley Woods. The System entered into a voluntary closing agreement (VCAP) with the IRS to remedy this technical violation. Within this VCAP, the System has agreed to purchase and cancel $1,200,000 of Series 2003A bonds on the closing date of the 2013 bond financing.

The Series 2003 bonds were issued at a discount of $899,454 which is being amortized on the effective interest method over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011 was approximately $33,500.

(3) On August 1, 1998, the System issued $46,530,000 Series 1998A Retirement Facility Revenue Bonds, $8,095,000 Retirement Facility Revenue Bonds Series 1998B-1 Extended Rate Adjustable Securities, $4,055,000 Taxable Series 1998B-2 Extended Rate Adjustable Securities Retirement Facility Revenue Bonds and $1,435,000 Taxable Series 1998C Retirement Facility Revenue Bonds, under the Abilene Health Facilities Development Corporation. Proceeds of the bonds were used to construct improvements and expansions to certain facilities of the Obligated Group located in Abilene and Amarillo, Texas and to pay the cost of issuance of the bonds and the refinancing and defeasance of the 1996 Bonds. Interest and principal on the 1998 Series Bonds are paid semi-annually at rates from 5.875% to 5.90%. The Series 1998B-1 and 1998B-2 bonds have been fully redeemed.

The Series 1998 bonds were issued at a discount of $307,128 which is being amortized on the effective interest method over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011 was approximately $11,500.

(4) On January 15, 1999, the System issued $13,085,000 Series 1999 Retirement Facility Revenue Bonds under the Abilene Health Facilities Development Corporation. The Series 1999 Bonds are secured equally and ratably by the Series 1999 Note, which is secured by a security interest in the gross revenues of the Obligated Group as supplemented by the Supplemental Indenture date January 1, 1999 between the Obligated Group and the master trustee. Bond proceeds were used to construct improvements and expand certain facilities of the Obligated Group located in Odessa and Abilene, Texas; refinance an existing mortgage; pay capitalized interest on bond proceeds allocated to Windcrest and Parks and purchase new equipment. Interest and principal on the 1999 Series Bonds are paid semi-annually at rates from 5.875% to 6.00%.

The Series 1999 bonds were issued at a discount of $136,568 which is being amortized on the effective interest method over the life of the bonds. Amortization expense for the years ended December 31, 2012 and 2011 was approximately $5,000.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

(5) On December 1, 2011, Garrison entered into a note payable with American State Bank for $9,000,000, separated under three borrower notes. Principal and interest on Series 2011A loan is payable monthly in equal amounts of $40,666. This amount is calculated based on a 300-month amortization at an interest rate of 3.5%. Principal and interest on Series 2011B loan is payable monthly in equal amounts of $10,281. This amount is calculated based on a 60-month amortization at an interest rate of 3.5%. Principal and interest on Series 2011C loan is payable monthly in equal amounts of $6,445. This amount is calculated based on a 60-month amortization and an interest rate equal to the prime rate plus 1%. However, in no event the rate would be less than 4.25% or greater than 7.25% for the series 2011C loan.

The principal and interest payments of these three loans may be adjusted at any time in order to keep the monthly payments consistent with the original amortization period in case of prepayment or a change in interest. Each loan is to mature on October 1, 2016.

(6) On April 10, 2008, Sears Caprock issued $3,275,000 Series 2008A Variable Rate Demand Retirement Facility Revenue Bonds and $4,620,000 Series 2008B Issuer's Variable Rate Demand Retirement Facility Revenue Bonds. The proceeds of the Series 2008A and 2008B were used to finance the acquisition, remodeling and equipping of, Mesa Springs in Abilene, Texas. The bonds were also used to fund additional startup costs and miscellaneous capital expenditures for Mesa Springs.

By, definition, a Variable Rate Demand Bond is a long-term tax-exempt bond the interest rate of which is indexed to a current short-term market rate. The interest rate of the Series 2008A and 2008B bonds for the periods ended December 31, 2012 and 2011 were .41% and .80%, and .42% and .46%, respectively.

In May 2013, the existing reimbursement and credit agreement was amended to extend the maturity of the letter of credit for one year, with a maturity set for April 2014. Under the terms of this agreement, Sears Caprock is to make monthly principal payments of $18,500 beginning May 2013 through maturity in April 2014, at which time all unpaid principal and interest is due. Interest payments are due monthly at an interest rate of 3.00% of unpaid principal based on an interest rate basis of the greater of one-month LIBOR plus 2.50% or 3.00%.

(7) In August 2010, the System issued a note payable in the amount of $15,500,000, and a revolving line of credit agreement with Capital One. The proceeds of these debts were used to refund the Series 1998B-1, 1998B-2, 2003B-1 and 2003B-2 Bonds, as well as replace the revolving line of credit entered into with TMF. The note payable is due in monthly installments of $99,281 based upon an 18-year maturity, and matures in August 2015. The revolving line of credit will lend up to an aggregate amount of $9,000,000 outstanding at any one time to the System under a defined borrowing base. The System will continue to advance amounts for construction of the executive homes at Meadow Lake and Wesley Court, and other site costs under the Line of Credit agreement. The revolving line of credit has interest only payments through maturity in August 2012, which was extended to May 2013, subject to the System's right to extend the line of credit for an additional one-year period, which was enacted.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

These note payable and revolving line of credit are secured by a deed of trust, undeveloped land held in Waco, Texas, and cash collateral of $4,000,000 held by Capital One. According to the note payable and line of credit agreement, interest will accrue on the outstanding balance at a fluctuating rate (Note Rate) that is equal to the Index Rate of one-month LIBOR as published from time to time by Bloomberg, L.P., plus 2.75%. In no event shall the Note Rate be lower than 3.75% (Floor Rate). The Note Rate will be adjusted two business days prior to the following calendar month and be effective for the following calendar month. If the Index Rate of one-month LIBOR is no longer available, Lender will choose a new index which is based upon comparable information.

In addition, the System entered into an interest rate swap agreement with Capital One for the $15,500,000 note payable notional amount to convert the variable interest rate to a fixed rate of 1.5%. The maturity date of this interest rate swap agreement is October 1, 2013 (see Note 7).

The note payable, line of credit agreement and interest rate swap agreement were terminated with the issuance of the Series 2013 bonds in May 2013. All amounts due for these obligations were satisfied on or before the closing date of May 9, 2013.

(8) Effective April 10, 2008, Sears Caprock acquired the assets of Mesa Springs. In consideration for the assets of Mesa Springs, Sears Caprock paid the seller $5,600,000 which was financed through the issuance of Series 2008A Revenue Bonds.

Mesa Springs has 16 executive homes. Prior to the purchase of Mesa Springs by Sears Caprock, Mesa Springs had been gifted twelve of these residential executive independent living homes (the Gifted Homes). As part of the asset purchase agreement, Caprock agreed to pay the seller 50% of the proceeds of any initial sale or transaction where a deposit is generated or received involving any of the twelve Gifted Homes and 50% of the increase in the amount of the refundable portion of any new deposits collected over the amount of the refundable portion of the previous deposit (the Appreciated Value) in any sale or other transaction (a Resale) where a deposit is generated or received involving the remaining four non-gifted executive homes at any time within seven years after the closing date of the sale of Mesa Springs to Sears Caprock up to a maximum of one million three hundred thousand dollars ($1,300,000) or a minimum of eight hundred thousand dollars ($800,000) (Deferred Purchase Price Payment).

This Deferred Purchase Price Payment is payable in installments equal to 50% of the sales proceeds of the initial sale of a Gifted Home or, if applicable, 50% of the appreciated value resulting from a resale of a non-gifted home payable promptly upon closing of such sale or other transaction at any time within the seven-year period after the closing date. If the aggregate amount of $800,000 has not been paid within the seven-year period, then on the seventh anniversary of the closing date, a final installment shall be payable equal to the $800,000 less the amount of all such prior installments of the deferred purchase price payment that have been paid prior to the seventh year anniversary date.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

During 2008, $800,000 was recorded as a note payable on the balance sheet and the timing of payment is contingent upon the future sale and resale of the gifted and non-gifted executive homes. The remaining amount potentially due to a maximum of $1,300,000 is contingent upon the same factors and currently has not been recorded as a liability. Management will evaluate annually over the seven years their liability based on annual occurrences surrounding the homes and adjust the balance due to seller accordingly, as well as adjust the purchase price of the buildings on the balance sheet.

During 2012, the System did not sell any Gifted Homes. During 2011, the System sold Gifted Homes and paid the seller $125,000. The balance of the contingent liability as of December 31, 2012 and 2011 was $465,000 and $465,000, respectively.

Under terms of the bond indentures the System is required to maintain certain deposits with the respective trustees that are recorded as assets limited as to use on the consolidated balance sheets of the System.

Substantially all of the System's property, equipment and assets are pledged as collateral for the above the bonds.

Scheduled principal payments on long-term debt are as follows:

Year Ending December 31,	Amount
2013	$ 51,360,240
2014	7,843,202
2015	43,372
2016	36,555
2017	1,498,356
Thereafter	95,242,727
Subtotal	156,024,452
Less: Current Maturities on Long-Term Debt	(51,360,240)
Less: Unamortized Discount on Revenue Bonds	(1,670,040)
Total Long-Term Debt	$ 102,994,172

Obligated Group Refinancing- May 2013

In May 2013, the Obligated Group entered into a tender and exchange agreement for the remaining par value of the Series 1998, 1999 and 2003 bonds. As part of this tender and exchange program, the Obligated Group successfully exchanged $69,130,000 of the existing $73,095,000 Series 1998, 1999 and 2003 bonds. The remaining $3,965,000 of bonds remained outstanding and payable under the existing terms of the Series 1998, 1999 and 2003 bonds. For those bonds of $69,130,000 that were tendered, these bonds were exchanged for the Series 2013A and 2013D bonds issued through the Red River Health Facilities Development Corporation with interest rates ranging from 5.00% to 6.05% and are due in semi-annual interest payments through maturity in November 2046, and annual principal sinking fund payments beginning November 2017 through maturity in November 2046.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Obligated Group Refinancing- May 2013 (Continued)

In addition, in May 2013, the Obligated Group issued $22,455,000 Series 2013B, 2013C and 2013D bonds through the Red River Health Facilities Development Corporation for the purpose of (1) redeeming the Series 2003 bonds as required through the VCAP noted above; (2) refinancing the existing Capital One notes payable as included in the table above; (3) repaying the existing accrued interest on the exchanged bonds; (4) providing capital for future capital expenditures; (5) funding costs of issuance, and (6) establishing a debt service reserve and operating reserve fund. As part of this transaction, $4 million of funds held as security on the Capital One notes payable were released and included as additional equity from the Obligated Group to complete this transaction. These bonds carry an interest rate ranging from 6.05% to 6.25% and are due in semi-annual interest payments through maturity in November 2053, and annual principal sinking fund payments beginning November 2017 through maturity in November 2053.

In connection with the $22,455,000 Red River Health Facilities Development Corporation Series 2013 bonds noted above, the Obligated Group also issued a $3,500,000 taxable fixed rate note with Texas Methodist Foundation (TMF). This note carries an interest rate of 5% and due in monthly principal and interest payments from July 2013 through maturity in December 2017. This note is secured by certain assets of the Obligated Group that are not currently part of the collateral securing the Series 2013 bonds, and a $1.5 million letter of credit issued as credit support from Life Care Services (LCS).

The Obligated Group will reimburse LCS for the fees incurred in connection with this letter of credit, and if any advance is made on the letter of credit, the Obligated Group will be required to repay such advance from its available excess available cash as defined in the credit support agreement between LCS and the Obligated Group. In addition, if no advance on the letter of credit is outstanding, then the Obligated Group will be required to use all excess cash available to make principal payments until this TMF loan is repaid in full.

Due to the tender and exchange of the Series 1998, 1999 and 2003 bonds, as well as the refinancing of the Capital One note payable, the Obligated Group recognized a loss on refinancing of approximately $2.3 million in May 2013.

Restricted Covenants-Obligated Group

The provisions of the debt agreements of the bonds payable described above contain various restrictive covenants that limit the occurrence of additional debt, place restrictions on the disposition of property and require that certain measures of financial performance be satisfied as long as the bonds are outstanding. As noted above, the Obligated Group was in default of certain financial covenants included in the master trust indenture related to these Obligated Group bonds as of December 31, 2012 and 2011, and is in payment default on these Obligated Group bonds as the Obligated Group did not make the required bond payment due on May 1, 2012 and November 1, 2012. As discussed above, in May 2013 the Obligated Group restructured the outstanding debt. Based upon the restructuring of the debt completed in May 2013, the debt is classified as non-current.

NOTE 6 LONG-TERM DEBT (CONTINUED)

Restricted Covenants-Series 2009 and 2011 Bonds

The provisions of the trust indenture for the Series 2009 Bonds require that certain financial covenants are required at the earlier of stable occupancy or the year ended December 31, 2013. As of December 31, 2012 and 2011, the Master Trust Indenture has a marketing covenant based on a number of reserved independent living apartments and the occupancy level of independent units. At December 31, 2012 and 2011, Sears Tyler was not in compliance with the covenant related to number of depositors. In addition, Sears Tyler is in an event of default in relation to the trust indenture of these bonds as Sears Tyler did not make the required bond payments due on May 1, 2012 and November 1, 2012.

NOTE 7 DERIVATIVES

The System entered into an interest rate swap agreement for the purpose of aligning its over-all exposure to interest rate fluctuations and the effect these changes in interest rates have on interest income and interest expense. The System does not enter into derivative instruments for any purpose other than risk management purposes. The derivative financial instruments expose the System to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of the derivative contract is positive, the counterparty owed the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty and therefore does not possess credit risk. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of the System's derivative positions in the context of its total blended cost of capital. The swap agreements were not designated as hedging instruments.

To balance the exposure, and to improve the net financial margin between the interest income and the interest expense rates, the following swap was in effect as of December 31, 2012:

Instrument Type	Notional Amount	Maturity Date	Rate Paid	Rate Received
Interest Rate Swap	$ 14,154,713	October 1, 2013	1.15%	LIBOR

The fair value of derivative instruments is as follows:

	Balance Sheet Location	December 31, 2012	December 31, 2011
Liabilities Derivative:			
Derivatives Not Designated as Hedging Instruments	Other Liabilities	$ 97,488	$ 160,766

NOTE 7 DERIVATIVES (CONTINUED)

The effects of derivative instruments on the consolidated statements of operations are as follows:

	Location of Loss Recognized in Excess (Deficit) of Revenue Over Expense on Derivatives	Amount of Loss Recognized in Excess (Deficit) of Revenue Over Expense on Derivatives Year Ended December 31,	
		2012	2011
Derivatives Not Designated as Hedging Instruments	Interest Rate Swap market adjustment	$ 63,278	$ (110,797)

Derivative transactions contain credit risk in the event parties are unable to meet the terms of the contract, which is generally limited to the fair value due from counterparties on outstanding contracts.

NOTE 8 OTHER LIABILITIES

Included in other liabilities at December 31, 2012 and 2011 is $7,899,892 of funds received from the draw down on the tax credit exchange program, recapture mortgage by the Partnership to pay for the construction project to renovate the Canyons. The maximum amount of funds available under this agreement is $7,899,892 (the Subaward). The exchange program under which these funds are eligible is from the Federal Housing Tax Credit Exchange Program under Title XII of the American Recovery and Reinvestment Act of 2009. These funds are not required to be repaid unless an event of recapture occurs, as specified in the agreement. The recapture amount shall be equal to the full amount of the Subaward, less 6.67% for each full calendar year of the compliance period in which a recapture event has not occurred. The agreement is secured by the portion of the Mortgaged Property. Under the terms of this agreement, the funds are being amortized over a period of 40 years to coincide with the duration of the compliance period for this project. At December 31, 2012 and 2011, the net unamortized balance of this liability was $7,702,395 and $7,899,892, respectively.

Also included in other liabilities at December 31, 2012 and 2011 is $272,333 of funds received from a grant with the City of Amarillo, Texas, which were used to fund the construction project. The maximum amount available under this grant is $272,333. These funds are not required to be repaid unless one of the objectives as noted in the agreement is not attained for a period of 20 years. This agreement is unsecured.

NOTE 9 HUD CAPITAL ADVANCE

Desert Haven received a capital advance note from HUD in the amount of $1,942,600. The note bears no interest and payment is not required as long as the housing remains available for low-income elderly persons. The note will be forgiven at its maturity date of September 1, 2037, if the housing facility remains available for occupancy by eligible families until that date. Otherwise, the entire amount, plus interest at 7% since October 9, 1996, will be declared due and payable to HUD. The note is secured by all property owned by Desert Haven and all related receipts attributed to its operations. The capital advance is carried in temporarily restricted net assets.

NOTE 10 FAIR VALUE MEASUREMENTS

The System uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how the System measures fair value refer to Note 1 – Summary of Significant Accounting Principles.

The following tables present the fair value hierarchy for the balances of the assets and liabilities of the Company measured at fair value on a recurring basis as of December 31, 2012 and 2011:

	2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Assets Limited as to Use:				
Fixed Income Securities	$ 316,522	$ -	$ -	$ 316,522
Funds Held by Texas Methodist Foundation	-	-	1,733,732	1,733,732
Guaranteed Investment Contracts	-	2,498,441	-	2,498,441
Other Assets:				
Equity Securities	-	-	-	-
Total Assets Measured at Fair Value	$ 316,522	$ 2,498,441	$ 1,733,732	$ 4,548,695
Liabilities:				
Interest Rate Swap Agreement	$ -	$ 97,488	$ -	$ 97,488

	2011			
	Level 1	Level 2	Level 3	Total
Assets:				
Assets Limited as to Use:				
Equities	$ 526,788	$ -	$ -	$ 526,788
Fixed Income Securities	4,280,310	-	-	4,280,310
Funds Held by Texas Methodist Foundation	-	-	1,019,373	1,019,373
Guaranteed Investment Contracts		5,227,178		5,227,178
Other Assets:				-
Equity Securities	429,555	-	-	429,555
Total Assets Measured at Fair Value	$ 5,236,653	$ 5,227,178	$ 1,019,373	$ 11,483,204
Liabilities:				
Interest Rate Swap Agreement	$ -	$ 160,766	$ -	$ 160,766

NOTE 10 FAIR VALUE MEASUREMENTS (CONTINUED)

Investments are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasure and other U.S. governmental and agency mortgage-based securities that are traded by dealers or brokers in active over-the-counter markets. Securities valued using Level 2 inputs include private collateralized obligations, municipal bonds, and corporate debt securities. Level 3 inputs include those without a readily determinable market input.

Quoted market prices are available and used for exchange-traded derivatives, such as certain interest rate futures and option contracts; such derivatives are classified as using Level 1 inputs. However, substantially all of our derivatives are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, fair values are determined using internally developed models that are primarily market observable inputs, such as yield curves and option volatilities and, accordingly, are classified as using Level 2 inputs.

The following table provides a summary of changes to fair value of the System's Level 3 financial assets for the years ended December 31, 2012 and 2011.

Balance at January 1, 2011	$ 3,500,583
Transfer of Net Assets to Financial Institution	(2,481,210)
Balance at December 31, 2011	1,019,373
Transfer of Net Assets from Financial Institution	714,359
Balance at December 31, 2012	$ 1,733,732

Funds held by TMF are pooled equity investment funds which are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, if available. Unrealized gain (loss) and other investment earnings are allocated among the members of the pool on a monthly basis based on percentage of ownership. The System values the pooled investment funds using Level 3 inputs as there is no active market for the System to sell their interest in the pooled investment funds.

The following table presents the fair value hierarchy for the balances of assets and liabilities of the System measured at fair value on a non-recurring basis as of December 31, 2012. The System did not measure any assets or liabilities on a non-recurring basis for the year ended December 31, 2011.

Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis

	Level 1	Level 2	Level 3	Total
Assets:				
Assets Limited as to Use:				
Restricted Land	$ -	$ -	$ 1,830,000	$ 1,830,000

NOTE 10 FAIR VALUE MEASUREMENTS (CONTINUED)

In accordance with the provisions of the standards for impairment or disposal of long-lived asset, long-lived assets held and used with a carrying value of $4,100,000 was written down to the fair value of $1,830,000 at December 31, 2012, resulting impairment charges of $2,270,000 for the year ended December 31, 2012.

The System considers the need for impairment on its facilities annually. Potentially impaired long-lived assets are identified by those with negative cash flow from operations, and those to be sold at a fair value below its carrying value. If the long-lived asset's fair value is below its carrying value, and impairment loss is recognized. The impairment loss recognized in 2012 was based upon an appraisal received of the land below its carrying amount.

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:

HUD Capital Advances

The fair value of the HUD capital advance is estimated based upon the remaining term of the advance and current rates for similar instruments.

Long-Term Debt

The fair value of long-term debt is estimated for each individual issue based upon current reasonable interest rates taking type of debt and maturities into account.

All Other

The carrying value is a reasonable estimate of the fair value for all other financial instruments due to the short-term nature of those financial instruments.

The following disclosures represent financial instruments in which the ending balances at December 31, 2012 and 2011 are not carried at fair value in their entirety on the consolidated balance sheets.

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
HUD Capital Advances	$ 1,942,600	$ 2,475,798	$ 1,942,600	$ 2,764,361
Long-Term Debt Fixed	$ 117,368,907	$ 84,943,588	$ 121,067,331	$ 102,588,950
Long-Term Debt Variable	$ 7,415,000	$ 7,415,000	$ 7,545,000	$ 7,545,000
Notes Payable and Capital Lease Obligations	$ 31,240,545	$ 31,240,545	$ 33,834,823	$ 33,834,823

NOTE 11 RETIREMENT PLANS

Non-Qualified Retirement Plans

The System has entered into a deferred compensation contract with a certain officer to provide benefits after retirement or the attainment of age 65. The present value of these benefits is recognized in accrued liabilities over the service life of the officer. The deferred compensation liability related to this contract as of December 31, 2012 and 2011 was approximately $115,000 and $109,000, respectively. Employee benefit expense related to this agreement was $5,692 and $6,146 for the years ended December 31, 2012 and 2011, respectively.

The System provides a 457(f) plan for the benefit of selected executives. The assets of the 457(f) plan totaled $832,565 and $711,524 at December 31, 2012 and 2011, respectively. The System contributed $161,512 and $203,515 for the years ended December 31, 2012 and 2011, respectively. The plan assets are included in assets limited as to use with a corresponding liability in other liabilities in the consolidated balance sheets.

Qualified Retirement Plans

The System also sponsors a defined contribution 403(b) plan available to substantially all employees with the exception of those employed by SDI, a for profit corporation. The System currently does not match employee contributions.

The System sponsors a defined contribution 401(k) plan for the employees of SDI. All employees of SDI are eligible to enter the plan upon employment. An employee may participate by contributing, at their election, a percentage of their salary within IRS regulations. The System currently does not match employee contributions.

NOTE 12 CONCENTRATION OF CREDIT RISK

The System's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and temporary cash investments. The System believes it places its cash and cash equivalents and temporary cash investments with high quality credit institutions. At times such investments may be in excess of the FDIC insurance limit.

The System grants credit without collateral to its various facility residents or their families, most of whom are local individuals and are insured under third-party payor agreements. The mix of receivables from residents and third-party payors was as follows at December 31, 2012 and 2011:

	2012	2011
Medicaid	7.1 %	5.0 %
Medicare	24.8	29.8
Private and Insurance	20.4	22.5
Veterans Land Board of Texas	47.7	42.7
Total	100.0 %	100.0 %

NOTE 13 NET ASSET CLASSIFICATIONS

Temporarily Restricted Net Assets

Temporarily Restricted Net Assets consist of amounts restricted for benevolent care, Alzheimer's care, HUD capital advance and miscellaneous operational purposes as noted in the table below:

	2012	2011
Capital Advance Note from HUD to Desert Haven (see Note 9)	$ 1,942,600	$ 1,942,600
Funds Held by the Foundation for the following:		
Benevolent Care, Alzheimer's Research, and Other Alzheimer's Care at Garrison	-	839,954
Total Temporarily Restricted Net Assets	$ 1,942,600	$ 2,782,554

Net assets released from restriction for operations of $839,954 and $27,812 consists of proceeds from contributions that were used for the donor imposed restricted purpose during the years ended December 31, 2012 and 2011, respectively.

Permanently Restricted Net Assets

Permanently restricted net assets at December 31, 2012 and 2011 consist of investments providing a permanent source of income for capital, equipment, patient care and other operating purposes as follows:

	2012	2011
Garrison Permanent Endowment	$ 500,000	$ 500,000
Holbert Endowment	100,000	100,000
Benevolent Endowment	1,024,774	1,024,774
Parks Methodist Endowment	142,661	142,661
Total Permanently Restricted Net Assets	$ 1,767,435	$ 1,767,435

NOTE 13 NET ASSET CLASSIFICATIONS (CONTINUED)

Permanently Restricted Net Assets (Continued)

Changes in endowment net assets during the years ended December 31, 2012 and 2011 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets December 31, 2010	$ (5,121)	$ -	$ 1,767,435	$ 1,762,314
Interest Income	-	39,765	-	39,765
Appropriation of Endowment Assets for Expenditure	-	(39,765)	-	(39,765)
Endowment Net Assets December 31, 2011	(5,121)	-	1,767,435	1,762,314
Interest Income	-	35,246	-	35,246
Appropriation of Endowment Assets for Expenditure	-	(35,246)	-	(35,246)
Endowment Net Assets, December 31, 2012	$ (5,121)	$ -	$ 1,767,435	$ 1,762,314

As required by GAAP, net assets associated with endowment funds, including those designated by the board of directors as to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The State of Texas adopted State Prudent Management of Institutional Funds Act (the Act) effective July 1, 2007. The Board of Directors of the System has interpreted the Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the System classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

NOTE 13 NET ASSET CLASSIFICATIONS (CONTINUED)

Interpretation of Relevant Law (Continued)

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed in the Act. In accordance with the Act, the System considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Organization
- The investment policies of the Organization

Return Objectives and Risk Parameters

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment. Endowment assets include those assets of donor-restricted funds that the System must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to preserve and grow capital, strive for consistent absolute returns, preserve purchasing power by striving for long-term returns which either match or exceed the set payout, fees and inflation without putting the principal value at imprudent risk, and diversify investments consistent with commonly accepted industry standard to minimize the risk of large losses.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation that meets the System’s long-term rate-of-return objectives while avoiding undue risk from imprudent concentration in any single asset class or investment vehicle.

Spending Policy

The System’s spending policy is consistent with its objective of preservation of the fair value of the original gift of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment return.

NOTE 14 CAPTIVE INSURANCE

The System had a claim made policy for its general and professional liability insurance through Caring Communities Insurance Company (CCIC). The System was required to make a capital contribution of $336,445 at inception of the insurance policy. The System made subsequent capital contributions of $345,492 from 2003 through 2008. The capital contributions are recorded as an investment at December 31, 2012 and 2011, using the cost basis, which is included in other long-term investments as of December 31, 2012 and 2011. The System also paid annual amounts to CCIC for their professional liability insurance coverage. The policy includes professional, commercial, and employee benefits liability and calls for a $75,000 deductible per occurrence and liability limits of $1,000,000 per occurrence and $3,000,000 in the aggregate. This captive program covered all campuses except for the three Land Board homes, which had a standard policy with another insurance program.

Effective July 1, 2011, the System terminated its contract with CCIC and created a wholly owned captive insurance program called Southwest Assurance Company, Ltd. (SWAC), which provides general and professional liability insurance coverage for the System and its subsidiary companies. Effective July 1, 2011, SWAC issued a primary claims made healthcare facilities general and professional and employee benefits liability insurance policy which provides direct insurance. The limits of the general and professional and employee benefits liability policy are $250,000 each claim / $500,000 per policy aggregate. In addition, SWAC issued an excess liability policy which is 100% reinsured by a third party. The limits of this policy are $1,000,000 per occurrence, $3,000,000 per aggregate per location and $10,000,000 per policy aggregate.

Insurance expense under these programs amounted to $978,000 and $937,000 for the years ended December 31, 2012 and 2011, respectively.

NOTE 15 CONTINGENT LIABILITIES

Government Regulations - Medicaid

The THHSC reserves the right to perform field audit examinations of the System's records. Any adjustments resulting from such examinations could retroactively adjust Medicaid revenue.

Government Regulations - Medicare

The Medicare intermediary has the authority to audit the skilled nursing facility's records any time within a three-year period after the date the skilled nursing facility receives a final notice of program reimbursement for each cost reporting period. Any adjustments resulting from these audits could retroactively adjust Medicare revenue.

Workers' Compensation Insurance and Health Insurance

The System is a non-subscriber to workers' compensation. Claims paid for employee injuries approximated $66,000and $154,000 for the years ended December 31, 2012 and 2011, respectively. No liabilities have been accrued for potential claims at December 31, 2012 and 2011.

NOTE 15 CONTINGENT LIABILITIES (CONTINUED)

Workers' Compensation Insurance and Health Insurance (Continued)

Health insurance claims paid during the years ended December 31, 2012 and 2011 approximated $2,493,000 and $4,119,000, respectively, and a liability of approximately $645,600 and $861,000 has been recorded for outstanding unpaid claims at December 31, 2012 and 2011, respectively.

The first $150,000 of covered health insurance claims for each individual participant is the responsibility of the System. If total claims for an individual exceed $150,000, the System will be reimbursed by the insurance provider up to a maximum of $800,000 per individual participant.

Litigation

The System is subject to asserted and unasserted claims encountered in the normal course of business. The System's Management and legal counsel assess such contingent liabilities and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the System or unasserted claims that may result in such proceedings, the System's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein. In the opinion of management, disposition of these matters will not have a material effect on the System's financial condition or results of operations.

Health Care

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for resident services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Professional Services Agreement

Effective July 1, 2009, Sears Tyler entered into professional services agreement (the Services Agreement) with the System. The Services Agreement calls for the System to provide centralized management services in the areas of accounting, budgeting, cash management, payroll, purchasing, long range planning and fund raising as well as negotiate with vendors and suppliers on Sears Tyler's behalf. The term of the Service Agreement is five years and will renew annually unless directed otherwise by the board of directors. The System will not begin charging Sears Tyler a management fee for these services until after December 31, 2013, at which time the fee will be based upon census level, net revenue and other operational factors.

NOTE 15 CONTINGENT LIABILITIES (CONTINUED)

Management Services Agreement

Subsequent to year-end, the System entered into two management services agreements with LCS for day-to-day management. There is an agreement with the Obligated Group of entities within the System and another agreement with the entities outside the Obligated Group. The agreements do not cover the Foundation, SLAI or SWAC. The terms of the agreements are for five years from the execution of the agreement, unless terminated sooner pursuant to the agreement. The aggregate base management fee is $900,000 for the year ending December 31, 2013 (prorated from effective date of agreement), $1,691,000 for the year ending December 31, 2014, and adjusted annually thereafter based upon the increase in the CPI-U index.

In addition, LCS may earn an incentive fee to the extent the audited cash operating expenses are less than the amount contained in the five-year forecast as provided by SMRS. The incentive fee is calculated for each agreement separately. The incentive fee that may be paid to LCS is equal to a maximum of $1,150,000 for the year first of the agreement (prorated from the effective date of agreement), and $809,000 each year thereafter, based upon the audited results of the System. As part of this overall incentive fee, LCS may earn up to $350,000 in 2013 and 2014 if Sears Tyler exceeds a debt service coverage ratio of 1.15 and the marketing and minimum liquidity requirements in accordance with the Series 2009 and Series 2011 bond documents.

Additional fees paid to LCS as a part of the management agreement include an application service provider fee for use of LCS' marketing, sales, accounting, billing, payroll and dashboard technology. The application service fee consists of an installation / activation fee of $500,000 to be paid in equal annual installments of $100,000 over a five-year period, and an annual maintenance fee of $190,988 (contract amended on November 14, 2013), which is adjusted annually for inflation.

NOTE 16 COMMITMENTS

The System has entered into operating lease commitments for the lease of corporate office facilities and various equipment. The following minimum rental payments are to be incurred under operating leases for the years ending December 31:

Year Ending December 31,	Amount
2013	$ 380,893
2014	310,974
2015	162,980
2016	32,493
2017	8,106
Total	$ 895,446

NOTE 17 RELATED PARTY TRANSACTIONS

The System and its subsidiaries share office facilities and perform services for one another. All inter-company revenue and expense is eliminated upon consolidation.

NOTE 18 INCOME TAXES

SDI files a Federal income tax return on a calendar year basis. The provision for income taxes consisted of the following for the years ended December 31, 2012 and 2011:

	2012	2011
Deferred Tax Expense	$ 652,431	$ 40,803

The income tax provision differs from the amount of income tax determined by applying the U.S. Federal income tax rate to pretax income for the years ended December 31, 2012 and 2011:

	2012	2011
Computed "Expected" Tax Expense (Benefit)	$ 649,153	$ 38,186
Increase in Income Taxes Resulting from Permanent Differences	3,278	2,617
Net Tax Expense	$ 652,431	$ 40,803

The components of the net deferred tax asset included in the consolidated balance sheets were as follows at December 31, 2012 and 2011:

	2012	2011
Deferred Tax Asset	$ 987,193	$ 570,031
Valuation Allowance	(987,193)	-
Net Deferred Tax Asset	$ -	$ 570,031

The tax effects of each type of significant item that gave rise to deferred taxes are as follows at December 31, 2012 and 2011:

	2012	2011
Accrued Vacation	$ 73,397	$ 77,414
Allowance for Uncollectible Accounts	9,587	33,379
Prepaid Expenses	(3,526)	(18,565)
Net Operating Loss Carryforward	893,153	463,378
AMT Credit Carryover	14,582	14,425
Net Deferred Tax Asset	$ 987,193	$ 570,031

As of December 31, 2012, management determined that an allowance for the deferred tax asset was necessary.

NOTE 18 INCOME TAXES (CONTINUED)

SDI's income tax returns are subject to review and examination by federal authorities. The tax returns for the years 2009 to 2012 are open to examination by federal authorities.

NOTE 19 FUNCTIONAL CLASSIFICATION OF EXPENSES

Functional classification of expenses for the years ended December 31, 2012 and 2011 consisted of the following:

	2012	2011
Program	$ 64,904,027	$ 65,787,775
Management and General Support	18,306,264	14,376,216
Total Operating Expenses	$ 83,210,291	$ 80,163,991

Salaries and related expenses are allocated based on job descriptions and the best estimates of Management. Expenses, other than salaries and related expenses, which are not directly identifiable by program or supporting services, are allocated based on the best estimates of management.

NOTE 20 FUTURE ACCOUNTING AND REPORTING REQUIREMENTS

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-01, *Health Care Entities: Continuing Care Retirement Communities – Refundable Advance Fees*. The amendments in this ASU clarify that an entity should classify an advance fee as deferred revenue when a CCRC has a resident contract that provides for payment of the refundable advance fee upon re-occupancy by a subsequent resident, which is limited to the proceeds of re-occupancy by a subsequent resident. The amendments also clarify that refundable advance fees that are contingent upon re-occupancy by a subsequent resident but are not limited to the proceeds of re-occupancy should be accounted for and reported as a liability.

The amendments in the ASU are effective for fiscal periods beginning after December 31, 2012 for public entities, and beginning after December 15, 2013 for non public entities, as defined, with early adoption permitted. Therefore the amendments will be effective for our financial statements for the year ending December 31, 2013. The adoption of the amendment is expected to result in an adjustment decreasing net assets and increasing the liability for refundable fees by approximately $5,800,000 based on our estimate as of December 31, 2012. Income from amortization of deferred revenue arising from entrance fees would be reduced by approximately $1,100,000 based upon our estimate for the year ended December 31, 2012.

NOTE 21 CURRENT OPERATING ENVIRONMENT

The accompanying consolidated financial statements have been prepared in conformity with GAAP, which contemplate continuation of the System as a going concern. However, the System has sustained operating losses in 2012 and 2011 from the slow fill up of Sear's Tyler health center and independent living units, which have resulted in a lack of liquidity that causes concerns regarding the System's ability to cover its on-going operating costs and debt service. In addition, the Obligated Group, Sears Tyler and Garrison were in default on their bond payments or covenants as of December 31, 2012. Further, at December 31, 2012, current liabilities exceed current assets by approximately $45,715,000 due to the classification of long-term debt as a current liability from the bond default matters noted above, and total liabilities exceed total assets by approximately $27,744,000.

In view of these matters, realization of a major portion of the assets in the accompanying consolidated balance sheet is dependent upon continued operations of the System, which in turn is dependent upon the System's ability to meet its financing requirements, and the success of its future operations. Management is thoroughly reviewing its current operating results and is in the process of making the necessary changes. In addition, management has engaged a management consultant to review the operations and market of the System to offer recommendations for operating improvements. Management believes that actions presently being taken to revise the company's operating and financial requirements provide the opportunity for the company to continue as a going concern. Also, management is in the process of negotiating a forbearance agreement with the existing bondholders. Management anticipate the terms of the forbearance agreement will include lowering the interest rates on the Series 2009 and Series 2011 bonds, deferring principal payments on the Series 2009 and 2011 bonds for a period of time, and modifying the debt service coverage ratio requirements. Management anticipates a finalized forbearance agreement or other financing agreement will be entered into in 2014.

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc.	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Sears Permian Retirement Corporation	Sears Brazos Retirement Corporation	Odessa Methodist Housing, Inc.
ASSETS							
CURRENT ASSETS							
Cash and Cash Equivalents	$ 4,374,824	$ 5,351,781	$ (2,639,287)	$ (1,035,430)	$ (5,791,091)	$ (3,709)	$ 11,920
Accounts Receivable, Net	155,247	-	283,692	671,144	594,642	-	1,138
Due from Related Party	1,057,938	(344)	106,506	-	901	-	(33,358)
Current Portion of Assets Limited as to Use	600,571	2,100,059	384,082	9,970	11,667	-	9,383
Other Current Assets	235,920	29,249	27,558	62,536	23,710	-	802
Total Current Assets	6,424,500	7,480,745	(1,837,449)	(291,780)	(5,160,171)	(3,709)	(10,115)
ASSETS LIMITED AS TO USE	6,356,490	3,597,435	-	-	-	-	23,203
PROPERTY AND EQUIPMENT, NET	1,900,358	-	28,927,751	25,812,226	11,254,192	-	1,151,870
OTHER ASSETS							
Deferred Financing Costs	2,189,419	-	-	-	-	-	-
Deferred Marketing Costs	-	-	-	-	-	-	-
Other Investments	681,937	-	-	-	-	-	-
Investment in Sears Methodist Foundation	11,143,842	-	735,757	1,354,327	2,419,110	100	60
Investment in Southwest Assurance Co., Ltd.	300,000	-	-	-	-	-	-
Note Receivable from Related Party	-	2,184,700	-	-	-	-	-
Other Assets	1,033,201	241,422	-	-	50,000	-	-
Total Other Assets	15,348,399	2,426,122	735,757	1,354,327	2,469,110	100	60
Total Assets	$ 30,029,747	$ 13,504,302	$ 27,826,059	$ 26,874,773	$ 8,563,131	$ (3,609)	$ 1,165,018
LIABILITIES AND NET ASSETS (DEFICIT)							
CURRENT LIABILITIES							
Current Maturities of Long-Term Debt	$ 97,716	$ -	$ -	$ -	$ -	$ -	$ -
Accounts Payable	393,307	2,638	197,380	303,608	586,176	767	3,478
Construction Payable	-	-	-	-	-	-	-
Accrued Expenses	2,015,262	38,516	327,922	252,325	224,610	-	1,922
Deferred Revenue	141,666	-	384,082	-	-	-	-
Resident Security Deposits	-	-	136,812	73,525	30,584	-	9,382
Total Current Liabilities	2,647,951	41,154	1,046,196	629,458	841,370	767	14,782
LONG-TERM DEBT (Net of Current Maturities Shown Above)	93,832,789	-	300,429	-	-	-	-
OTHER LIABILITIES							
Deferred Revenue from Residency Fees	-	-	9,260,274	6,153,626	2,655,331	-	-
Entrance Fee Deposits	-	-	-	-	-	-	-
Note Payable to Related Party	-	-	-	-	-	-	-
Deferred Compensation	947,614	-	-	-	-	-	-
Charitable Gift Annuities Payable	-	138,736	-	-	-	-	-
Interest Rate Swap Agreement	97,488	-	-	-	-	-	-
Other Liabilities	-	-	-	-	-	-	-
Total Other Liabilities	1,045,102	138,736	9,260,274	6,153,626	2,655,331	-	-
Total Liabilities	97,525,842	179,890	10,606,899	6,783,084	3,496,701	767	14,782
CONTINGENCIES AND COMMITMENTS							
NET ASSETS (DEFICIT)							
Unrestricted:							
Unrestricted	(67,496,095)	11,556,977	17,219,160	20,091,689	5,066,430	(4,376)	(792,364)
Noncontrolling Interest	-	-	-	-	-	-	-
Total Unrestricted	(67,496,095)	11,556,977	17,219,160	20,091,689	5,066,430	(4,376)	(792,364)
Temporarily Restricted	-	-	-	-	-	-	1,942,600
Permanently Restricted	-	1,767,435	-	-	-	-	-
Retained Earnings (Deficit)	-	-	-	-	-	-	-
Total Net Assets (Deficit)	(67,496,095)	13,324,412	17,219,160	20,091,689	5,066,430	(4,376)	1,150,236
Total Liabilities and Net Assets (Deficit)	$ 30,029,747	$ 13,504,302	$ 27,826,059	$ 26,874,773	$ 8,563,131	$ (3,609)	$ 1,165,018

Senior Dimensions Inc.	Sears Plains Retirement Corporation	Sears Tyler Methodist Retirement Corporation	Sears Caprock Retirement Corporation	Canyons Senior Living L.P.	Senior Living Assurance, Inc.	Southwest Assurance Company, Ltd.	Texas Senior Management, Inc.	Eliminating Entries	Total
$ 600	$ 487,248	$ 82,689	$ 338,828	$ 51,069	$ 20	$ 864,354	$ -	$ -	$ 2,093,816
3,235,040	495,966	396,900	537,782	34,772	-	500,900	-	(165,385)	6,741,838
69,007	(595,168)	69,483	(467,511)	(42,714)	(101,300)	-	(60,800)	(2,640)	-
264,073	4,713	2,446,582	328,281	69,769	-	-	-	-	6,229,150
31,607	28,298	35,919	38,082	20,803	-	587,489	-	-	1,121,973
3,600,327	421,057	3,031,573	775,462	133,699	(101,280)	1,952,743	(60,800)	(168,025)	16,186,777
-	-	-	-	131,179	-	-	-	-	10,108,307
185,626	9,486,924	50,145,294	8,580,660	12,515,138	-	-	-	(1,606,500)	148,353,539
-	335,243	2,136,489	323,441	255,804	21,300	-	-	-	5,261,696
-	-	2,091,731	-	-	-	-	-	-	2,091,731
-	-	-	-	-	-	-	-	-	681,937
-	1,588,544	23,861	1,702	1,800	-	-	-	(17,269,103)	-
-	-	-	-	-	-	-	-	(300,000)	-
-	-	-	-	-	-	-	-	(2,184,700)	-
-	-	-	-	3,000	-	-	-	-	1,327,623
-	1,923,787	4,252,081	325,143	260,604	21,300	-	-	(19,753,803)	9,362,987
$ 3,785,953	$ 11,831,768	$ 57,428,948	$ 9,681,265	$ 13,040,620	$ (79,980)	$ 1,952,743	$ (60,800)	$ (21,528,328)	$ 184,011,610
$ 24,696	$ 8,622,136	$ 42,184,443	$ 399,607	$ 31,642	$ -	$ -	$ -	$ -	$ 51,360,240
695,255	225,392	248,176	149,398	100,795	510	69,675	-	(170,395)	2,806,160
-	-	-	-	167,835	-	-	-	-	167,835
1,265,662	219,046	547,028	174,616	65,937	2,910	1,601,350	-	-	6,737,106
-	-	-	-	-	-	-	-	-	525,748
-	-	-	15,000	39,436	-	-	-	-	304,739
1,985,613	9,066,574	42,979,647	738,621	405,645	3,420	1,671,025	-	(170,395)	61,901,828
32,586	-	13,732	7,413,944	3,585,392	-	-	-	(2,184,700)	102,994,172
-	287,550	15,861,501	2,847,972	-	-	-	-	-	37,066,254
-	-	664,559	-	-	-	-	-	-	664,559
-	-	4,955,011	-	-	-	-	-	(4,955,011)	-
-	-	-	-	-	-	-	-	-	947,614
-	-	-	-	-	-	-	-	-	138,736
-	-	-	-	-	-	-	-	-	97,488
-	-	-	-	7,974,728	-	-	-	-	7,974,728
-	287,550	21,481,071	2,847,972	7,974,728	-	-	-	(4,955,011)	46,889,379
2,018,199	9,354,124	64,474,450	11,000,537	11,965,765	3,420	1,671,025	-	(7,310,106)	211,785,379
-	1,977,644	(7,045,502)	(1,319,272)	10,749	-	-	-	(11,812,950)	(32,547,910)
-	-	-	-	1,064,106	-	-	-	-	1,064,106
-	1,977,644	(7,045,502)	(1,319,272)	1,074,855	-	-	-	(11,812,950)	(31,483,804)
-	-	-	-	-	-	-	-	-	1,942,600
-	500,000	-	-	-	-	-	-	(500,000)	1,767,435
1,767,754	-	-	-	-	(83,400)	281,718	(60,800)	(1,905,272)	-
1,767,754	2,477,644	(7,045,502)	(1,319,272)	1,074,855	(83,400)	281,718	(60,800)	(14,218,222)	(27,773,769)
$ 3,785,953	$ 11,831,768	$ 57,428,948	$ 9,681,265	$ 13,040,620	$ (79,980)	$ 1,952,743	$ (60,800)	$ (21,528,328)	$ 184,011,610

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF OPERATIONS
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Sears Permian Retirement Corporation	Sears Brazos Retirement Corporation	Odessa Methodist Housing, Inc.	Senior Dimensions Inc.
OPERATING REVENUE								
Resident Service	$ -	$ -	$ 6,958,785	$ 11,787,593	$ 7,322,379	$ -	$ 113,595	$ 25,145,917
Amortization of Residency Fees	-	261,702	258,095	287,446	85,851	-	-	-
Management Fees	4,724,000	-	-	-	-	-	-	-
Net Assets Released from Restriction	-	710,323	-	-	-	-	-	-
Other	10,916	2,000	97,042	287,567	17,765	-	104,561	-
Total Operating Revenue	4,734,916	974,025	7,313,922	12,362,606	7,425,995	-	218,156	25,145,917
OPERATING EXPENSE								
Nursing	-	-	1,193,040	3,471,552	3,271,224	-	-	12,496,679
Dietary	-	-	911,509	1,189,883	802,636	-	-	2,175,142
Activity Services	-	-	53,494	142,005	53,117	-	-	281,328
Social Services	-	-	29,184	39,019	45,981	-	-	229,260
Environmental Services and Utilities	68,080	-	1,206,321	1,518,629	830,093	-	106,184	2,703,872
Consultant Services	-	-	-	94,072	75,760	-	-	-
General and Administrative	4,806,194	335,314	769,920	1,624,127	1,212,408	-	58,460	4,230,286
Risk Management and Training	-	-	49,946	72,600	17,775	-	-	98,892
Marketing and Admissions	-	-	117,742	194,334	153,410	-	-	117,237
Employee Benefits	620,362	-	609,030	941,838	627,154	-	12,965	2,904,495
Interest Expense	5,575,727	118,280	18,602	1,408	1,875	-	-	136,734
Depreciation and Amortization	386,606	-	966,641	1,240,210	553,678	-	67,876	42,924
Total Operating Expense	11,456,969	453,594	5,925,429	10,529,677	7,645,111	-	245,485	25,416,849
OPERATING INCOME (LOSS)	(6,722,053)	520,431	1,388,493	1,832,929	(219,116)	-	(27,329)	(270,932)
OTHER INCOME (EXPENSE)								
Unrealized Gain (Loss) on Investments	14,935	242,800	-	-	-	-	-	-
Realized Loss on Investments	(15,648)	-	-	-	-	-	-	-
Investment Income	249,552	139,763	(156)	40,446	2,805	-	9	-
Contributions	180,358	455,522	-	-	-	-	-	-
Other Revenue (Expenses)	(242,815)	-	(22,856)	(8,990)	(18,686)	-	-	4,077
Gain (Loss) on Sale of Assets	-	-	-	-	-	-	-	-
Impairment Loss on Long-Lived Assets	-	(2,270,000)	-	-	-	-	-	-
Change in Investment in Sears Methodist Foundation	1,110,903	-	(435,075)	(56,823)	18,016	(56,489)	-	-
Transfers from Sears Methodist Foundation	20,703	(479,034)	24,433	49,501	29,351	-	-	8,820
Debt Service Payments	8,400,000	-	(3,000,000)	(4,320,000)	(1,080,000)	-	-	-
Bad Debt Expense - Related Party	(4,031,494)	(923,517)	-	-	-	-	-	-
Change in Fair Value of Interest Rate Swap	63,278	-	-	-	-	-	-	-
Total Other Income (Expense)	5,749,772	(2,834,466)	(3,433,654)	(4,295,866)	(1,048,514)	(56,489)	9	12,897
EXCESS (DEFICIT) OF REVENUE OVER EXPENSE	(972,281)	(2,314,035)	(2,045,161)	(2,462,937)	(1,267,630)	(56,489)	(27,320)	(258,035)
Federal Income Tax Expense (Benefit)	-	-	-	-	-	-	-	(652,431)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS FROM CONTINUING OPERATIONS	(972,281)	(2,314,035)	(2,045,161)	(2,462,937)	(1,267,630)	(56,489)	(27,320)	(910,466)
Equity Transfer (to) from Affiliates	3,775,831	(641,739)	(11,029,432)	(604,500)	(57,914)	(24,895)	57,916	5,585,632
Loss from Discontinued Operations	-	-	(854,221)	-	-	(229,583)	-	-
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS AFTER TAXES AND DISCONTINUED OPERATIONS	$ 2,803,550	$ (2,955,774)	$ (13,928,814)	$ (3,067,437)	$ (1,325,544)	$ (310,967)	$ 30,596	$ 4,675,166

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF OPERATIONS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012

	Sears Plains Retirement Corporation	Sears Tyler Methodist Retirement Corporation	Sears Caprock Retirement Corporation	Canyons Senior Living L.P.	Senior Living Assurance, Inc.	Southwest Assurance Company, Ltd.	Texas Senior Management, Inc.	Eliminating Entries	Total
OPERATING REVENUE									
Resident Service	$ 7,646,380	$ 6,107,228	$ 6,291,275	$ 528,279	$ -	$ -	$ -	$ -	$ 71,901,431
Amortization of Residency Fees	-	719,919	75,962	-	-	-	-	-	1,688,975
Management Fees	-	-	-	-	-	-	-	(4,724,000)	-
Net Assets Released from Restriction	622,927	-	-	-	-	-	-	(493,296)	839,954
Other	132,336	160,537	50,007	216,296	278,000	629,404	-	-	1,986,431
Total Operating Revenue	8,401,643	6,987,684	6,417,244	744,575	278,000	629,404	-	(5,217,296)	76,416,791
OPERATING EXPENSE									
Nursing	4,567,244	2,226,429	2,615,283	-	-	-	-	(2,513,146)	27,328,305
Dietary	518,774	934,667	696,285	103,235	-	-	-	-	7,332,131
Activity Services	153,689	48,113	61,675	23,989	-	-	-	-	817,410
Social Services	-	32,146	41,458	-	-	-	-	-	417,048
Environmental Services and Utilities	535,059	1,216,454	759,566	338,952	-	-	6,342	-	9,289,552
Consultant Services	-	-	-	-	-	-	-	-	169,832
General and Administrative	915,786	824,525	950,349	66,098	307,778	616,213	-	(4,556,000)	12,161,458
Risk Management and Training	92,226	-	159,580	102	-	-	-	-	491,121
Marketing and Admissions	118,117	255,583	94,206	7,040	-	-	-	-	1,057,669
Employee Benefits	687,561	726,832	574,545	95,324	11,810	-	-	-	7,811,916
Interest Expense	286,111	3,426,554	233,258	192,522	-	-	-	(130,677)	9,860,394
Depreciation and Amortization	467,298	1,959,014	503,436	314,272	-	-	-	(28,500)	6,473,455
Total Operating Expense	8,341,865	11,650,317	6,689,641	1,141,534	319,588	616,213	6,342	(7,228,323)	83,210,291
OPERATING INCOME (LOSS)	59,778	(4,662,633)	(272,397)	(396,959)	(41,588)	13,191	(6,342)	2,011,027	(6,793,500)
OTHER INCOME (EXPENSE)									
Unrealized Gain (Loss) on Investments	-	(3,069)	2,127	-	-	-	-	-	256,793
Realized Loss on Investments	-	680	-	-	-	-	-	-	(14,968)
Investment Income	(4,319)	4,842	5,639	164	-	-	-	(130,677)	308,068
Contributions	1,570	3	-	-	-	-	-	-	637,453
Other Revenue (Expenses)	(27,984)	(171,393)	(3,034)	(41,705)	-	-	-	-	(533,386)
Gain (Loss) on Sale of Assets	-	-	-	-	-	-	-	-	-
Impairment Loss on Long-Lived Assets	-	-	-	-	-	-	-	-	(2,270,000)
Change in Investment in Sears Methodist Foundation	(198,424)	12,251	399	-	-	-	-	(394,758)	-
Transfers from Sears Methodist Foundation	320,586	23,684	1,956	-	-	-	-	-	-
Debt Service Payments	-	-	-	-	-	-	-	-	-
Bad Debt Expense - Related Party	-	-	-	-	-	-	-	4,955,011	-
Change in Fair Value of Interest Rate Swap	-	-	-	-	-	-	-	-	63,278
Total Other Income (Expense)	91,429	(133,002)	7,087	(41,541)	-	-	-	4,429,576	(1,552,762)
EXCESS (DEFICIT) OF REVENUE OVER EXPENSE	151,207	(4,795,635)	(265,310)	(438,500)	(41,588)	13,191	(6,342)	6,440,603	(8,346,262)
Federal Income Tax Expense (Benefit)	-	-	-	-	-	-	-	-	(652,431)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS FROM CONTINUING OPERATIONS	151,207	(4,795,635)	(265,310)	(438,500)	(41,588)	13,191	(6,342)	6,440,603	(8,998,693)
Equity Transfer (to) from Affiliates	34,217	1,101,751	(3)	1,803,136	-	-	-	-	-
Loss from Discontinued Operations	-	-	-	-	-	-	-	(2,345,146)	(3,428,950)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS AFTER TAXES AND DISCONTINUED OPERATIONS	$ 185,424	$ (3,693,884)	$ (265,313)	$ 1,364,636	$ (41,588)	$ 13,191	$ (6,342)	$ 4,095,457	$ (12,427,643)

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF CHANGES IN NET ASSETS (DEFICIT)
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Sears Permian Retirement Corporation	Sears Brazos Retirement Corporation	Odessa Methodist Housing, Inc.	Senior Dimensions Inc.	Sears Plains Retirement Corporation
UNRESTRICTED NET ASSETS									
Net Assets or Equity - December 31, 2011	$ (70,299,645)	$ 14,512,751	$ 31,147,974	$ 23,159,126	$ 6,391,974	$ 306,591	$ (822,960)	$ -	$ 1,792,220
Change in Net Assets:									
Excess (Deficit) of Revenue Over Expense	(972,281)	(2,314,035)	(2,045,161)	(2,462,937)	(1,267,630)	(56,489)	(27,320)	-	151,207
Elimination in Retained Earnings	-	-	-	-	-	-	-	-	-
Equity Transfer from (to) Affiliate	3,775,831	(641,739)	(11,029,432)	(604,500)	(57,914)	(24,895)	57,916	-	34,217
Loss from Discontinued Operations	-	-	(854,221)	-	-	(229,583)	-	-	-
Change in Net Assets	2,803,550	(2,955,774)	(13,928,814)	(3,067,437)	(1,325,544)	(310,967)	30,596	-	185,424
Net Assets or Equity - December 31, 2012	$ (67,496,095)	$ 11,556,977	$ 17,219,160	$ 20,091,689	$ 5,066,430	$ (4,376)	$ (792,364)	$ -	$ 1,977,644
TEMPORARILY RESTRICTED NET ASSETS									
Net Assets - December 31, 2011	$ -	$ 710,323	$ -	$ -	$ -	$ -	$ 1,942,600	$ -	$ 622,927
Change in Net Assets:									
Contributions	-	-	-	-	-	-	-	-	-
Net Assets Released from Restriction	-	(710,323)	-	-	-	-	-	-	(622,927)
Change in Net Assets	-	(710,323)	-	-	-	-	-	-	(622,927)
Net Assets - December 31, 2012	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,942,600	$ -	$ -
PERMANENTLY RESTRICTED NET ASSETS									
Net Assets - December 31, 2011	$ -	$ 1,767,435	$ -	$ -	$ -	$ -	$ -	$ -	$ 500,000
Change in Net Assets:									
Contributions	-	-	-	-	-	-	-	-	-
Change in Net Assets	-	-	-	-	-	-	-	-	-
Net Assets - December 31, 2012	$ -	$ 1,767,435	$ -	$ -	$ -	$ -	$ -	$ -	$ 500,000
STOCKHOLDERS' EQUITY									
Stockholders Equity (Deficit) - December 31, 2011	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (2,907,412)	$ -
Net Income	-	-	-	-	-	-	-	(258,035)	-
Equity Transfer	-	-	-	-	-	-	-	5,585,632	-
Contributed Capital	-	-	-	-	-	-	-	-	-
Federal Income Tax Benefit	-	-	-	-	-	-	-	(652,431)	-
Change in Net Assets	-	-	-	-	-	-	-	4,675,166	-
Stockholders Equity (Deficit) - December 31, 2012	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,767,754	$ -

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF CHANGES IN NET ASSETS (DEFICIT) (CONTINUED)
YEAR ENDED DECEMBER 31, 2012

	Sears Tyler Methodist Retirement Corporation	Sears Caprock Retirement Corporation	Canyons Senior Living L.P.	Senior Living Assurance, Inc.	Southwest Assurance Company, Ltd.	Texas Senior Management, Inc.	Eliminating Entries	Total
UNRESTRICTED NET ASSETS								
Net Assets or Equity - December 31, 2011	$ (3,351,618)	$ (1,053,959)	$ (289,781)	$ -	$ -	$ -	$ (20,548,834)	$ (19,056,161)
Change in Net Assets:								
Excess (Deficit) of Revenue Over Expense	(4,795,635)	(265,310)	(438,500)	-	-	-	6,440,603	(8,053,488)
Elimination in Retained Earnings	-	-	-	-	-	-	(945,205)	(945,205)
Equity Transfer from (to) Affiliate	1,101,751	(3)	1,803,136	-	-	-	5,585,632	-
Loss from Discontinued Operations	-	-	-	-	-	-	(2,345,146)	(3,428,950)
Change in Net Assets	(3,693,884)	(265,313)	1,364,636	-	-	-	8,735,884	(12,427,643)
Net Assets or Equity - December 31, 2012	$ (7,045,502)	$ (1,319,272)	$ 1,074,855	$ -	$ -	$ -	$ (11,812,950)	$ (31,483,804)
TEMPORARILY RESTRICTED NET ASSETS								
Net Assets - December 31, 2011	$ -	$ -	$ -	$ -	$ -	$ -	$ (493,296)	$ 2,782,554
Change in Net Assets:								
Contributions	-	-	-	-	-	-	-	-
Net Assets Released from Restriction	-	-	-	-	-	-	493,296	(839,954)
Change in Net Assets	-	-	-	-	-	-	493,296	(839,954)
Net Assets - December 31, 2012	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,942,600
PERMANENTLY RESTRICTED NET ASSETS								
Net Assets - December 31, 2011	$ -	$ -	$ -	$ -	$ -	$ -	$ (500,000)	$ 1,767,435
Change in Net Assets:								
Contributions	-	-	-	-	-	-	-	-
Change in Net Assets	-	-	-	-	-	-	-	-
Net Assets - December 31, 2012	$ -	$ -	$ -	$ -	$ -	$ -	$ (500,000)	$ 1,767,435
STOCKHOLDERS' EQUITY								
Stockholders Equity (Deficit) - December 31, 2011	$ -	$ -	$ -	$ (41,812)	$ 268,527	$ (54,458)	2,735,155	$ -
Net Income	-	-	-	(41,588)	13,191	(6,342)	292,774	-
Equity Transfer	-	-	-	-	-	-	(5,585,632)	-
Contributed Capital	-	-	-	-	-	-	-	-
Federal Income Tax Benefit	-	-	-	-	-	-	652,431	-
Change in Net Assets	-	-	-	(41,588)	13,191	(6,342)	(4,640,427)	-
Stockholders Equity (Deficit) - December 31, 2012	$ -	$ -	$ -	$ (83,400)	$ 281,718	$ (60,800)	$ (1,905,272)	$ -

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Parks Methodist Retirement Village	Sears Brazos Retirement Corporation	Desert Haven	Senior Dimensions Inc.	Sears Plains Retirement Corporation
CASH FLOWS FROM OPERATING ACTIVITIES									
Change in Net Assets from Continuing Operations	$ 2,803,550	$ (3,666,097)	$ (13,074,593)	$ (3,067,437)	$ (1,325,544)	$ (81,384)	$ 30,596	$ 4,675,166	$ (437,503)
Change in Net Assets from Discontinued Operations	-	-	(854,221)	-	-	(229,583)	-	-	-
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:									
Depreciation and Amortization	386,606	-	966,641	1,240,210	553,678	-	67,876	42,924	467,298
Depreciation and Amortization in Discontinued Operations	-	-	10,640	-	-	-	-	-	-
Equity Transfer to (from) Related Party	(3,775,831)	641,739	11,029,432	604,500	57,914	24,895	(57,916)	(5,585,632)	(34,217)
Amortization of Deferred Income	-	(261,702)	(258,095)	(287,446)	(85,851)	-	-	-	-
Realized (Gain) Loss on Investments	15,648	-	-	-	-	-	-	-	-
Unrealized (Gain) Loss on Investments	(14,935)	(242,800)	-	-	-	-	-	-	-
Change in Investment in Sears Methodist Foundation	(1,110,903)	-	435,075	56,823	(18,016)	56,489	-	-	198,424
Change in Fair Value of Interest Rate Swap	(63,278)	-	-	-	-	-	-	-	-
(Gain) Loss on Disposal of Property and Equipment	-	2,270,000	(31,997)	-	-	228,684	-	-	-
Change in Current Assets and Liabilities:									
Accounts Receivable	(113,245)	-	1,126,121	(155,905)	506,518	227,627	(1,135)	137,559	100,824
Due (to) from Related Party	14,324,168	1,611,866	(10,948,106)	200,012	(75,150)	-	(4,889)	179,006	385,057
Other Assets	(131,798)	146,315	39,147	92,062	5,281	-	(238)	612,243	9,103
Accounts Payable	(18,652)	(19,677)	(143,417)	(9,679)	282,566	(233,151)	(3,842)	(22,330)	(87,865)
Accrued Expenses and Other Liabilities	(430,594)	(60,637)	(52,008)	30,382	48,525	-	242	(1,228)	20,904
Resident Security Deposits	-	-	(526,829)	(27,653)	19,430	-	(6)	-	-
Net Cash Provided (Used) by Operating Activities	11,870,736	419,007	(12,282,210)	(1,324,131)	(30,649)	(6,423)	30,688	37,708	622,025
CASH FLOWS FROM INVESTING ACTIVITIES									
Purchase of Property, Plant, and Equipment, Net	(12,084)	-	(1,325,911)	(952,420)	(1,108,610)	-	(26,533)	(151,367)	(413,711)
Change in Assets Limited as to Use	4,934,065	1,981,576	26,907	(1,603)	418	-	120	56,377	(1,118)
Net Cash Provided (Used) by Investing Activities	4,921,981	1,981,576	(1,299,004)	(954,023)	(1,108,192)	-	(26,413)	(94,990)	(414,829)
CASH FLOWS FROM FINANCING ACTIVITIES									
Repayment of Long-Term Debt	(4,644,319)	-	(132,358)	-	-	-	-	(17,756)	(346,931)
Proceeds from Notes Payable	-	-	-	-	-	-	-	75,038	-
Increase in Deferred Financing Costs	(145,483)	-	-	-	-	-	-	-	(38,046)
Proceeds Received from Entrance Fees and Deposits	-	-	2,853,599	1,498,550	1,160,500	-	-	-	-
Refunds to Residents for Entrance Fees and Deposits	-	-	(903,517)	(1,106,424)	(956,463)	-	-	-	-
Net Cash Provided (Used) by Financing Activities	(4,789,802)	-	1,817,724	392,126	204,037	-	-	57,282	(384,977)
NET CHANGE IN CASH AND CASH EQUIVALENTS	12,002,915	2,400,583	(11,763,490)	(1,886,028)	(934,804)	(6,423)	4,275	-	(177,781)
Cash and Cash Equivalents at Beginning of Year	(7,628,091)	2,951,198	9,124,203	850,598	(4,856,287)	2,714	7,645	600	665,029
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 4,374,824	$ 5,351,781	$ (2,639,287)	$ (1,035,430)	$ (5,791,091)	$ (3,709)	$ 11,920	$ 600	$ 487,248

SEARS METHODIST RETIREMENT SYSTEM, INC.
CONSOLIDATING STATEMENT OF CASH FLOWS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012

	Sears Tyler Methodist Retirement Corporation	Sears Caprock Retirement Corporation	Canyons Senior Living L.P.	Senior Living Assurance, Inc.	Southwest Assurance Company, Ltd.	Texas Senior Management	Eliminating Entries	Total
CASH FLOWS FROM OPERATING ACTIVITIES								
Change in Net Assets from Continuing Operations	$ (3,693,884)	$ (265,313)	$ 1,364,636	$ (41,588)	$ 13,191	$ (6,342)	$ 6,933,899	$ (9,838,647)
Change in Net Assets from Discontinued Operations	-	-	-	-	-	-	(2,345,146)	(3,428,950)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:								
Depreciation and Amortization	1,959,014	503,436	314,272	-	-	-	(28,500)	6,473,455
Depreciation and Amortization in Discontinued Operations	-	-	-	-	-	-	-	10,640
Equity Transfer to (from) Related Party	(1,101,751)	3	(1,803,136)	-	-	-	-	-
Amortization of Deferred Income	(719,919)	(75,962)	-	-	-	-	-	(1,688,975)
Realized (Gain) Loss on Investments	(680)	-	-	-	-	-	-	14,968
Unrealized (Gain) Loss on Investments	3,069	(2,127)	-	-	-	-	-	(256,793)
Change in Investment in Sears Methodist Foundation	(12,251)	(399)	-	-	-	-	394,758	-
Change in Fair Value of Interest Rate Swap	-	-	-	-	-	-	-	(63,278)
(Gain) Loss on Disposal of Property and Equipment	-	-	-	-	-	-	-	2,466,687
Change in Current Assets and Liabilities:								
Accounts Receivable	(204,702)	(116,532)	573,857	-	(152,396)	6,509	428,480	2,363,580
Due (to) from Related Party	(69,652)	171,476	500,502	57,037	-	3,883	(6,335,210)	-
Other Assets	16,640	23,485	(14,620)	-	(298,891)	-	69,512	568,241
Accounts Payable	(97,560)	(147,662)	(21,478)	(6,651)	-	-	(61,929)	(591,327)
Accrued Expenses and Other Liabilities	97,853	(118,604)	(640,229)	(9,481)	740,858	(4,050)	595,447	217,380
Resident Security Deposits	(111,039)	(36,900)	17,833	-	-	-	-	(665,164)
Net Cash Provided (Used) by Operating Activities	(3,934,862)	(65,099)	291,637	(683)	302,762	-	(348,689)	(4,418,183)
CASH FLOWS FROM INVESTING ACTIVITIES								
Purchase of Property, Plant, and Equipment, Net	(1,393,917)	(185,163)	(246,323)	-	-	-	-	(5,816,039)
Change in Assets Limited as to Use	3,618,636	(6,509)	(17,373)	-	-	-	-	10,591,496
Net Cash Provided (Used) by Investing Activities	2,224,719	(191,672)	(263,696)	-	-	-	-	4,775,457
CASH FLOWS FROM FINANCING ACTIVITIES								
Repayment of Long-Term Debt	(1,143,880)	(130,000)	(20,266)	-	-	-	348,689	(6,086,821)
Proceeds from Notes Payable	-	-	-	-	-	-	-	75,038
Increase in Deferred Financing Costs	(94,464)	-	20,295	-	-	-	-	(257,698)
Proceeds Received from Entrance Fees and Deposits	3,024,115	500,075	-	-	-	-	-	9,036,839
Refunds to Residents for Entrance Fees and Deposits	-	(343,800)	-	-	-	-	-	(3,310,204)
Net Cash Provided (Used) by Financing Activities	1,785,771	26,275	29	-	-	-	348,689	(542,846)
NET CHANGE IN CASH AND CASH EQUIVALENTS	75,628	(230,496)	27,970	(683)	302,762	-	-	(185,572)
Cash and Cash Equivalents at Beginning of Year	7,061	569,324	23,099	703	561,592	-	-	2,279,388
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 82,689	$ 338,828	$ 51,069	$ 20	$ 864,354	$ -	$ -	$ 2,093,816

SEARS METHODIST RETIREMENT SYSTEM, INC.
COMBINING BALANCE SHEET – OBLIGATED GROUP
DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation
ASSETS				
CURRENT ASSETS				
Cash and Cash Equivalents	$ 4,374,824	$ 5,351,781	$ (2,639,287)	$ (1,035,430)
Accounts Receivable, Net	155,247	-	283,692	671,144
Current Portion of Assets Limited as to Use	600,571	2,100,059	384,082	9,970
Other Current Assets	235,920	29,249	27,558	62,536
Total Current Assets	5,366,562	7,481,089	(1,943,955)	(291,780)
ASSETS LIMITED AS TO USE	6,356,490	3,597,435	-	-
PROPERTY AND EQUIPMENT, NET	1,900,358	-	28,927,751	25,812,226
OTHER ASSETS				
Deferred Financing Costs, Net	2,189,419	-	-	-
Other Investments	681,937	-	-	-
Investment in Sears Methodist Foundation	11,143,842	-	735,757	1,354,327
Investment in Southwest Assurance Co., Ltd.	300,000	-	-	-
Due from Related Party	1,057,938	(344)	106,506	-
Note Receivable - Related Party	-	2,184,700	-	-
Other Assets	1,033,201	241,422	-	-
Total Other Assets	16,406,337	2,425,778	842,263	1,354,327
Total Assets	$ 30,029,747	$ 13,504,302	$ 27,826,059	$ 26,874,773
LIABILITIES AND NET ASSETS (DEFICIT)				
CURRENT LIABILITIES				
Current Maturities of Long-Term Debt	$ 97,716	$ -	$ -	$ -
Accounts Payable	393,307	2,638	197,380	303,608
Accrued Expenses	2,015,262	38,516	327,922	252,325
Deferred Revenue	141,666	-	384,082	-
Resident Security Deposits	-	-	136,812	73,525
Total Current Liabilities	2,647,951	41,154	1,046,196	629,458
LONG-TERM DEBT (Net of Current Maturities Shown Above)	93,832,789	-	300,429	-
OTHER LIABILITIES				
Deferred Revenue from Residency Fees	-	-	9,260,274	6,153,626
Deferred Compensation	947,614	-	-	-
Charitable Gift Annuities Payable, Net of Current Portion	-	138,736	-	-
Interest Rate Swap Agreement	97,488	-	-	-
Total Other Liabilities	1,045,102	138,736	9,260,274	6,153,626
Total Liabilities	97,525,842	179,890	10,606,899	6,783,084
CONTINGENCIES AND COMMITMENTS				
NET ASSETS (DEFICIT)				
Unrestricted	(67,496,095)	11,556,977	17,219,160	20,091,689
Temporarily Restricted	-	-	-	-
Permanently Restricted	-	1,767,435	-	-
Total Net Assets (Deficit)	(67,496,095)	13,324,412	17,219,160	20,091,689
Total Liabilities and Net Assets (Deficit)	$ 30,029,747	$ 13,504,302	$ 27,826,059	$ 26,874,773

Parks Methodist Retirement Village	Sears Brazos Retirement Corporation	Eliminating Entries	Total Obligated Group
$ (5,791,091)	$ (3,709)	$ -	$ 257,088
594,642	-	(72,280)	1,632,445
11,667	-	-	3,106,349
23,710	-	-	378,973
(5,161,072)	(3,709)	(72,280)	5,374,855
-	-	-	9,953,925
11,254,192	-	-	67,894,527
-	-	-	2,189,419
-	-	-	681,937
2,419,110	100	(15,653,136)	-
-	-	-	300,000
901	-	-	1,165,001
-	-	(2,184,700)	-
50,000	-	-	1,324,623
2,470,011	100	(17,837,836)	5,660,980
$ 8,563,131	$ (3,609)	$ (17,910,116)	$ 88,884,287
$ -	$ -	$ -	$ 97,716
586,176	767	(72,280)	1,411,596
224,610	-	-	2,858,635
-	-	-	525,748
30,584	-	-	240,921
841,370	767	(72,280)	5,134,616
-	-	(2,184,700)	91,948,518
2,655,331	-	-	18,069,231
-	-	-	947,614
-	-	-	138,736
-	-	-	97,488
2,655,331	-	-	19,253,069
3,496,701	767	(2,256,980)	116,336,203
5,066,430	(4,376)	(15,653,136)	(29,219,351)
-	-	-	-
-	-	-	1,767,435
5,066,430	(4,376)	(15,653,136)	(27,451,916)
$ 8,563,131	$ (3,609)	$ (17,910,116)	$ 88,884,287

SEARS METHODIST RETIREMENT SYSTEM, INC.
COMBINING STATEMENT OF OPERATIONS – OBLIGATED GROUP
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Parks Methodist Retirement Village	Sears Brazos Retirement Corporation	Eliminating Entries	Total Obligated Group
OPERATING REVENUE								
Resident Service	$ -	$ -	$ 6,958,785	$ 11,787,593	$ 7,322,379	$ -	$ -	$ 26,068,757
Amortization of Residency Fees	-	261,702	258,095	287,446	85,851	-	-	893,094
Management Fees	4,724,000	-	-	-	-	-	(1,848,000)	2,876,000
Net Assets Released from Restriction	-	710,323	-	-	-	-	-	710,323
Other	10,916	2,000	97,042	287,567	17,765	-	-	415,290
Total Operating Revenue	4,734,916	974,025	7,313,922	12,362,606	7,425,995	-	(1,848,000)	30,963,464
OPERATING EXPENSE								
Nursing	-	-	1,193,040	3,471,552	3,271,224	-	(1,145,555)	6,790,261
Dietary	-	-	911,509	1,189,883	802,636	-	-	2,904,028
Activity Services	-	-	53,494	142,005	53,117	-	-	248,616
Social Services	-	-	29,184	39,019	45,981	-	-	114,184
Environmental Services and Utilities	68,080	-	1,206,321	1,518,629	830,093	-	-	3,623,123
Consultant Services	-	-	-	94,072	75,760	-	-	169,832
General and Administrative	4,806,194	335,314	769,920	1,624,127	1,212,408	-	(1,680,000)	7,067,963
Risk Management and Training	-	-	49,946	72,600	17,775	-	-	140,321
Marketing and Admissions	-	-	117,742	194,334	153,410	-	-	465,486
Employee Benefits	620,362	-	609,030	941,838	627,154	-	-	2,798,384
Interest Expense	5,575,727	118,280	18,602	1,408	1,875	-	(130,677)	5,585,215
Depreciation and Amortization	386,606	-	966,641	1,240,210	553,678	-	-	3,147,135
Total Operating Expenses	11,456,969	453,594	5,925,429	10,529,677	7,645,111	-	(2,956,232)	33,054,548
OPERATING INCOME (LOSS)	(6,722,053)	520,431	1,388,493	1,832,929	(219,116)	-	1,108,232	(2,091,084)
OTHER INCOME (EXPENSE)								
Unrealized Gain on Investments	14,935	242,800	-	-	-	-	-	257,735
Realized Loss on Investments	(15,648)	-	-	-	-	-	-	(15,648)
Investment Income	249,552	139,763	(156)	40,446	2,805	-	(130,677)	301,733
Contributions	180,358	455,522	-	-	-	-	-	635,880
Grant Revenue-Net of Expenses	-	-	-	-	-	-	-	-
Other Revenue (Expenses)	(242,815)	-	(22,856)	(8,990)	(18,686)	-	-	(293,347)
Impairment Loss on Long-Lived Assets	-	(2,270,000)	-	-	-	-	-	(2,270,000)
Change in the Investment in Sears Methodist Foundation	1,110,903	-	(435,075)	(56,823)	18,016	(56,489)	(580,532)	-
Transfers from Sears Methodist Foundation	20,703	(479,034)	24,433	49,501	29,351	-	-	(355,046)
Debt Service Payments	8,400,000	-	(3,000,000)	(4,320,000)	(1,080,000)	-	-	-
Bad Debt Expense - Related Party	(4,031,494)	(923,517)	-	-	-	-	-	(4,955,011)
Change in Valuation of Interest Rate Swap	63,278	-	-	-	-	-	-	63,278
Total Other Income (Expense)	5,749,772	(2,834,466)	(3,433,654)	(4,295,866)	(1,048,514)	(56,489)	(711,209)	(6,630,426)
EXCESS (DEFICIT) OF REVENUE OVER EXPENSE	(972,281)	(2,314,035)	(2,045,161)	(2,462,937)	(1,267,630)	(56,489)	397,023	(8,721,510)
Equity Transfer (to) from Affiliates	3,775,831	(641,739)	(11,029,432)	(604,500)	(57,914)	(24,895)	-	(8,582,649)
CHANGE IN UNRESTRICTED NET ASSETS FROM CONTINUING OPERATIONS	2,803,550	(2,955,774)	(13,074,593)	(3,067,437)	(1,325,544)	(81,384)	397,023	(17,304,159)
Loss from Discontinued Operations	-	-	(854,221)	-	-	(229,583)	(983,938)	(2,067,742)
CHANGE IN UNRESTRICTED NET ASSETS	$ 2,803,550	$ (2,955,774)	$ (13,928,814)	$ (3,067,437)	$ (1,325,544)	$ (310,967)	$ (586,915)	$ (19,371,901)

SEARS METHODIST RETIREMENT SYSTEM, INC.
COMBINING STATEMENT OF CHANGES IN NET ASSETS (DEFICIT) – OBLIGATED GROUP
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Retirement System, Inc	Sears Methodist Foundation	Sears Methodist Centers, Inc.	Sears Panhandle Retirement Corporation	Parks Methodist Retirement Village	Sears Brazos Retirement Corporation	Eliminating Entries	Total Obligated Group
UNRESTRICTED NET ASSETS								
Net Assets or Equity - December 31, 2011	$ (70,299,645)	$ 14,512,751	$ 31,147,974	$ 23,159,126	$ 6,391,974	$ 306,591	$ (15,066,221)	$ (9,847,450)
Change in Net Assets:								
Excess (Deficit) of Revenue Over Expense	(972,281)	(2,314,035)	(2,045,161)	(2,462,937)	(1,267,630)	(56,489)	397,023	(8,721,510)
Equity Transfer from (to) Affiliate	3,775,831	(641,739)	(11,029,432)	(604,500)	(57,914)	(24,895)	-	(8,582,649)
Loss from Discontinued Operations	-	-	(854,221)	-	-	(229,583)	(983,938)	(2,067,742)
Change in Net Assets	2,803,550	(2,955,774)	(13,928,814)	(3,067,437)	(1,325,544)	(310,967)	(586,915)	(19,371,901)
Net Assets or Equity - December 31, 2012	$ (67,496,095)	$ 11,556,977	$ 17,219,160	$ 20,091,689	$ 5,066,430	$ (4,376)	$ (15,653,136)	$ (29,219,351)
TEMPORARILY RESTRICTED NET ASSETS								
Net Assets - December 31, 2011	$ -	$ 710,323	$ -	$ -	$ -	$ -	$ -	$ 710,323
Change in Net Assets:								
Contributions	-	-	-	-	-	-	-	-
Release from Restrictions	-	(710,323)	-	-	-	-	-	(710,323)
Change in Net Assets	-	(710,323)	-	-	-	-	-	(710,323)
Net Assets - December 31, 2012	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
PERMANENTLY RESTRICTED NET ASSETS								
Net Assets - December 31, 2011	$ -	$ 1,767,435	$ -	$ -	$ -	$ -	$ -	$ 1,767,435
Change in Net Assets	-	-	-	-	-	-	-	-
Net Assets - December 31, 2012	$ -	$ 1,767,435	$ -	$ -	$ -	$ -	$ -	$ 1,767,435

SEARS METHODIST RETIREMENT SYSTEM, INC.
COMBINING BALANCE SHEET – SEARS METHODIST CENTERS, INC.
DECEMBER 31, 2012

	Sears Methodist Center	Windcrest Alzheimer's Care Center	Sears Home Health	Sears Methodist Hospice	Southwest Therapy Associates	Wesley Court Methodist Retirement Center	Total
ASSETS							
CURRENT ASSETS							
Cash and Cash Equivalents	$ 5,489,220	$ (8,232)	$ (898)	$ (562)	$ (1,006,647)	$ (7,112,168)	$ (2,639,287)
Accounts Receivable, Net	-	-	-	-	184,705	98,987	283,692
Due from Related Party	4,570	-	-	-	-	101,936	106,506
Current Portion of Assets Limited as to Use	-	-	-	-	-	384,082	384,082
Other Current Assets	-	-	-	-	-	27,558	27,558
Total Current Assets	5,493,790	(8,232)	(898)	(562)	(821,942)	(6,499,605)	(1,837,449)
ASSETS LIMITED AS TO USE	-	-	-	-	-	-	-
PROPERTY AND EQUIPMENT, NET	-	-	-	-	18,133	28,909,618	28,927,751
OTHER ASSETS							
Investment in Sears Methodist Foundation	510,882	140,577	14,394	195	3,181	66,528	735,757
Total Other Assets	510,882	140,577	14,394	195	3,181	66,528	735,757
Total Assets	$ 6,004,672	$ 132,345	$ 13,496	$ (367)	$ (800,628)	$ 22,476,541	$ 27,826,059
LIABILITIES AND NET ASSETS							
CURRENT LIABILITIES							
Current Maturities of Long-Term Debt	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Accounts Payable	-	-	-	-	54,327	143,053	197,380
Due to Related Party	-	-	-	-	-	-	-
Accrued Expenses	26,926	-	44,000	-	163,435	93,561	327,922
Deferred Income	-	-	-	-	-	384,082	384,082
Resident Security Deposits	-	-	-	-	-	136,812	136,812
Total Current Liabilities	26,926	-	44,000	-	217,762	757,508	1,046,196
LONG-TERM DEBT (Net of Current Maturities Shown Above)	300,429	-	-	-	-	-	300,429
OTHER LIABILITIES							
Deferred Revenue from Residency Fees	-	-	-	-	-	9,260,274	9,260,274
Total Liabilities	327,355	-	44,000	-	217,762	10,017,782	10,606,899
CONTINGENCIES AND COMMITMENTS							
NET ASSETS							
Unrestricted	5,677,317	132,345	(30,504)	(367)	(1,018,390)	12,458,759	17,219,160
Total Liabilities and Net Assets	$ 6,004,672	$ 132,345	$ 13,496	$ (367)	$ (800,628)	$ 22,476,541	$ 27,826,059

SEARS METHODIST RETIREMENT SYSTEM, INC.
COMBINING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT) – SEARS METHODIST CENTERS, INC.
YEAR ENDED DECEMBER 31, 2012

	Sears Methodist Center	Windcrest Alzheimer's Care Center	Sears Home Health	Sears Methodist Hospice	Southwest Therapy Associates	Wesley Court Methodist Retirement Center	Total
OPERATING REVENUE							
Resident Service	$ -	$ -	$ -	$ -	$ -	$ 6,958,785	$ 6,958,785
Amortization of Residency Fees	-	-	-	-	-	258,095	258,095
Net Assets Released from Restriction	-	-	-	-	-	-	-
Other	-	-	-	-	-	97,042	97,042
Total Operating Revenue	-	-	-	-	-	7,313,922	7,313,922
OPERATING EXPENSE							
Nursing	-	-	-	-	-	1,193,040	1,193,040
Dietary	-	-	-	-	-	911,509	911,509
Activity Services	-	-	-	-	-	53,494	53,494
Social Services	-	-	-	-	-	29,184	29,184
Environmental Services and Utilities	-	-	-	-	-	1,206,321	1,206,321
Consultant Services	-	-	-	-	-	-	-
General and Administrative	-	-	-	-	-	769,920	769,920
Risk Management and Training	-	-	-	-	-	49,946	49,946
Marketing and Admissions	-	-	-	-	-	117,742	117,742
Employee Benefits	-	-	-	-	-	609,030	609,030
Interest Expense	-	-	-	-	-	18,602	18,602
Depreciation and Amortization	-	-	-	-	-	966,641	966,641
Total Operating Expenses	-	-	-	-	-	5,925,429	5,925,429
OPERATING INCOME (LOSS)	-	-	-	-	-	1,388,493	1,388,493
OTHER INCOME (EXPENSE)							
Investment Income	-	-	-	-	-	(156)	(156)
Other Expense	-	-	-	-	-	(22,856)	(22,856)
Change in the Investment in Sears Methodist Foundation	(30,225)	(368,211)	(23,160)	(37,445)	-	23,966	(435,075)
Transfers from Sears Methodist Foundation	-	-	-	5,385	-	19,048	24,433
Debt Service Payments	-	-	-	-	-	(3,000,000)	(3,000,000)
Total Other Expense	(30,225)	(368,211)	(23,160)	(32,060)	-	(2,979,998)	(3,433,654)
DEFICIT OF REVENUE OVER EXPENSE	(30,225)	(368,211)	(23,160)	(32,060)	-	(1,591,505)	(2,045,161)
Equity Transfer (to) from Affiliates	-	(8,150,841)	(1,140,555)	(1,703,820)	(34,216)	-	(11,029,432)
CHANGE IN UNRESTRICTED NET ASSETS FROM CONTINUING OPERATIONS	(30,225)	(8,519,052)	(1,163,715)	(1,735,880)	(34,216)	(1,591,505)	(13,074,593)
Gain (Loss) from Discontinued Operations	(106,122)	(107,131)	(332,339)	434,009	(742,638)	-	(854,221)
CHANGE IN UNRESTRICTED NET ASSETS	(136,347)	(8,626,183)	(1,496,054)	(1,301,871)	(776,854)	(1,591,505)	(13,928,814)
Unrestricted Net Assets - Beginning of Year	5,813,664	8,758,528	1,465,550	1,301,504	(241,536)	14,050,264	31,147,974
UNRESTRICTED NET ASSETS - END OF YEAR	$ 5,677,317	$ 132,345	$ (30,504)	$ (367)	$ (1,018,390)	$ 12,458,759	$ 17,219,160