ARTESIA SPECIAL HOSPITAL DISTRICT

EDDY COUNTY, NEW MEXICO

FINANCIAL STATEMENTS

AS OF JUNE 30, 2008 AND 2007

TOGETHER WITH REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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INTRODUCTORY SECTION

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Artesia Special Hospital District
Official Roster
June 30, 2008

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Artesia Special Hospital
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FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

Hector H. Balderas
New Mexico State Auditor
The Board of Trustees and
Management of Artesia Special Hospital District
Artesia, New Mexico

We have audited the accompanying financial statements of the business-type activity of Artesia Special Hospital District (the District), a political subdivision of the State of New Mexico as of and for the years ended June 30, 2008 and 2007, which collectively comprise the District's basic financial statements as listed in the table of contents. We also have audited Schedule III - Schedule of Revenues and Expenses with Budget Comparison presented as supplementary information for the year ended June 30, 2008. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business type activities as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above present fairly, in a material respects, the budgetary comparisons for the enterprise fund for the year ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 13, 2008, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements and budgetary comparison. The supplemental schedules, Schedule I – Schedule of Collateral Pledged by Depository for Public Funds and Schedule II – Schedule of Deposit and Investment Accounts, are presented for purposes of additional analysis and are not a required part of the basic financial statements. . Schedule I – Schedule of Collateral Pledged by Depository for Public Funds and Schedule II – Schedule of Deposit and Investment Accounts have been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion, are fairly stated in all material respects, in relation to the basic financial statements taken as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it

Accounting & Consulting Group, LLP
Certified Public Accountants

Accounting & Consulting Group, L.L.P.

Albuquerque, New Mexico
October 13, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Artesia Special Hospital District's (District) financial performances provides an overview of the District's financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the District's financial statements.

Financial Highlights

- The District's change in unrestricted net assets between 2008 and 2007 was $526,816 or a 24.99% increase mainly due to non- operating revenues (expenses) exceeding the operating loss by $1,150,071. Non-operating revenues exceeded non-operating expenses primarily because general obligation bond mill levy collections are used to pay both principal and interest but the principal payments are not an expense item. Principal payment on general obligation bond debt was $2,255,000 in 2008. The District also continued to benefit from interest earnings on proceeds from the $8,000,000 general obligation bond issuance in November 2006 that are currently being used by the District to renovate portions of the District's hospital facilities.
- The District reported an operating loss of $1,027,083 in 2007 and $1,536,203 in 2008 mainly due to large depreciation deductions that exceed operating revenues. While the District receives operating mill levy collections that exceed depreciation deductions, these collections are passed through to Artesia General Hospital ("AGH") under the terms of the District's lease agreement with the AGH. The District does receive lease income from AGH that is sufficient to cover all operating expenses except depreciation. Excluding depreciation, the District has operating income of $164,739 in 2008. The large depreciation deductions are due to the completion of a $20,000,000 expansion of the District's hospital facilities in November 2006 along with the ongoing renovation project. This expansion was funded by proceeds from the $20,000,000 and $8,000,000 general obligation bond issuances approved by voters in August 2004 and November 2006, respectively.
- Oil and gas production increases in 2007-2008 resulted in an Operating mill levy tax revenue increase of $901,601 or 46.66%.
- The 2008 General Obligation Bond mill levy was $3,386,268 in 2008 and $2,503,935 in 2007.
- Construction in progress decreased $5,364,234 for renovation and new construction for the Hospital.
- Accounts payable decreased $2,043,127 due to the repayment of many construction payables.

Using This Annual Report

The District's financial statements consist of three statements— Statements of Net Assets; Statements of Revenues, Expenses and Changes in Net Assets; and Statements of Cash Flows. These financial statements and related notes provide information about the activities of the District, including resources held by the District but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Statements of Net Assets and Statements of Revenues, Expenses, and Changes in Net Assets

One of the most important questions asked about the District finances is, "Is the District as a whole better or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the District's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the District's net assets and changes in them. You can think of the District's net assets—the difference between assets and liabilities—as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the District's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the District.

The District is a unique organization in the fact that it does not have normal operations. The District is a governmental entity that its sole purpose is to own District assets and collect Mill Levy funds. The District has suffered large losses over the years but it is mainly depreciation expense. The cash portion of the District is sound.

Table 1: Assets, Liabilities, and Net Assets

	2008	2007	2006
Assets:			
Current assets	$ 3,714,636	$ 2,085,866	$ 1,967,703
Capital assets, net	30,194,890	30,246,686	19,435,002
Other non-current assets	4,024,548	7,199,868	9,628,957
Total assets	**37,934,074**	**39,532,420**	**31,031,662**
Liabilities:			
Long-term obligations outstanding	24,107,113	26,362,663	19,420,000
Other current and non-current liabilites	2,098,785	3,588,580	3,148,699
Total Liabilities	**26,205,898**	**29,951,243**	**22,568,699**
Net assets:			
Invested in capital assets net of related debt	5,922,574	4,284,724	3,711,886
Restricted for capital improvements	-	-	673,112
Restricted for general care	154,672	154,672	73,714
Restricted for cardiac care	-	-	72,047
Restricted for debt service	3,015,870	3,033,537	2,474,075
Unrestricted	2,635,060	2,108,244	1,458,129
Total net assets	**11,728,176**	**9,581,177**	**8,462,963**
Total liabilities and net assets	**$ 37,934,074**	**$ 39,532,420**	**$ 31,031,662**

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balances during the reporting period?"

The District's Net Assets

The District's net assets are the difference between its assets and liabilities reported in the Statements of Net Assets. The District's net assets increased $2,146,999 or 22.4% as you can see from Table 1.

During Fiscal year 2005, the voters approved a $20,000,000 bond issue to help with a major expansion and renovation of the District facilities. The election for the bond issue was held August 2004. During fiscal year 2007, the voters approved a bond issue to expand, equip, furnish, remodel and renovate the District facilities. The election for the bond issue was held the first part of August 2006.

Operating Results and Changes in the District Net Assets

In the year of 2008, the District's net assets increased $2,146,999 as you can see in Table 2.

Table 2: Operating Results and Changes in the District's Net Assets

	2008	2007	2006
Operating revenues:			
Mill levy taxes	$ 3,854,531	$ 3,107,031	$ 2,429,928
Less amounts passed through to : AGH	(3,170,671)	(2,754,661)	(2,429,928)
Dialysis unit	(657,241)	(352,370	-
Lease income	250,004	125,004	162,071
Other	845	3,692	5,764
Total operating revenues	277,468	128,696	167,835
Operating expenses			
Miscellaneous	45,668	26,187	8,915
Professional fees	67,061	80,441	29,739
Depreciation and amortization	1,700,942	1,049,151	374,809
Total operating expenses	1,813,671	1,155,779	413,463
Operating loss	(1,536,203)	(1,027,083)	(245,628)
Nonoperating revenues and expenses			
G.O. Bond mill levy	3,386,268	2,503,935	2,194,379
Investment income	116,195	407,905	672,766
Interest expense	(816,189)	(814,714)	(595,090)
Total nonoperating revenues (expenses)	2,686,274	2,097,126	2,272,055
Excess of revenues over expenses before capital grants, contributions, and additions to permanent endowments	1,150,071	1,070,043	2,026,427
Restricted contributions	1,020	-	664,201
Capital grants	995,908	48,171	11,314
Increase in net assets	2,146,999	1,118,214	2,701,942
Net assets beginning of year	9,581,177	8,462,963	5,761,021
Net assets end of year	$ 11,728,176	$ 9,581,177	$ 8,462,963

Operating Income/(Loss)

Operating income/(loss) consists of three main items. One, the mill levy funds ($3,854,530 in 2008) are collected and paid directly to the dialysis unit and the management company operating the Hospital. The mill levy funds consists of ad valorem taxes, which are received 60 days after collection and oil and gas revenue, which are received 30 days after collection. Eddy County oversees the distribution of these funds. The management company must spend these funds on the operation of the District. The second component is lease income. The lease income is from the management company for the lease of the hospital. A new lease agreement began in October 2004. The third component is other which primarily consists of bad debt recoveries and various other payments from operations from years past.

Non-operating Revenues and Expenses

Non-operating revenues and expenses consist primarily of the General Obligation Bond mill levy. The other components of non-operating revenues and expenses relate to investment income and investment expense. The District's cash is invested in Certificate of Deposits.

Grants, Contributions, and Endowments

The District received capital grant revenue from state agencies for the purchase of equipment. These are discussed in detail in Note 1.

The District Cash Flows

Changes in the District cash flows are consistent with changes in operating losses and non-operating revenues and expenses, discussed earlier.

Significant variances between final budget and actual

Revenues exceeded budgeted amounts by $1,503,797, this was mostly due to the GO Bond mill levy revenue that was $1,069,273 more than budgeted. Actual expenses were $376,703 less than budgeted due mostly to $255,422 of budgeted capital projects expense that was not spent.

Capital Assets

At the end of 2008, the District had $30,194,890 invested in capital assets, net of accumulated depreciation, as detailed in Note 7 to the financial statements. In 2008, the District purchased equipment costing $218,328 and reclassified $6,789,605 from CIP for total equipment additions of $7,007,933.

In 2005 the District began a 65,000 square feet expansion of its hospital facilities. This expansion was funded by proceeds from the issuance of $20,000,000 in general obligation bonds approved by voters in August 2004. Actual construction of the expansion project was completed in November 2006.

The District also began renovations of existing hospital facilities in December 2006 funded by proceeds from the issuance of $8,000,000 in general obligation bonds approved by voters in August 2006. The renovation work was still in progress at June 30, 2008.

Debt

The District had $22,482,113, net of current maturities of $1,625,000, of General Obligation Bonds outstanding as outlined in Note 8 to the financial statements. Debt was incurred for renovations and new construction for the Hospital.

Subsequent Events

The District is close to consenting to the agreement with the Hospital and a third party to run the almost completed Dialysis Unit. This would free up the money reserved for the Dialysis Unit for use on other projects as the Hospital District sees fit.

Other Issues

There are no known facts, decisions or conditions that are expected to have a significant effect on the financial position (net assets) or results of operations. (revenue, expenses, and other charges)

Contacting the District Financial Management

The financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the District finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District Board Chairman, at Artesia Special Hospital District, P. O. Box 628, Artesia, New Mexico 88210.

BASIC FINANCIAL STATEMENTS

Artesia Special Hospital District
Statements of Net Assets
June 30, 2008 and 2007

Assets

		2008		2007
Current Assets				
Cash and cash equivalents (Note 2)	$	2,494,249	$	1,411,821
Mill levy receivable, net of uncollectible amounts (Note 5)		1,088,090		658,583
Rent receivable		125,000		-
Accrued interest receivable		7,297		15,462
Total current assets		3,714,636		2,085,866
Noncurrent cash and investments				
Cash restricted by donor for cardiac and general care		24,866		859,823
Cash restricted for dialysis unit		859,817		339,759
Cash restricted for debt service		3,015,870		3,033,537
Cash restricted for construction		29,510		2,866,817
Total noncurrent assets		3,930,063		7,099,936
Capital Assets				
Land		60,052		60,052
Depreciable capital assets, net of accumulated depreciaton		29,685,784		24,373,346
Construction in progress (Note 7)		449,054		5,813,288
Net capital assets		30,194,890		30,246,686
Other Assets				
Bond issuance costs net of accumulated amortization $5,447 in 2007 and $3,230 in 2006		94,485		99,932
Total assets	$	37,934,074	$	39,532,420

The accompanying notes are an integral part of these statements.

Artesia Special Hospital District
Statements of Net Assests
June 30, 2008 and 2007

Liabilities and Net Assets

	2008	2007
Current Liabilities		
Current portion of long-term debt	$ 1,625,000	$ 2,255,000
Due to AGH	483,804	687,971
Due to Dialysis Unit	1,028,056	-
Accounts payable (Note 6)	172,967	2,216,094
Retainage payable (Note 6)	21,746	250,022
Accrued bond interest payable (Note 6)	384,617	426,898
Estimated third-party payor settlements (Note 4)	7,595	7,595
Total current liabilities	3,723,785	5,843,580
Long Term Liabilities		
Long-term debt, net of current maturities (Note 8)	22,482,113	24,107,663
Total liabilities	26,205,898	29,951,243
Net Assets		
Invested in capital assets, net of related debt	5,922,574	4,284,724
Restricted, expendable for:		
General care	154,672	154,672
Debt service	3,015,870	3,033,537
Unrestricted	2,635,060	2,108,244
Total net assets	11,728,176	9,581,177
Total liabilities and net assets	$ 37,934,074	$ 39,532,420

The accompanying notes are an integral part of these statements.

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Artesia Special Hospital District
Statement of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2008 and 2007

	2008	2007
Operating Revenues		
Mill levy taxes		
Ad-valorem taxes	$ 1,020,650	$ 1,174,751
Oil and gas taxes	2,833,881	1,932,280
Less amounts passed through to AGH	(3,170,671)	(3,107,031)
Less amounts passed through to Dialysis Unit	(657,241)	-
Lease income	250,004	125,004
Other	845	3,692
Total operating revenues	277,468	128,696
Operating Expenses		
Miscellaneous	24,892	5,395
Contract labor	-	4,710
Advertising	1,234	5,576
Insurance	10,830	10,506
Professional fees	67,061	80,441
Rentals and Leases	8,712	0
Depreciation and amortization	1,700,942	1,049,151
Total operating expenses	1,813,671	1,155,779
Operating (loss)	(1,536,203)	(1,027,083)
Nonoperating Revenues (Expenses):		
GO Bond mill levy	3,386,268	2,503,935
Investment income	116,195	407,905
Interest expense	(816,189)	(814,714)
Total nonoperating revenues and expenses	2,686,274	2,097,126
Excess of revenues over expenses before capital grants, contributions, and additions to permanent endowments	1,150,071	1,070,043
Contributions restricted to capital improvements	1,020	-
Capital grants	995,908	48,171
Increase in net assets	2,146,999	1,118,214
Net Assets - beginning of the year	9,581,177	8,462,963
Net Assets - end of the year	$ 11,728,176	$ 9,581,177

The accompanying notes are an integral part of these statements.

Artesia Special Hospital District
Statements of Cash Flows
For the Years Ended June 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Receipts from customers and users	$ 845	$ 3,692
Receipts from leases	125,004	125,004
Payments to vendors	(86,110)	(101,972)
Net cash provided by operating activities	**39,739**	**26,724**
Cash flows from non-capital financing activities:		
Mill levy taxes: Eddy County	3,622,178	3,002,060
Pass through of mill levy taxes to AGH	(3,030,642)	(2,667,685)
Net cash provided (used) by non-capital financing activities	**591,536**	**334,375**
Cash flows from capital and related financing activities:		
Capital grant revenue	995,908	48,171
Gift revenue	1,020	-
Bond mill levy	3,189,113	2,410,847
Purchase of capital assets	(3,915,101)	(11,973,491)
Proceeds from long-term debt	-	8,003,030
Interest payment on long-term debt	(858,470)	(701,839)
Principal payments on long-term debt	(2,255,000)	(1,060,000)
Bond issuance costs	-	(44,340)
Net cash (used) by capital and related financing activities	**(2,842,530)**	**(3,317,622)**
Cash flows from investing activities:		
Investment Income	123,810	396,386
Net cash provided by investing activities	**123,810**	**396,386**
Net (decrease) in cash and temporary investments	**(2,087,445)**	**(2,560,137)**
Cash and temporary investments - beginning of year	**8,511,757**	**11,071,894**
Cash and temporary investments - end of year	**$ 6,424,312**	**$ 8,511,757**
Unrestricted cash and cash equivalents	**$ 2,494,249**	**$ 1,411,821**
Restricted cash and cash equivalents		
Restricted by donor for cardiac and general care	24,866	859,823
Restricted for dialysis unit	859,817	339,759
Restricted for debt service	3,015,870	3,033,537
Restricted for construction	29,510	2,866,817
Total cash and cash equivalents	**$ 6,424,312**	**$ 8,511,757**

The accompanying notes are an integral part of these financial statements.

Artesia Special Hospital District

Statements of Cash Flows

For the Years Ended June 30, 2008 and 2007

		2008		2007
Reconciliation of operating (loss) to net cash provided by operating activities:				
Operating (loss)	$	(1,536,203)	$	(1,027,083)
Adjustments to reconcile operating (loss) to net cash flows from operating activities:				
Depreciation and amortization		1,700,942		1,049,151
Increase (decrease) in:				
Accounts payable				4,656
Decrease (increase) in:				
Accounts receivable		(125,000)		
Net cash provided by operating activities	$	39,739	$	26,724

The accompanying notes are an integral part of these financial statements.

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NOTE 1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Reporting Entity

In September 1978, the Artesia Special Hospital District (District) was created pursuant to the New Mexico Special Hospital District Act and under that authority operated Artesia General Hospital (Hospital) until October 31, 1999. The Hospital, which is licensed for 38 beds, began operation on November 14, 1981. The Board of Trustees are elected by the residents of the District pursuant to Chapter 4, Article 48A-6 NMSA 1978 and they are authorized by New Mexico statute to call for a resolution imposing ad valorem taxes on all properties located within the Special Hospital District. The Artesia Special Hospital District has no component units and is not a component unit of another governmental entity.

As of October 31, 1999, the District entered into a series of agreements to lease the hospital to VHA Southwest Community Health Corporation (CHC), a Texas not-for-profit corporation, which CHC will operate through a wholly owned subsidiary, Artesia General Hospital (AGH), a New Mexico not-for-profit corporation. The agreement between the District and CHC/AGH is explained through the following documents:

District Operating Agreement between the District and CHC

CHC retains certain reserved powers as necessary to perform its oversight responsibilities of the ongoing operation of AGH, which, in turn, must remain committed to serving the healthcare needs of all the citizens of Artesia to the extent and manner that the citizens expect from Artesia General Hospital. The District must pay to AGH and dialysis unit the total amount of the mill levy tax that the District receives each year. For the first twelve months of the agreement, however, the District is allowed to reserve 15% of the mill levy tax that it receives to help defray the amount due under the previous management agreement with Presbyterian Healthcare Services (PHS). This agreement has an initial five-year period and will be automatically renewed for two successive five-year periods after that, as long as neither the District nor CHC have given notice of termination at least one hundred and eighty days before the end of the initial or renewal term. The agreement is due to expire in 2009.

Facility and Equipment Lease Agreement between the District (as landlord) and AGH (tenant)

The leased property consists of land, a hospital building and storage building located in Artesia and virtually all personal property located at this site as well as two suites in a medical office building and an offsite storage facility.

Under the lease agreement, covering the period from October 31, 2004 to October 31, 2009, the tenant will pay rent to the landlord in the amount of $125,000 annually or 20% of tenant's net income not to exceed $250,000 annually. The tenant must keep and maintain the entire premises in good condition, promptly making all necessary repairs and replacements and maintain adequate coverage through fire, casualty and liability insurance. At the end of the agreement, the District has the option to purchase the personal property purchased by AGH during the term of the agreement at the then book value (as depreciated).

Summary of Significant Accounting Policies

The summary of significant accounting policies of the District is presented to assist in the understanding of the District's financial statements. The financial statements and notes are the representation of Artesia Special Hospital District's management who is responsible for their integrity and objectivity. The financial statements of the District conform to accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

NOTE 1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of Accounting - Enterprise Fund Accounting - The District uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. As initially provided in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, and made permanent for enterprise funds by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* ,the District has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents – Cash and Cash Equivalents include investments with an original maturity of three months or less. Cash and temporary investments consist of checking accounts and a certificate of deposit maintained at local financial institutions. The certificate of deposit is carried at cost, which approximates fair value.

Capital Assets - State law sets a capitalization threshold of $5,000 for acquisitions of property and equipment. The District has elected to follow State policy. Acquisitions of capital assets are recorded at cost. Improvements and replacements of building and equipment are capitalized. Maintenance and repairs that do not improve or extend the lives of property and equipment are charged to expense as incurred. When assets are sold or retired, their cost and related accumulated depreciation are removed from the accounts and any gain or loss is reported in the statements of revenues, expenses and changes in net assets. The District does not have any infrastructure.

Capital assets donated for healthcare operations are recorded as additions to the donor-restricted plant, replacement and expansion funds at fair value at the date of receipt, and as a transfer to the general fund balance when the assets are placed in service.

Depreciation is provided over the estimated useful life of the asset and is computed using the straight-line method. Useful lives are assigned using industry guidelines published by the American Hospital Association and typically range from 3 to 40 years.

Donor-Restricted Funds – Contributed funds, the use of which is specified by donors or grantors, are recorded as additions to restricted fund balance. Resources restricted by donors for specific operating purposes are reported in other operating revenue to the extent used within the period. Restricted amounts are released from restricted fund balance when the restriction imposed by the donor has been satisfied.

Mill Levy – An operating mill levy, approved by the voters of Eddy County, expires in 2009. The District recorded $3,854,530 in 2008 and $3,107,031 in 2007 in mill levy operating revenues. The amounts were used in accordance with the provisions of the property tax referendum. A General Obligation (GO) bond mill levy, approved by voters of Eddy County in November, 2004 and August 2006 will expire in 2019. The District recorded $3,386,268 in 2008 and $2,503,935 in 2007 of mill levy revenue under the GO bond mill levy. The amounts will be used in accordance with the provisions of the property tax referendum.

The District receives mill levy taxes from the Treasurer of Eddy County. The County serves as the intermediary collecting agency and remits the District's share of mill levy tax collections. The District does not maintain detailed records of mill levy taxes receivable by the individual taxpayer.

NOTE 1 **DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

Mill levy property taxes are levied on November 1 based on the assessed value of property as listed on the previous January 1 and are due in two payments by November 10th and April 10th. The taxes attach as an enforceable lien on property thirty (30) days thereafter, at which time they become delinquent. The District recognizes revenue from mill levy property taxes in the period for which they are levied, net of estimated refunds and uncollectible amounts.

Grants and Contributions –From time to time, the District receives grants from the State of New Mexico and the City of Artesia as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

Restricted Resources – When the District has both restricted and unrestricted resources available to finance a particular program, it is the District's policy to use restricted resources before unrestricted resources.

Net Assets – Net assets of the District are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District, including amounts deposited with trustees as required by revenue bond indentures. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted.* The Statement of Net Assets reports $3,170,542 of restricted net assets, of which $0 is restricted by enabling legislation.

Operating Revenues and Expenses – The District statements of revenues, expenses and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with passing mill levy taxes through to the operating company, collecting lease income, and collecting old debts. Non-exchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues. Operating expenses are all expenses incurred to administer the operating revenues.

Revenue Recognition for Derived Tax Revenues – It is the policy of the District to recognize non-exchange revenues for which there are time requirements in the period in which those time requirements are met, regardless of whether the revenues are due or whether an enforceable legal claim to the assets exists. If no time requirements are specified in enabling legislation, revenues are recognized when the District has an enforceable legal claim to the assets or when they are received, whichever occurs first.

Budgets and Budgetary Accounting – Prior to the beginning of each fiscal year, the budget for the general fund of the District is prepared on the non-GAAP budgetary basis by the Chairman and is presented to the District's Board of Trustees (the Board) for review and approval. Upon Board approval, the budget is sent to the Department of Finance and Administration of the State of New Mexico (DFA) for tentative approval. Final approval is granted after the beginning of the fiscal year when net assets for the prior year are known. Expenditures legally cannot exceed the total budget. Any budget amendments are first reviewed and approved by the Board and then sent to the DFA for state approval. The board is authorized to transfer budgeted amounts between departments; however, any revisions that alter total expenditures must be approved by the DFA. As of June 30, 2008 and 2007, the District was in compliance with these requirements.

Risk Management – The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters.

NOTE 1. **DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Investments in debt and equity securities - Investments in debt and equity securities are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in non-operating revenue when earned.

Bond issuance cost and amortization – Bond premiums and discounts, as well as bond issuance costs, are deferred and amortized over the life of the bonds using the straight line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the life of the related debt.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of asset and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual events and results could differ from those assumptions and estimates.

Comparability - Certain prior year balances have been reclassified to conform to the June 30, 2008 financial statement presentation.

NOTE 2**.** **DEPOSITS AND INVESTMENTS**

State statutes authorize the investment of the District's funds in a wide variety of instruments including certificates of deposit and other similar obligations, state investment pool, and money market accounts. The District is also allowed to invest in United States Government obligations. All funds of the District must follow the above investment policies.

Deposits of funds may be made in interest or non-interest bearing checking accounts in one or more banks or savings and loan associations within the geographical boundaries of the District. Deposits may be made to the extent that they are insured by an agency of the United States or by collateral deposited as security or by bond given by the financial institution.

The rate of interest in non-demand interest-bearing accounts shall be set by the State Board of Finance, but in no case shall the rate of interest be less than one hundred percent of the asked price on United States treasury bills of the same maturity on the day of deposit.

Excess of funds may be temporarily invested in securities which are issued by the State or by the United States government, or by their departments or agencies, and which are either direct obligations of the State or the United States or are backed by the full faith and credit of those governments.

According to the Federal Deposit Insurance Corporation, public unit deposits are funds owned by the District. Time deposits, savings deposits and interest bearing NOW accounts of an institution in the same state will be insured up to $100,000 in aggregate and separate from the $100,000 coverage for public unit demand deposits at the same institution.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk. New Mexico State Statutes require collateral

NOTE. 2. **DEPOSITS AND INVESTMENTS** (continued)

pledged for deposits in excess of the federal deposit insurance to be delivered, or a joint safekeeping receipt be issued, to the District for at least one half of the amount on deposit with the institution. As of June 30, 2008 and 2007, $6,224,312 and $8,332,736 of the District's bank balances were exposed to custodial credit risk as follows:

	First National	**Western Bank**	**Total**
Year ended June 30, 2008			
Total amount of deposits	$ 5,205,130	$ 1,219,182	$ 6,424,312
FDIC Coverage	(100,000)	(100,000)	(200,000)
Total uninsured public funds	5,105,130	1,119,182	6,224,312
Collateralized by securities held by the pledging institution or by its trust department or agent in other than the District's name	5,105,130	1,103,336	6,208,466
Uninsured and uncollateralized	-	15,846	15,846
Collateral requirement (50% of uninsured public funds)	2,552,565	559,591	3,112,156
Pledged securities	5,272,529	1,103,335	6,375,864
Over (under) collateralization	$ 2,719,964	$ 543,744	$ 3,263,708

	First National	**Western Bank**	**Total**
Year ended June 30, 2007			
Total amount of deposits	$ 7,371,428	$ 1,161,308	$ 8,532,736
FDIC Coverage	(100,000)	(100,000)	(200,000)
Total uninsured public funds	7,271,428	1,061,308	8,332,736
Collateralized by securities held by the pledging institution or by its trust department or agent in other than the District's name	7,271,428	1,061,308	8,332,736
Uninsured and uncollateralized	-	-	-
Collateral requirement (50% of uninsured public funds)	3,635,714	530,654	4,166,368
Pledged securities	10,726,047	1,103,446	11,829,493
Over (under) collateralization	$ 7,090,333	$ 572,792	$ 7,663,125

NOTE 3. **RESTRICTED NET ASSETS**

Restricted net assets are expendable for the following purposes:

	2008	2007
Capital improvements	$ -	$
General care	154,672	154,672
Debt service	3,015,870	3,033,537
Total restricted net assets	$ 3,170,542	$ 3,188,209

Reconciliation to the Statement of Net Assets

The carrying amounts of deposits and investments shown above are included in the District's statements of net assets as follows:

	2008	2007
Deposits	$ 6,424,312	$ 8,532,736
Reconciling items	-	(20,979)
Carrying amount	$ 6,424,312	$ 8,511,757
Included in the following Statement of Net Assets captions:		
Cash and cash equivalents	$ 2,494,249	$ 1,411,821
Non-current cash and investments		
Restricted by donor for cardiac and general care	24,866	859,823
Restricted for dialysis unit	859,817	339,759
Restricted for debt service	3,015,870	3,033,537
Restricted for construction	29,510	2,866,817
Total	$ 6,424,312	$ 8,511,757

NOTE 4. **CONTINGENCIES**

The estimated third party payor settlements recorded at June 30, 2008 could differ from actual settlements based on the results of cost report audits. Medicaid cost reports for all years and Medicare cost reports for all years up to October 1, 1999 have been audited and settled as of the date of the prior year Independent Auditor's Report. There are no amounts receivable and payable relating to final settlements as of June 30, 2008. All settled cost reports can be re-opened and are, therefore, subject to subsequent adjustment. The District believes there may be a claim for the fiscal year ended June 30, 1999. In the opinion of management, adequate reserves for estimated final settlements have been provided as of June 30, 2008.

NOTE 5. **MILL LEVY TAXES RECEIVABLE**

A New Mexico law adopted in 1980 and amended in 1981 allows counties to provide expanded tax support to qualified Districts. Mill levy taxes are reported as revenue in the period for which they were levied. Due to additional information obtained from Eddy County, the District changed their estimate for uncollectible ad-valorem taxes in 2007. The allowable-uncollectible amount represents taxes protested by Navajo Refinery Company for 2005, 2006, and 2007 and amounts protested by Qwest for 2006 and 2007.

The District received cash operating mill levy proceeds of $3,854,530 and $3,107,031 in 2008 and 2007 respectively and passed through to AGH and Dialysis Unit the amounts of $3,827,912 and $3,107,031 in 2008 and 2007, NOTE 5. **MILL LEVY TAXES RECEIVABLE (continued)**

respectively. Mill levies were used in accordance with the provisions of the 1980 Hospital Funding Act, as amended. The new mill levy was passed in August 2006 and is set to expire in 2009.

The District recorded General Obligation Bond mill levy revenues of $3,386,268 and $2,503,935 in 2008 and 2007, respectively. This mill levy was passed by the voters in November 2004 and August 2006. Bonds are scheduled to be paid off August 2019.

The total Mill levy receivable was $1,088,090 and $658,583 at June 30, 2008 and 2007 respectively. Mill levy receivable consists of the following at June 30, 2008 and 2007:

	2008	2007
Mill levy receivable		
Ad-valorem	$ 449,114	$ 424,874
Oil and gas	1,027,084	375,378
Less allowance for uncollectible amounts	388,108	141,669
Mill levy receivable	$ 1,088,090	$ 658,583

NOTE 6. **ACCOUNTS RECEIVABLE AND PAYABLE**

Accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the District at June 30, 2008 and 2007 consisted of these amounts:

Accounts Receivable and Accrued Interest	**2008**	**2007**
Mill levy receivable	$ 1,088,090	$ 658,583
Rent receivable	125,000	-
Accrued interest receivable	7,297	15,462
Total accounts receivable and accrued interest	$ 1,220,387	$ 674,045

Accounts Payable and Accrued Expenses	**2008**	**2007**
Accounts payable to contractors and others	$ 172,967	$ 2,216,094
Retainage payable to contractors	21,746	250,022
Accrued bond interest payable	384,617	426,898
Total accounts payable and accrued expenses	$ 579,330	$ 2,893,014

NOTE 7. **CAPITAL ASSETS**

Depreciation expense for the periods ended June 30, 2008 and 2007 was $1,695,495 and $1,044,443 and interest capitalized for the years ended June 30, 2008 and 2007 was $461,831 and $350,208, respectively.

Costs to complete construction in progress are estimated at $711,301.

Capital assets, additions, retirements, and balances for the year ended June 30, 2008 are as follows:

	Balance June 30, 2007	Additions	Disposals	Balance June 30, 2008
Non-depreciable assets:				
Land and improvements	$ 60,052	$ -	$ -	$ 60,052
Construction in progress	5,813,288	1,425,371	6,789,605	449,054
	5,873,340	1,425,371	6,789,605	509,106
Depreciable assets:				
Land improvements	1,117,060	112,909	-	1,229,969
Buildings and improvements	25,934,619	6,656,700	-	32,591,319
Equipment	7,642,079	238,324	-	7,880,403
	34,693,758	7,007,933	-	41,701,691
Accumulated depreciation				
Land improvements	(306,206)	(90,371)	-	(396,577)
Buildings and improvements	(4,540,570)	(1,213,196)	-	(5,753,766)
Equipment	(5,473,636)	(391,928)	-	(5,865,564)
	(10,320,412)	(1,695,495)	-	(12,015,907)
Net capital assets	$ 30,246,686	$ 6,737,809	$ 6,789,605	$ 30,194,890

NOTE 7. **CAPITAL ASSETS** (continued)

Capital assets, additions, retirements, and balances for the year ended June 30, 2007 are as follows:

	Balance June 30, 2006	Additions	Disposals	Balance June 30, 2007
Non-depreciable assets:				
Land and improvements	$ 60,052	$ -	$ -	$ 60,052
Construction in progress	17,457,812	10,569,378	22,213,902	5,813,288
	17,517,864	10,569,378	22,213,902	5,873,340
Depreciable assets:				
Land improvements	278,997	838,063	-	1,117,060
Buildings and improvements	4,977,552	20,957,067	-	25,934,619
Equipment	5,936,558	1,705,521	-	7,642,079
	11,193,107	23,500,651	-	34,693,758
Accumulated depreciation				
Land improvements	(251,736)	(54,470)	-	(306,206)
Buildings and improvements	(3,865,816)	(674,754)	-	(4,540,570)
Equipment	(5,158,417)	(315,219)	-	(5,473,636)
	(9,275,969)	(1,044,443)	-	(10,320,412)
Net capital assets	$ 19,435,002	$ 33,025,586	$ 22,213,902	$ 30,246,686

Depreciation expense for the periods ended June 30, 2008 and June 30, 2007 was $1,695,495 and $1,044,443, respectively.

NOTE 8. **LONG-TERM DEBT**

A schedule of changes in the District's General Obligation Bonds for 2008 and 2007 follows:

	Balance June 30, 2007	Additions	Reduction	Balance June 30, 2008	Amounts Due Within One Year
2005 GO Bond	$ 18,360,000	$ -	$ 1,105,000	$ 17,255,000	$ 1,150,000
2006 GO Bond	8,000,000	-	1,150,000	6,850,000	475,000
2006 Premium	2,663	-	550	2,113	-
Total Long-Term Debt	$ 26,362,663	$ -	$ 2,255,550	$ 24,107,113	$ 1,625,000

	Balance June 30, 2006	Additions	Reduction	Balance June 30, 2007	Amounts Due Within One Year
2005 GO Bond	$ 19,420,000	$	$ 1,060,000	$ 18,360,000	$ 1,105,000
2006 GO Bond		8,000,000		8,000,000	1,150,000
2006 Premium		3,030	367	2,663	
Total Long-Term Debt	$ 19,420,000	$ 8,003,030	$ 1,060,367	$ 26,362,663	$ 2,255,000

NOTE 8. **LONG-TERM DEBT** (continued)

Bonds outstanding at June 30, 2008, consist of the following issues:

General Obligation Bonds Series : 2005
Original Issue : $20,000,000
Principal : August 1
Interest : February 1 and August 1
Rates : 3.25% - 4.5%
Purpose : To renovate and make additions to the Hospital

Scheduled principal and interest repayments on long-term debt obligations are as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2009	1,150,000	629,475	1,779,475
2010	1,195,000	576,713	1,771,713
2011	1,240,000	528,125	1,768,125
2012	1,290,000	483,850	1,773,850
2013	1,345,000	439,419	1,784,419
2014-2018	7,565,000	1,432,007	8,997,007
2019	3,470,000	140,200	3,610,200
Total	$ 17,255,000	$ 4,229,789	$ 21,484,789

General Obligation Bonds Series : 2006
Original Issue : $8,000,000
Principal : August 1
Interest : February 1 and August 1
Rates : 3.75% - 4.5%
Purpose: To erect, remodel, make additions to and furnish and provide equipment to the Hospital or any combination of these purposes.

Scheduled principal and interest repayments on long-term debt obligations are as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2009	475,000	257,934	732,934
2010	475,000	238,341	713,341
2011	500,000	218,231	718,231
2012	500,000	197,606	697,606
2013	525,000	176,466	701,466
2014-2018	3,000,000	550,226	3,550,226
2019	1,375,000	52,031	1,427,031
Total	$ 6,850,000	$ 1,690,835	$ 8,540,835

NOTE 9. SUBSEQUENT EVENTS

The District is close to consenting to the agreement with the Hospital and a third party to run the almost completed Dialysis Unit. This would free up the money reserved for the Dialysis Unit for use on other projects as the Hospital District sees fit.

NOTE 10. COMMITMENTS

The District estimates that it will have to spend an additional $711,301 in the 2008-2009 fiscal year in order to complete the renovation project

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SUPPLEMENTARY INFORMATION

Artesia Special Hospital District **Schedule I**

Schedule of Collateral Pledged by Depository

For Public Funds

June 30, 2008

Name of Depository and Description of Pledged Collateral		Fair Market Value June 30, 2008	Name and Location of Safekeeper
1st National Bank of Artesia			
FHLB, FHLMC S/A			Federal Home Loan Bank
Due 07/28/2009, CUSIP#3128X1UE50310080135	$	100,103	Dallas, Texas
FHLB, SANTA FE NM			Federal Home Loan Bank
Due 08/01/2009 CUSIP#801891ED00202210024		125,258	Dallas, Texas
FHLB, FHLMC 1TIME			Federal Home Loan Bank
Due 11/15/2011 CUSIP#3128X3K690411120054		508,118	Dallas, Texas
FHLB, MBS FHLMC			Federal Home Loan Bank
Due 11/15/2011 CUSIP#312966WH30506210077		177,574	Dallas, Texas
FHLB, MBS FNMA			Federal Home Loan Bank
Due 04/01/2015 CUSIP#31376KMB90509190018		525,988	Dallas, Texas
FHLB, MBX FHLMC			Federal Home Loan Bank
Due 04/01/2015 CUSIP#31294KP580411150056		423,256	Dallas, Texas
FHLB, MBXS FHLMC GOLD			Federal Home Loan Bank
Due 05/01/2018 CUSIP#3128H3W980604100027		525,720	Dallas, Texas
FHLB, MBS FNMA			Federal Home Loan Bank
Due 06/01/2018 CUSIP#31401HMH20411160115		130,609	Dallas, Texas
FHLB, MBS FNMA			Federal Home Loan Bank
Due 08/01/2018 CUSIP#31404UDX50405070008		88,904	Dallas, Texas
FHLB, MBS FHLMC			Federal Home Loan Bank
Due 11/01/2022, CUSIP #31282CMP90803070017		872,137	Dallas, Texas
FHLB, MBS FHLMC			Federal Home Loan Bank
Due 11/01/2024 CUSIP#31335H5Y50604100024		1,066,259	Dallas, Texas
FHLB, MBS FHLMC GOLD			Federal Home Loan Bank
Due 11/01/2034, CUSIP #31283YRE00602160016		728,603	Dallas, Texas
	$	5,272,529	
Western Bank			
FHLMC Pool #C90015			Federal Home Loan Bank
Due 5/1/2013, CUSIP #31335HAQ6/00041000056	$	12,409	Dallas, Texas
FHLMC Pool #C90015			Federal Home Loan Bank
Due 5/1/2013, CUSIP #31335HAQ6/00041000056		36,996	Dallas, Texas
GNMA II Pool #1753			Federal Home Loan Bank
Due 6/20/2024, CUSIP#36202B5N1/0012130038		86,186	Dallas, Texas
MBS FNLB ONE-TIME CALL			Federal Home Loan Bank
Due 8/25/2010, CUSIP#3133XOM220308220109		967,744	Dallas, Texas
	$	1,103,335	

See Independent Auditor's Report

Artesia Special Hospital District
Schedule of Deposit and Investment Accounts
June 30, 2008

Schedule II

Deposit Type	**1st National Bank**	**Western Bank**	**Total**
Operational - checking	$ 1,275,067	$ -	$ 1,275,067
General needs - checking	24,866	-	24,866
Bond sinking fund - checking	3,015,870	-	3,015,870
Renovation - checking	26,989	-	26,989
Dialysis - checking	859,817	-	859,817
Construction escrow - checking	2,521	-	2,521
Certificate of deposit	-	1,219,182	1,219,182
Total on deposit	5,205,130	1,219,182	6,424,312
Reconciling items:			
Deposits in transit	-	-	-
Outstanding checks	-	-	-
Total, June 30, 2007	$ 5,205,130	$ 1,219,182	$ 6,424,312

Reconciliation to June 30, 2008	
Statement of Net Assets	
Unristricted cash and cash equivalents	$ 2,494,249
Cash restricted by donor for cardiac and general care	24,866
Cash restricted for dialysis unit	859,817
Cash restricted for debt service	3,015,870
Cash restricted for construction	29,510
	$ 6,424,312

See Independent Auditor's Report

Artesia Special Hospital District
Schedule of Revenues and Expenditures with Budget
Comparison - (Non-GAAP Budgetary Basis)
For the Year Ended June 30, 2008

Schedule III

	Original Budget	Final Appropriated Budget	Non-GAAP Budgetary Actual	Variance with Final Budget
Revenues:				
Mill levy taxes	$ 2,646,121	$ 2,646,121	$ 3,854,530	$ 1,208,409
Less amounts passed				
through to: AGH	(2,973,434)	(2,973,434)	(3,170,671)	(197,237)
Dialysis	-	-	(657,241)	(657,241)
GO Bond mill levy	2,316,995	2,316,995	3,386,268	1,069,273
Lease income	125,004	125,004	250,004	125,000
Investment income	98,000	98,000	116,195	18,195
Capital grants	1,060,000	1,060,000	995,908	(64,092)
Other	375	375	1,865	1,490
Total revenues	3,273,061	3,273,061	4,776,858	1,503,797
Expenditures:				
Current:				
Miscellaneous	1,295	1,295	26,125	(24,830)
Professional fees	47,000	47,000	67,061	(20,061)
Insurance	11,000	11,000	10,830	(170)
Rentals and leases	-	-	8,712	8,712
Debt service:				
Principal payments	2,255,000	2,255,000	2,255,000	-
Interest	973,819	973,819	816,189	157,630
Capital projects	255,422	255,422	-	255,422
Total expenditures	3,543,536	3,543,536	3,183,917	376,703
(Deficiency) excess of revenues over expenditures	(270,475)	(270,475)	1,592,941	1,127,094
Other financing sources and (uses):				
GO Bond proceeds	-	-	-	-
Total other financing sources and (uses):	-	-	-	-
Change in net assets	(270,475)	(270,475)	$ 1,592,941	$ 1,127,094
Cash and investments required to balance budget	270,475	270,475		
	$ -	$ -		
Reconciliation to Statement of Revenues and Expenses:				
Principal payments			2,255,000	
Depreciation and amortization			(1,700,942)	
Increase in net assets			$ 2,146,999	

See Independent Auditor's Report

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COMPLIANCE SECTION

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Hector H. Balderas
New Mexico State Auditor
The Office of Management and Budget
To the Board of Trustees
Artesia Special Hospital District
Artesia, New Mexico

We have audited the accompanying financial statements of the business-type activities of Artesia Special Hospital District (the District), a political subdivision of the State of New Mexico as of the years ended June 30, 2008 and 2007, which collectively comprise the District's basic financial statements as listed in the table of contents. We also have audited Schedule III – Schedule of Revenues and Expenses with Budget Comparison presented as supplementary information for the year ended June 30, 2008, and have issued our report thereon dated October 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the agency's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

The results of our tests disclosed no instances of noncompliance or other matters that are required to be included in this report under *Government Auditing Standards.* However, we noted certain matters that are required to be communicated to management under *Government Auditing Standards* paragraphs 5.14 and 5.16, and required to be included in this report by Section 12-6-5, NMSA 1978, which are described in the accompanying schedule of findings and responses as findings 2007-1, and 2007-2.

The District's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the District's response and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Trustee's management, the Office of the State Auditor, and the New Mexico Legislature, and is not intended to be and should not be used by anyone other than these specified parties.

Accounting & Consulting Group, LLP
Certified Public Accountants

Accounting & Consulting Group, L.L.P.

Albuquerque, New Mexico
October 13, 2008

FINDINGS – FINANCIAL STATEMENT AUDIT

2007-1 <u>Preparation of Financial Statements</u>

Condition

The financial statements and related note disclosures are not being prepared by the management of the District.

Criteria

According to the American Institute of Certified Public Accountants' Statement on Auditing Standards No. 112 *Communicating Internal Control Related Matters Identified in an Audit* (SAS 112), a system of internal control over financial reporting does not stop at maintaining the general ledger, rather the system should also include controls over financial statement preparation, including the preparation of the footnote disclosures.

Cause

The District's does not employ personnel. Bookkeeping is done by a contracted CPA, with oversight from the board, and controls are in place for the maintenance of the general ledger, but formal controls over capturing the data required for the final preparation of the financial statements and related note disclosures have not been developed and implemented.

Effect

A control deficiency under SAS 112 exists because the District does not have in place, formal controls over capturing the data necessary for the preparation of its annual financial statements and related footnote disclosures.

Recommendation

We recommend that the District design and implement a formal system of internal control that will allow the District to prevent and detect material errors that could occur in its financial statements and related note disclosures.

Response

The District prepares a Balance Sheet, Income Statement and Statement of Actual and Projected Cash Flows each month. Due to the District's limited resources (i.e. the District does not employ any personnel), the District does not prepare the final annual audited financial statements and related footnote disclosures. The District Board of Trustees is comprised of individuals who have significant business and governmental agency knowledge. In addition, the Chairman of the District is a CPA. The Board maintains oversight over the financial statements and related footnotes of the District as prepared by the District's Independent Public Accountant and is confident that sufficient internal controls exist that will allow the District Board to prevent and detect material errors that could occur in its financial statements and related footnote disclosures.

2007-2 <u>Segregation of Duties</u>

Condition

The District does not have any employees, and accordingly, proper segregation of duties is not possible.

Criteria

Systems of internal control with the most favorable designs allow for an adequate segregation of duties to reduce the risk of error or fraud because they are structured using a combination of controls designed to either detect instances of error or fraud that occur, or optimally, to prevent instances of error or fraud before they occur. (AU 325)

Cause

District operations are primarily directed by the Chairman of the Board of Trustees assisted by a CPA engaged to maintain the bookkeeping, and the District has no employees, thus an adequate segregation of duties is not possible.

Effect

Absent an adequate segregation of duties, an entity's financial statements are exposed to additional risks of misstatement due to error or fraud.

Recommendation

Proper segregation is not always possible in a small organization. We recommend that the Board continue to provide extensive oversight, and continue to implement limited segregation to the extent possible to reduce the risk of errors or fraud.

Response

Due to the District's limited resources (i.e. the District does not employ any personnel), there are some duties that would be segregated in a larger organization. However, the Board does feel that there is good segregation of duties in the most vital accounting areas. The Board requires two signatures on all disbursements to outside entities. Bank statements for all District accounts are reconciled by the District's outside contracted CPA firm that is not authorized to sign checks. Bank Statements are mailed directly to the outside CPA firm and not to the District Board. The District receives a listing of all deposits and disbursements, which is prepared by the District's contracted CPA firm and not by those individuals who have authority to make disbursements. The District Board of Trustees is comprised of individuals who have significant business and governmental agency knowledge. In addition, the Chairman of the District is a CPA. The Board will continue to provide extensive oversight, and will implement additional segregation of duties to the extent possible to reduce the risk of errors or fraud.

PRIOR YEAR FINDINGS

2007-1 Preparation of Financial Statements, repeated
2007-2 Lack of Segregation of Duties, repeated
2007-3 Capital Assets Threshold for Capitalization, resolved

AUDITOR PREPARED FINANCIAL STATEMENTS

Although it would be preferred and desirable for the District to prepare its own GAAP-basis financial statements, it is felt that the District did not have the time to prepare them. Therefore, Accounting & Consulting Group, LLP prepared the financial statements and footnotes for inclusion in the annual audit report.

EXIT CONFERENCE

The contents of this report were discussed on October 15, 2008. The following individuals were in attendance.

Artesia Special Hospital District	Auditors
Dennis Maupin, Chairman	**Ray Roberts, Partner**
S. Gary Sims, Secretary/Treasurer	**Danny Martinez, Staff II Accountant**