NOR-LEA GENERAL HOSPITAL

AUDITOR'S REPORT AND FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

Moss Adams LLP

6100 Uptown Blvd NE Suite 400

Albuquerque, New Mexico

(505) 830-6200

TABLE OF CONTENTS

NOR-LEA GENERAL HOSPITAL

TABLE OF CONTENTS

NOR-LEA GENERAL HOSPITAL

OTHER SUPPLEMENTAL INFORMATION

NOR-LEA GENERAL HOSPITAL
OFFICIAL ROSTER
JUNE 30, 2008

Board of Trustees

Leon Faris	Chairman
Joe Trujillo	Member
James Odle	Member
Jerome Hanners	Member
Archie Cunningham	Secretary

Principal Employee

David Shaw	Administrator

MOSS-ADAMS LLP

CERTIFIED PUBLIC ACCOUNTANTS | BUSINESS CONSULTANTS

www.mossadams.com

T 505-830-6200
F 505-830-6282

Independent Auditors' Report

Board of Trustees and the Management of
Nor-Lea General Hospital
and
Mr. Hector Balderas
New Mexico State Auditor

We have audited the accompanying financial statements of the business-type activities of Nor-Lea General Hospital (Hospital), 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 Hospital's basic financial statements, as listed in the table of contents. We have also audited the budget comparison of the Hospital presented as supplemental information for the year ended June 30, 2008. These financial statements and budget comparison are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements and budget comparison based on our audits.

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 Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Hospital as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows 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 all material respects the budgetary comparison of the Hospital for the year ended June 30, 2008 in conformity with accounting principles generally accepted in the United States of America.

6100 Uptown Blvd NE, Suite 400
Albuquerque, NM 87110

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Board of Trustees and the Management of
Nor-Lea General Hospital
and
Mr. Hector Balderas
New Mexico State Auditor

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2008, on our consideration of the Hospital's internal control over financial reporting and 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 is important for assessing the results of our audit.

Management's Discussion and Analysis on pages 4 through 12 is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the basic financial statements and budgetary comparison of the Hospital. The accompanying schedules of pledged collateral, and deposits and investment accounts, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such schedules 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.

Moss Adams LLP

Albuquerque, New Mexico
October 14, 2008

Our discussion and analysis of Nor-Lea General Hospital's (Hospital) financial performances provides an overview of the Hospital's financial activities for the fiscal years ended June 30, 2008 and June 30, 2007. Please read it in conjunction with the Hospital's financial statements.

The Lea County Commissioners closed Nor-Lea General Hospital in 1976, but the residents of the Lovington and Tatum school districts lobbied the state legislature for a hospital district seeing the need for access to healthcare in northern Lea County. They were successful in creating the new hospital district through an act of the New Mexico State Legislature. Nor-Lea Hospital District became a political subdivision of the State in 1980. The Hospital provides affordable healthcare for the residents of Lea County and the surrounding area. The Hospital provides care for patients who have little or no health insurance or other means of repayment. This service to the community is consistent with the goals of the Hospital when it was established in 1980.

Financial Highlights

- The Hospital's net assets increased in each of the past three years with a $4,222,556 or 23.6 percent increase in 2006; a $4,032,561 or 18.2 percent increase in 2007: and a $4,818,059 or an 18.4 percent increase in 2008.
- The Hospital reported operating income in 2006 of $568,370; $96,009 in 2007; and a loss of $235,444 in 2008.
- Net patient revenue increased in each of the past three years. The net patient revenue increased in 2006 by $1,488,635 or 8.2 percent; in 2007 by $3,040,347 or 15.4 percent; and in 2008 by $1,507,169 or 6.6 percent.
- Non-operating revenue increased in 2006 by $442,858 or 15.3 percent, in 2007 by $517,366 or 15.5 percent, and in 2008 by $706,951 or 18.4 percent.

Using This Annual Report

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

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

One of the most important questions asked about the Hospital finances is, "Is the Hospital 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 Hospital 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.

The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report the Hospital's net assets and changes in them. You can think of the Hospital's net assets—the difference between assets and liabilities—as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital net assets are one indicator of whether its financial health is improving or deteriorating. You will also need to consider other non-financial factors, such as changes in the Hospital'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 Hospital.

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 operations, 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 Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Statement of Net Assets on page 13. The Hospital's net assets increased in each of the past three years by $4,222,556 (23.6 percent) in 2006; $4,032,561 (18.2 percent) in 2007; and $4,818,059 (18.4 percent) in 2008 as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	2008	2007	2006
Assets			
Current assets	**$23,427,575**	$19,405,237	$14,597,208
Capital assets, net	**13,975,374**	13,472,195	13,281,086
Other non-current assets	**139,232**	181,442	583,390
Total assets	**37,542,181**	33,058,874	28,461,684
Liabilities			
Long-term debt outstanding	**4,023,288**	4,414,253	4,800,000
Other current and non-current liabilities	**2,551,171**	2,494,958	1,544,582
Total liabilities	**6,574,459**	6,909,211	6,344,582
Net assets			
Invested in cap. assets, net of related debt	**9,943,607**	9,052,663	8,481,086
Outpatient chemotherapy	**59,679**	56,884	47,889
Unrestricted	**20,964,436**	17,040,116	13,588,127
Total net assets	**$30,967,722**	$26,149,663	$22,117,102

A significant component of the change in the Hospital's assets is the increase in net patient revenue for 2006, 2007 and 2008. The net patient revenue increased by $1,488,635 in 2006, by $3,040,347 in 2007 and by $1,507,169 in 2008. The increase in net patient revenue allowed the hospital to grow the cash balance and purchase capital assets. Gross days in accounts receivable have decreased slightly due to increased collection efforts. The days in accounts receivable were, 94 in 2006; 87 in 2007 and 70 in 2008. The receivable/payable for estimated third party settlements relating to open cost reports has changed in each of the years 2006, 2007 and 2008. There was a net receivable in 2006 of $664,262, a net receivable in 2007 of $69,588 and a net receivable in 2008 of $444,781. The cash and cash equivalents decreased in 2008 by $(5,261,194); however, the current investments increased significantly in 2008 by $9,902,796. Funds are being held in investments for future hospital expansions.

Operating Results and Changes in the Hospital Net Assets

In 2008, the Hospital's net assets increased by $4,818,059 or 18.4 percent, as shown in Table 2. This increase is made up of several different components.

Table 2: Operating Results and Changes in Net Assets

	2008	2007	2006
Operating Revenues			
Net patient service revenues	**$24,254,750**	$22,747,581	$19,707,234
Other operating revenues	**402,235**	401,900	344,288
Total operating revenues	**24,656,985**	23,149,481	20,051,522
Operating Expenses			
Salaries and benefits	**12,481,891**	11,188,020	9,457,602
Purchased services and other	**5,332,633**	5,230,470	4,516,471
Supplies	**4,319,327**	3,868,361	2,935,667
Professional fees	**1,000,649**	1,033,539	1,082,481
Depreciation and amortization	**1,400,483**	1,406,234	1,222,470
Insurance	**357,446**	326,848	268,461
Total operating expenses	**24,892,429**	23,053,472	19,483,152
Operating income/(loss)	**(235,444)**	96,009	568,370
Non-operating Revenues and Expenses			
Mill levy	**3,717,497**	3,143,532	3,123,125
Investment income	**560,933**	489,589	224,316
Non-capital grants and contributions	**492,931**	449,523	236,813
Interest expense	**(212,858)**	(231,092)	(250,068)
Total non-operating revenues (expenses)	**4,558,503**	3,851,552	3,334,186
Excess of revenues over expenses Before capital grants and contributions	**$ 4,323,059**	$ 3,947,561	$ 3,902,556
Capital grants and contributions	**495,000**	85,000	320,000
Increase in net assets	**4,818,059**	4,032,561	4,222,556
Net assets beginning of year	**26,149,663**	22,117,102	17,894,546
Net assets end of year	**$30,967,722**	$26,149,663	$22,117,102

Operating Income

The first component of the overall change in the Hospital's net assets is its operating income—generally, the difference between net patient service and the expenses incurred to perform those services. The Hospital reported operating income of $568,370 in 2006, of $96,009 in 2007, and loss of $(235,444) in 2008. Fiscal year end 2003 is the first year in the history of the Hospital that an operating profit was made, and this trend continued through 2007. The operating revenues increased in 2008 by 6.5 percent; however, the operating expenses increased by 8.0 percent, resulting in an operating loss of $(235,444). Because there is no expectation of repayment, charity care is not reported as patient service revenues of the Hospital.

The primary components of operating results are:

- Net patient service revenue increased in each of the past four years. The net service patient revenue increased in 2005 by $4,580,735 (33.6 percent); in 2006 by $1,488,635 (8.2 percent); in 2007 by $3,040,347 (15.4 percent); and in 2008 by $1,507,169 or (6.6 percent).
- During 2004 and 2005 the hospital continued its upward trend by increasing net patient service revenue by 29.4 percent and operating expenses by only 24.7 percent in 2004; and by increasing net patient service revenue by 33.6 percent and operating expenses by only 27.4 percent in 2005. During 2006 the hospital's net patient service revenue increased by 8.2 percent and operating expenses increased by 16.3 percent. This increase in operating expenses was mainly in the increased staffing which was in response to the rapid growth experienced in the past few years and depreciation of the new hospital facilities completed in May 2005. During 2007 the gap was narrowed between the percentage growth in net patient revenue and the percentage growth in operating expenses. Net patient revenue increased by 15.4 percent, and operating expenses increased by 18.3 percent. Several new services were added in 2007 that had initial start up cost in supplies and staffing. The new services were cardiac rehab, sleep lab, school based clinic and pulmonary rehab. During 2008 the revenue increases slowed and expenses increased resulting in an operating loss. Net patient revenue only increased 6.5 percent and operating expenses increased 8.0 percent. The increase in operating expenses is primarily related to an 11.56 percent increase in salaries and benefits, 11.7 percent increase in supplies and a 9.4 percent increase in insurance costs.
- The Hospital became a sole community hospital beginning in 2003. As a sole community hospital, the Hospital receives additional state funding in addition to the county indigent dollars which help to offset uncompensated care. The uncompensated care is reflected in the net patient revenues as an allowance. The additional operating revenue generated was $283,352 in 2005; $320,978 in 2006; $353,639 in 2007; and $360,958 in 2008.

- The Hospital became a critical access hospital as of August 1, 2002 which allows the Hospital to be cost-based reimbursed for Medicare patients. Medicare accounted for 31.2 percent of the gross revenue in 2006, 41.6 percent in 2007, and 42.8 percent in 2008.

Non-operating Revenues and Expenses

Non-operating revenues consist primarily of property taxes levied by the Hospital and interest revenue and investment earnings. A mill levy, approved by the voters of the Lovington and Tatum school districts, expires on various dates. A 1.5 mill was approved in 2005 for 4 years and a 2.5 mill was approved in 2007 for 4 years. The next mill levy election will be in 2009. Mill levy property taxes are levied based on the assessed value of the property in the two school districts as well as on the value of oil & gas production and equipment. Mill levy property taxes are levied on November 1st and are due in two payments by November 10th and April 10th. The mill levy is a vital source of revenue for the Hospital because it not only funds operations when needed, but it also funds capital improvements in an ever changing healthcare environment. Without the necessary improvements to the Hospital facilities, the quality of patient care could be affected. The oil and gas amount of the mill levy, which was 79.8 percent of the mill levy proceeds in 2006, 78.6 percent in 2007, and 80.0 percent in 2008, can fluctuate from year to year depending upon the current economy.

Grants, Contributions, and Endowments

Historically, the Hospital has not received significant capital grants and contributions but is becoming more active in the pursuit of additional funding. During 2006 the Hospital received a Small Hospital Improvement Grant in the amount of $8,873, State Legislative funding for equipping and furnishing new patient rooms in the amount of $80,000, and $240,000 for upgrading the fire protection system. During 2007 the Hospital received $85,000 in State Legislative funding for the equipping and furnishing of the new cardiac rehabilitation area, $18,487 from two Small Hospital Improvement Grants, $160,000 from the State for the School Based Clinic, $15,016 in smoking cessation funds from the State, and other miscellaneous grants of $7,520. During 2008, the Hospital received $495,000 from the State Legislative Fund for expansion of the clinic, $8,497 from a Small Hospital Improvement Grant, $105,000 from the State for the School Based Clinic, $15,605 in smoking cessation funds from the State, and other miscellaneous grants of $13,490.

The Hospital established a foundation through its management company's foundation, Covenant Health System Foundation. All funds generated through the Nor-Lea Foundation are used solely by Nor-Lea Hospital District. The Nor-Lea Foundation account is reported as a separate fund by the Covenant Health System Foundation. All decisions regarding the funds generated by Nor-Lea Foundation are made by the Hospital and its Board. During the years ended June 30, 2006, 2007 and 2008, the Hospital received net donations (restricted and unrestricted) of $33,195, $37,929, and $40,937, respectively. The activity of the Nor-Lea Foundation and its ending cash balance are combined in the audited financial statements.

The Hospital Cash Flows

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

Capital Asset and Debt Administration

Capital Assets

At the end of 2008 the Hospital had $13,975,374 invested in capital assets, net of accumulated depreciation; see Note 6 to the financial statements. The Hospital purchased new equipment in the amount of $498,550 and spent $144,374 in building and improvements. During 2008, the Hospital completed the construction of the Lovington Clinic expansion, which added approximately 3870 square feet to the existing clinic and accounted for 2008 expenditures of $1,212,703, bringing the total cost of construction to $1,295,126. Also, in 2008, the Hospital began the architectural design to a planned expansion to the new hospital section, incurring fees of $43,901. It will house ancillary and financial services. All departments will take part in the development of the final architectural designs. The new expansion will be paid for out of excess cash reserves. During 2007, the Hospital had $13,472,195 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the financial statements. In 2007, the Hospital purchased new equipment costing $942,627 and expended $650,581 in buildings and improvements. This included $82,422 for construction in progress for the Lovington Clinic expansion. The Hospital expended $1,604,565 during 2006 for construction and new equipment and furniture.

Debt

The Hospital Board authorized the issuance of the Nor-Lea Special Hospital Revenue Bonds, Series 2003 in the amount of $4,000,000. The Hospital received funding in an Escrow account and entered into a credit agreement with Wells Fargo for $4,000,000 in May 2003. The Hospital Board also authorized the issuance of the Nor-Lea Special Hospital Revenue Bonds, Series 2004 in the amount of $2,000,000. The Hospital received funding in an Escrow account and entered into a credit agreement with Wells Fargo for $2,000,000 in May 2004. These Bonds do not constitute general obligation debt of the Hospital, and are payable solely out of the net revenues derived from the operations of the Hospital and its facilities. Schedule principal payments through 2008 have brought the outstanding balance on the 2003 bonds to $2,000,000. Also, the Hospital had outstanding debt associated with capital leases. The outstanding capital lease debt was $0 in 2006; $19,532 in 2007; and $31,767 in 2008.

Other Economic Factors

In the community of Hobbs, New Mexico approximately 30 miles south of Lovington, a major provider clinic was closed by Covenant Health System in May 2003. Nor-Lea General Hospital has since seen significant increases in patient revenues in its Lovington Clinic, rural health clinic. As of June 2006, the Hospital had three clinics, located in Lovington, Tatum and Hobbs, which had 5 mid-level practitioners and 5 physicians. In 2007, the Hospital added the school-based clinic, and in 2008, the Hospital added an additional physician to its clinics, for a total of 5 mid-level practitioners and 6 physicians.

Budgetary Analysis

The operating and capital budget is created through the cooperative efforts of all department managers, the CEO/Administrator and the CFO. The Hospital's Board reviews and approves the final budget before it is sent to the Department of Finance and Administration of the State of New Mexico (DFA) for approval. During the year, the Hospital Board may deem it necessary to amend the original budget based on increased services provided or other new changes in the operations of the Hospital. The same procedure is followed to develop the amended budget with the managers and administration working together. Once the Hospital Board approves the amended budget, it is sent to the DFA for final approval. During 2008 the Hospital developed an original budget with gross patient revenue of $50,463,006 and operating expenses of $26,178,886. The Hospital did not have to amend the 2008 budget. The Hospital's actual performance revealed gross patient revenue was under budget by $4,079,971 while the operating expenses were under budget by $1,286,457.

Contacting the Hospital Financial Management

The financial report is designed to provide our patients, supplier, taxpayers, and creditors with a general overview of the Hospital finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital CEO or CFO, at Nor-Lea General Hospital, 1600 N. Main Street, Lovington, New Mexico 88260.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF NET ASSETS
June 30, 2008 and 2007

		2008	2007
ASSETS			
Current Assets			
Cash and cash equivalents	$	1,818,485	7,079,679
Patient accounts receivable, net of estimated uncollectibles of $2,629,379 in 2008 and $3,277,085 in 2007		3,881,042	5,148,342
Other receivables		907,952	820,021
Estimated third-party payor settlements		649,215	279,224
Inventories and prepaid expenses		812,194	622,080
Short-term investments		15,299,008	5,399,007
Short-term investments - restricted		59,679	56,884
Total current assets		23,427,575	19,405,237
Capital assets			
Property and equipment, net		13,975,374	13,472,195
Other assets			
Physician receivables		117,560	155,636
Goodwill and intangibles, net of accumulated amortization, $66,303 in 2008 and $62,168 in 2007		21,672	25,806
Total other assets		139,232	181,442
Total assets	$	37,542,181	33,058,874
LIABILITIES AND NET ASSETS			
Current Liabilities			
Accounts payable	$	1,360,893	1,490,401
Accrued liabilities		556,497	388,005
Estimated third-party payor settlements		204,434	209,636
Current portion of capital leases		8,479	5,279
Compensated absences		420,868	401,637
Total current liabilities		2,551,171	2,494,958
Long-term debt, net of current portion		4,023,288	4,414,253
Total liabilities		6,574,459	6,909,211
Net Assets			
Invested in capital assets, net of related debt		9,943,607	9,052,663
Restricted - expendable		59,679	56,884
Unrestricted		20,964,436	17,040,116
Total net assets		30,967,722	26,149,663
Total liabilities and net assets	$	37,542,181	33,058,874

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
Years Ended June 30, 2008 and 2007

	2008	2007
Operating Revenue		
Net patient service revenue, net of provision for bad debts of $3,877,917 in 2008 and $3,800,175 in 2007	$ 24,254,750	22,747,581
Other revenue	402,235	401,900
Total operating revenue	24,656,985	23,149,481
Operating Expenses		
Salaries and wages	9,266,947	8,220,230
Employee benefits	3,214,944	2,967,790
Purchased services	3,459,938	3,335,467
Supplies	4,319,327	3,868,361
Professional fees	1,000,649	1,033,539
Depreciation and amortization	1,400,483	1,406,234
Insurance	357,446	326,848
Utilities	239,170	245,785
Leases and rentals	408,719	463,254
Other	1,224,806	1,185,964
Total operating expenses	24,892,429	23,053,472
Operating income	(235,444)	96,009
Nonoperating revenues		
Mill levy	3,717,497	3,143,532
Investment income	560,933	489,589
Interest expense	(212,858)	(231,092)
Noncapital grants and contributions	492,931	449,523
Total nonoperating revenues	4,558,503	3,851,552
Excess of revenues over expenses before capital grants and contributions	4,323,059	3,947,561
Capital grants and contributions	495,000	85,000
Increase in net assets	4,818,059	4,032,561
Net assets, beginning of year	26,149,663	22,117,102
Net assets, end of year	$ 30,967,722	26,149,663

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2008 and 2007

	2008	2007
Cash Flows From Operating Activities		
Receipts from and on behalf of patients	$ 25,146,857	22,405,604
Payments to suppliers and contractors	(11,329,677)	(10,153,929)
Payments to and on behalf of employees	(12,294,168)	(11,034,111)
Receipts from sole community provider funds	360,957	353,639
Other operating receipts (payments)	(46,653)	(26,376)
Net cash provided by operating activities	1,837,316	1,544,827
Cash Flows From Noncapital Financing Activities		
Mill levy support	3,717,497	3,168,452
Noncapital grants and contributions	492,931	435,023
Net cash provided by noncapital financing activities	4,210,428	3,603,475
Cash Flows From Capital and Related Financing Activities		
Payments on long-term debt	(400,000)	(400,000)
Interest paid on long-term debt	(212,858)	(231,092)
Payments on capital leases	(5,765)	(2,019)
Capital grants and contributions	495,000	85,000
Proceeds on disposition of assets	-	1,583
Capital expenditures	(1,881,529)	(1,571,104)
Net cash (used) by capital and related financing activities	(2,005,152)	(2,117,632)
Cash Flows From Investing Activities		
Net change in restricted investments	(2,795)	(56,884)
Loans to physicians	38,076	(97,836)
Purchase of investments	(22,373,869)	(27,630,103)
Sales of investments	12,473,869	23,224,546
Investment income	560,933	489,589
Net cash (used) by investing activities	(9,303,786)	(4,070,688)
(Decrease) in cash and cash equivalents	(5,261,194)	(1,040,018)
Cash and cash equivalents, beginning of year	7,079,679	8,119,697
Cash and cash equivalents, end of year	$ 1,818,485	7,079,679

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended June 30, 2008 and 2007

		2008	2007
Reconciliation of operating income to net cash provided by operating activities			
Operating income	$	(235,444)	96,009
Adjustments to reconcile operating income to net cash provided by operating activities			
Depreciation and amortization		1,400,483	1,404,099
Provision for bad debts		3,877,917	3,800,175
Changes in current assets and liabilities			
Patient accounts receivable		(2,610,617)	(4,736,826)
Other receivables		(87,931)	(74,637)
Inventories and prepaid expenses		(190,114)	(319,589)
Accounts payable		(129,508)	627,013
Accrued salaries, wages and benefits		168,492	96,288
Estimated third-party payor settlements		(375,193)	594,674
Compensated absences		19,231	57,621
Net cash provided by operating activities	$	1,837,316	1,544,827

Noncash Investing, Capital and Financing Activities

The Hospital purchased equipment in exchange for capital lease of $18,000 in 2008.

See Notes to Financial Statements.

NOTE 1. DESCRIPTION OF REPORTING ENTITY

Reporting Entity. Nor-Lea General Hospital (Hospital), a political subdivision of the State of New Mexico, is a 25-bed critical access hospital facility located in Lovington, Lea County, New Mexico, that operates two rural outpatient clinics, one freestanding clinic, a school-based clinic, a home health care division, and a durable medical equipment division. The Hospital is controlled by Nor-Lea Hospital District (District), which has no assets, liabilities, revenues or expenses. The Hospital provides health care services to patients in the surrounding southeast New Mexico region.

The accompanying financial statements present the Hospital and its component unit, the Nor-Lea Foundation (Foundation), an entity for which the Hospital is considered to be financially accountable. The Foundation, although a legally separate entity, is in substance, part of the Hospital's operations.

Blended Component Unit. The Foundation's mission is to provide or generate funding and resources for distant future improvements of the district's facilities and to provide sustainability for the future of Nor-Lea Hospital District. Nor-Lea Foundation accepts and manages gifts from individuals and corporations in order to continue exemplary healthcare to the community. The Foundation is reported as part of the Hospital's operations.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements and notes are the representation of the Hospital's management who are responsible for their integrity and objectivity. The financial statements of the Hospital 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 summary of significant accounting policies of the Hospital is presented to assist in the understanding of the Hospital's financial statements. The more significant of the Hospital's accounting policies are described below.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Enterprise Fund Accounting. The Hospital 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 Hospital 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 in highly liquid debt instruments with an original maturity of three months or less.

New Mexico State Statutes require collateral pledged for deposits in excess of the federal deposit insurance to be delivered, or a joint safekeeping receipt be issued, to the Hospital for at least one half of the amount on deposit with the institution, and one hundred two percent of the amount in overnight repurchase accounts on deposit with the institution.

The detail of collateral pledged is presented as supplemental information to these financial statements. The types of collateral allowed are limited to direct obligations of the United States Government and all bonds issued by any agency, district or political subdivision of the State of New Mexico.

Inventories. Inventories are recorded at the lower of cost or market on a first-in, first-out basis, and consist of medical, surgical, pharmaceutical, dietary and other supplies held for use in operations and are recorded as expenses when consumed rather than when purchased.

Patient Accounts Receivable. Patient accounts receivable are stated at the amount management expects to collect from outstanding balances. Estimated provisions for doubtful accounts are recorded to the extent it is probable a portion or all of a particular account will not be collected. The Hospital determines if patient accounts receivable are past-due based on the date the service was performed, and the Hospital does not charge interest on past-due accounts.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets. State law sets a capitalization threshold of $5,000 for acquisitions of property and equipment. Effective July 1, 2006, the Hospital elected to adopt the $5,000 capitalization threshold set by the State. Prior to that date, the Hospital capitalized assets costing $1,000. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated property and equipment are recorded at fair market value at date of donation. Depreciation is recorded using the straight-line method over the following estimated useful lives:

	Years
Land improvements	40
Building and improvements	10 - 40
Equipment	3 - 15

Costs of Borrowing. Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no significant construction activity that would have resulted in material capitalized interest for either 2008 or 2007.

Mill Levy. The Hospital is the recipient of mill levy taxes approved by the voters of Lea County every four years. The mill levy consists of a 1.5 mill levy, scheduled to expire on December 31, 2009, and a 2.5 mill levy, scheduled to expire on December 31, 2011. The Hospital recorded $3,717,497 in 2008 and $3,143,532 in 2007 in mill levy proceeds. Included in other receivables is $577,581 and $378,338 in mill levy receivables. Mill levy revenues are used in accordance with the provisions of the property tax referendum.

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

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 10 and April 10. The taxes attach as an enforceable lien on property thirty (30) days thereafter, at which time they become delinquent. The Hospital recognizes revenue from mill levy property taxes in the period for which they are levied.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Grants and Contributions. From time to time, the Hospital receives grants from the State of New Mexico 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 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.

The Hospital receives federal grant awards annually related to the Rural Primary Health Care Act (Act). The Act requires the Hospital, through its Lovington and Tatum clinics, to provide primary care health services to surrounding rural areas. The revenue recognized is based on allowable costs incurred. The Hospital recognized and expended $267,300 in 2008 and $176,800 in 2007 in federal grant awards. These amounts are included in non-capital grants and contributions in the accompanying statements of revenues, expenses, and changes in net assets.

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

Net Assets. Net assets of the Hospital 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 non-capital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including any amounts deposited with trustees pursuant to revenue bond indentures, discussed in Note 7. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Operating Revenues and Expenses. The Hospital's 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 providing health care services, the Hospital's principal activity. 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 provide health care services, other than financing costs.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences. Vacation pay is accrued for employees based on hours paid. Accrual rates of 14 to 34 days per year are based on years of service. Vacation hours vest to the employee as they are earned. As of June 30, 2008 and 2007, the Hospital had accrued $420,868 and $401,637 for compensated absences, respectively.

Budgets and Budgetary Accounting. Prior to the beginning of each fiscal year, the budget for the Hospital is prepared on the accrual basis by the Chief Financial Officer and is presented to the Hospital's Board of Trustees (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 the departments; however, any revisions that alter the total expenditures must be approved by the DFA. As of June 30, 2008 and 2007, the Hospital was in compliance with these requirements.

Investments in Debt and Equity Securities. Investments in debt and equity securities are reported at fair value. 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.

Risk Management. The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injures and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in 2008 and 2007.

Comparability. Certain prior year balances have been reclassified to conform to the June 30, 2008 financial statement presentation. These reclassifications did not affect total assets, total liabilities, total net assets, or total change in net assets.

NOTE 3. DEPOSITS AND INVESTMENTS

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

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

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 Hospital's 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 Hospital. 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 Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. New Mexico State Statutes require collateral pledged for deposits in excess of the federal deposit insurance to be delivered, or a joint safekeeping receipt be issued, to the Hospital for at least one half of the amount on deposit with the institution. As of June 30, 2008 and 2007, $1,072,980 and $925,213, respectively, of the Hospital's bank balances were exposed to custodial credit risk as indicated below. As of June 30, 2008 and 2007, the Hospital's deposits with Lea County State Bank consisted of a checking account and two certificates of deposit held in two other financial institutions, resulting in $100,000 FDIC coverage on the checking account and each certificate of deposit. The Hospital's deposits are subject to custodial credit risk as the deposits are uninsured and collateralized by securities held by the depository institution's trust department in the name of the trust department but not in the name of the Hospital.

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

	Wells Fargo	Lea County State Bank	Total
Year ended June 30, 2008			
Total amount of deposits	$ 1,172,980	186,139	1,359,119
FDIC Coverage	(100,000)	(186,139)	(286,139)
Total uninsured public funds	1,072,980	-	1,072,980
Collateralized by securities held by the pledging institution or by its trust department or agent in other than the Hospital's name	884,222	-	884,222
Uninsured and uncollateralized	$ 188,758	-	188,758
Collateral requirement (50% of uninsured public funds)	$ 536,490	-	536,490
Pledged securities	884,222	-	884,222
Over (under) collateralization	$ 347,732	-	347,732

	Wells Fargo	Lea County State Bank	Total
Year ended June 30, 2007			
Total amount of deposits	$ 1,025,213	146,997	1,172,210
FDIC Coverage	(100,000)	(146,997)	(246,997)
Total uninsured public funds	925,213	-	925,213
Collateralized by securities held by the pledging institution or by its trust department or agent in other than the Hospital's name	1,000,664	-	1,000,664
Uninsured and uncollateralized	$ -	-	-
Collateral requirement (50% of uninsured public funds)	$ 462,607	-	462,607
Pledged securities	1,000,664	-	1,000,664
Over (under) collateralization	$ 538,057	-	538,057

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

Custodial Credit Risk - Investments. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have an investment policy for custodial credit risk. New Mexico State Statutes require collateral pledged to be delivered for securities underlying an overnight repurchase agreement, or a joint safekeeping receipt be issued to the Hospital for at least one hundred two percent of the fair value of the securities underlying overnight repurchase accounts invested with the institution. At June 30, 2008 and 2007, the Hospital's investment balances were exposed to custodial credit risk as indicated below. The Hospital's investments are subject to custodial credit risk as the investments are uninsured and collateralized by securities held by the investment counterparty in the name of the counterparty but not in the name of the Hospital.

	Wells Fargo	New MexiGROW LGIP	Total
Year ended June 30, 2008			
Investments held in the Hospital's name by a custodial bank that is an agent of the Hospital:			
U.S. Government Sponsored Enterprise Securities	$ 6,937,575	-	6,937,575
Securities underlying an overnight repurchase agreement held by the investment's counterparty not in the Hospital's name	634,610	-	634.610
Investment in the State Treasurer's Local Government Investment Pool	-	8.273.753	8.273.753
Total investments subject to custodial credit risk	$ 7.572.185	8.273.753	15.845.938
Collateral requirement for repurchase agreements (102% of value of underlying securities)	$ 647,302	-	647,302
Pledged securities	647.302	-	647,302
Over (under) collateralization	$ -	-	-

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

	Wells Fargo	New MexiGROW LGIP	Total
Year ended June 30, 2007			
Investments held in the Hospital's name by a custodial bank that is an agent of the Hospital:			
U.S. Government Sponsored Enterprise Securities	$ 8,267,749	-	8,267,749
Securities underlying an overnight repurchase agreement held by the investment's counterparty not in the Hospital's name	1,368,833	-	1,368,833
Investment in the State Treasurer's Local Government Investment Pool	-	2,050,504	2,050,504
Total investments subject to custodial credit risk	$ 9,636,582	2,050,504	11,687,086
Collateral requirement for repurchase agreements (102% of value of underlying securities)	$ 1,396,207	-	1,396,207
Pledged securities	1,401,481	-	1,401,481
Over (under) collateralization	$ 5,274	-	5,274

Credit Risk. The New MexiGROW Local Government Investment Pool's (LGIP) investments are valued at fair value based on quoted market prices as of the valuation date. The LGIP is not SEC registered. The New Mexico State Treasurer is authorized to invest the short-term investment funds, with the advice and consent of the State Board of Finance, in accordance with Section 6-10-10 I through 6-10-10 P and Section 6-10-10.1 A and E, NMSA 1978. The pool does not have unit shares. Per Section 6-10-10.1 F, NMSA 1978, at the end of each month all interest earned is distributed by the State Treasurer to the contributing entities in amounts directly proportionate to the respective amounts deposited in the fund and the length of time the fund amounts were invested. Participation in the LGIP is voluntary.

As of June 30, 2008, the Hospital's investments were rated as follows:

Fannie Mae discount notes	Aaa	(Moody's)
LGIP	AAAm	(S&P)

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

Interest Rate Risk. The Hospital does not have a formal policy limiting investment maturities to manage its exposure to fair value losses from increasing interest rates. The Hospital's investments at June 30, 2008 and 2007 included the following:

Investments	Maturities	Fair Value 2008	Fair Value 2007
Securities underlying an overnight repurchase agreement	Overnight	$ **634,610**	1,368,833
LGIP	***	**8,290,127**	2,059,352
Freddie Mac discount notes	90 days	-	2,347,216
Freddie Mac discount notes	120 days	-	1,713,254
Federal Home Loan note	12 months	-	1,558,284
Fannie Mae discount notes	90 days	-	2,648,995
Fannie Mae discount notes	120 days	**6,937,575**	-
		$15,862,312	11,695,934

***The LGIP's weighted average maturity at June 30, 2008 is 38 days, which is a key determinant of the tolerance of the LGIP's investments to increases in interest rates.

Concentration of Credit Risk. The Hospital places no limit on the amount it may invest in any one issuer. The Hospital has a 44% concentration of investments in Fannie Mae discount notes.

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

Reconciliation to the Statements of Net Assets. The carrying amounts of deposits and investments shown above are included in the Hospital's statement of net assets as follows:

	2008	2007
Carrying amount		
Deposits	**$ 1,312,309**	837,186
Investments	**15,862,312**	11,695,934
Petty cash	**2,551**	2,450
	$17,177,172	12,535,570
Included in the following balance sheet captions		
Cash and cash equivalents	**$ 1,818,485**	7,079,679
Investments	**15,299,008**	5,399,007
Investments – restricted	**59,679**	56,884
	$17,177,172	12,535,570

NOTE 4. NET PATIENT SERVICE REVENUE

Net patient service revenue is reported at the estimated net amounts realizable from patient, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

A summary of the payment arrangements with major third-party payors follows:

Medicare - Effective August, 2002, the Hospital qualified as a "Critical Access Hospital" under the Medicare system. The designation as a Critical Access Hospital changes the method by which the Hospital is reimbursed for services provided to Medicare patients. Inpatient, inpatient non-acute services, and certain outpatient services related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital will be reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

NOTE 4. NET PATIENT SERVICE REVENUE (CONTINUED)

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 43% and 12%, respectively, of the Hospital's net patient revenue for the year ended June 30, 2008, and 42% and 13%, respectively, of the Hospital's net patient revenue for the year ended June 30, 2007. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Medicare cost reports for 2008 and 2007, and the Medicaid cost reports for 2008, 2007, and 2006 have not been finalized. In management's opinion, estimated Medicare and Medicaid settlements accrued for at June 30, 2008 and 2007 are adequate to provide for the settlement of all open cost reports.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, heath maintenance organizations, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

NOTE 5. RESTRICTED NET ASSETS

Restricted, expendable net assets are available for the provision of outpatient chemotherapy and cardiovascular rehabilitation services. Such restricted net assets were comprised as follows:

	2008	2007
Investments – restricted	$ 59,679	56,884

NOTE 6. CAPITAL ASSETS

Capital asset additions, retirements, and balances for the years ended June 30, 2008 and 2007 were as follows:

	Balance June 30, 2007	Additions	Transfers	Balance June 30, 2008
Non-depreciable assets				
Land	$ 33,000	-	-	33,000
Construction in progress	82,422	43,901	(82,422)	43,901
	115,422	43,901	(82,422)	76,901
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	14,028,396	1,357,076	82,422	15,467,894
Equipment	7,486,490	498,550	-	7,985,040
	21,543,546	1,855,626	82,422	23,481,594
Accumulated depreciation				
Land improvements	(26,711)	(715)	-	(27,426)
Building and improvements	(3,418,813)	(490,449)	-	(3,909,262)
Equipment	(4,741,249)	(905,184)	-	(5,646,433)
	(8,186,773)	(1,396,348)	-	(9,583,121)
Capital assets, net	$ 13,472,195	503,179	-	13,975,374

	Balance June 30, 2006	Additions	Retirements	Balance June 30, 2007
Non-depreciable assets				
Land	$ 33,000	-	-	33,000
Construction in progress	-	82,422	-	82,422
	33,000	82,422	-	115,422
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	13,460,237	568,159	-	14,028,396
Equipment	6,545,446	942,627	(1,583)	7,486,490
	20,034,343	1,510,786	(1,583)	21,543,546
Accumulated depreciation				
Land improvements	(25,996)	(715)	-	(26,711)
Building and improvements	(2,963,845)	(454,968)	-	(3,418,813)
Equipment	(3,796,416)	(946,416)	1,583	(4,741,249)
	(6,786,257)	(1,402,099)	1,583	(8,186,773)
Capital assets, net	$ 13,281,086	191,109	-	13,472,195

Depreciation expense, including amortization for equipment held under capital leases for the years ended June 30, 2008 and 2007 was $1,396,348 and $1,402,099, respectively. The Hospital acquired equipment under capital leases at a cost of $18,000 during the year ended June 30, 2008. Amortization expense for this equipment was $5,765 and $1,396 for the years ended June 30, 2008 and 2007, respectively, and amortized cost was $25,922 and $20,157 for the years ended June 30, 2008 and 2007, respectively.

NOTE 7. LONG-TERM DEBT

A schedule of changes in the Hospital's noncurrent liabilities for June 30, 2008 and 2007 follows:

	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008	Amounts Due Within One Year
Bonds Payable					
2004 Hospital Revenue Bond	$ 2,000,000	-	-	**2,000,000**	-
2003 Hospital Revenue Bond	2,400,000	-	400,000	**2,000,000**	-
Total Long-term debt	4,400,000	-	400,000	**4,000,000**	-
Compensated absences	401,637	887,935	868,704	**420,868**	420,868
Capital lease obligations	19,532	18,000	5,765	**31,767**	8,479
Total non-current liabilities	$ 4,821,169	905,935	1,274,469	**4,452,635**	429,347

	Balance June 30, 2006	Additions	Reductions	Balance June 30, 2007	Amounts Due Within One Year
Bonds Payable					
2004 Hospital Revenue Bond	$ 2,000,000	-	-	2,000,000	-
2003 Hospital Revenue Bond	2,800,000	-	400,000	2,400,000	-
Total Long-term debt	4,400,000	-	400,000	4,400,000	-
Compensated absences	344,016	778,240	720,619	401,637	401,637
Capital lease obligations	-	21,553	2,021	19,532	5,279
Total non-current liabilities	$ 5,144,016	799,793	1,122,640	4,821,169	406,916

Payments to employees for compensated absences are included in operating expenses on the Statement of Revenues, Expenses and Changes in Net Assets.

NOTE 7. LONG-TERM DEBT (CONTINUED)

The terms and due dates of the Hospital's long-term debt, including capital lease obligations, at June 30, 2008 and 2007 follow:

2004 Hospital Revenue Bond. On March 17, 2004, the Board authorized the issuance of the Nor-Lea Special Hospital Revenue Bonds, Series 2004 (2004 Bond), in the principal amount of $2,000,000. Nor-Lea entered into a credit agreement in the amount of $2,000,000 with Wells Fargo, dated May 25, 2004. Proceeds from the 2004 Bond were used to finance, in part, the cost of equipping, furnishing, remodeling and renovating the facilities of the Hospital. At June 30, 2008 and 2007, the balance remaining on the 2004 Bond was $2,000,000.

The 2004 Bond bears interest at a fixed rate of 4.90%, which is payable on January 1 and July 1 of each year through July 1, 2018. Principal is payable on July 1 of each year through July 1, 2018, however, no principal payments will be made on the 2004 Bond until the 2003 Hospital Revenue Bond has been paid in full. The 2004 Bond does not constitute indebtedness or a debt of the Hospital within the meaning of any constitutional or statutory provision or limitation and shall not be considered or held to be a general obligation of the Hospital. The 2004 Bond is payable and collectible solely out of the net revenues derived from the operation of the Hospital and its facilities, which is exclusive of mill levy or tax proceeds. The 2004 Bond is tax-exempt under Section 265(b)(3)(B) of the Internal Revenue Code of 1986, as amended.

Under the terms of the 2004 Bond Indenture, the Hospital is required to maintain certain deposits. Such deposits, if required, are included with restricted cash and investments in the accompanying statement of net assets. The 2004 Bond Indenture also requires that the Hospital satisfy certain measures of financial performance as long as the notes are outstanding. As of June 30, 2008, the Hospital was in compliance with these requirements.

2003 Hospital Revenue Bond. On April 16, 2003, the Board authorized the issuance of the Nor-Lea Special Hospital Revenue Bonds, Series 2003 (2003 Bond), in the principal amount of $4,000,000. Nor-Lea entered into a credit agreement in the amount of $4,000,000 with Wells Fargo, dated May 22, 2003. Proceeds from the 2003 Bond were used to finance, in part, the cost of equipping, furnishing, remodeling and renovating the facilities of the Hospital. At June 30, 2008 and 2007, the balance remaining on the 2003 Bond was $2,000,000 and $2,400,000 respectively.

NOTE 7. LONG-TERM DEBT (CONTINUED)

The 2003 Bond bears interest at a fixed rate of 4.75%, which is payable on January 1 and July 1 of each year through July 1, 2013. Principal is payable on July 1 of each year through July 1, 2013. The 2003 Bond does not constitute indebtedness or a debt of the Hospital within the meaning of any constitutional or statutory provision or limitation and shall not be considered or held to be a general obligation of the Hospital. The 2003 Bond is payable and collectible solely out of the net revenues derived from the operation of the Hospital and its facilities, which is exclusive of mill levy or tax proceeds. The 2003 Bond is tax-exempt under Section 265(b)(3)(B) of the Internal Revenue Code of 1986, as amended.

Under the terms of the 2003Bond Indenture, the Hospital is required to maintain certain deposits. Such deposits, if required, are included with restricted cash and investments on the balance sheet as of June 30, 2008 and 2007. The 2003 Bond Indenture also requires that the Hospital satisfy certain measures of financial performance as long as the notes are outstanding. As of June 30, 2008, the Hospital was in compliance with these requirements.

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

Year ending June 30,	Principal	Interest
2009	$ 8,479	191,834
2010	407,010	172,424
2011	406,252	153,001
2012	406,470	133,548
2013	403,556	114,139
2014 - 2018	2,000,000	285,000
2019	400,000	-
	$ 4,031,767	1,049,946

The Hospital incurred $212,858 and $231,092 in interest costs related to debt and capital leases during the years ended June 30, 2008 and 2007, respectively.

NOTE 8. EMPLOYEE RETIREMENT PLAN

The Nor-Lea General Hospital 403(b) defined contribution employee retirement plan (Plan) covers substantially all employees who have completed one year of service and have attained the age of 21. The Plan provides for Hospital contributions of 100% of eligible employees' deferred compensation up to 4% of such employees' compensation. Hospital contributions to the Plan totaled $195,167 in 2008 and $185,261 in 2007 and are fully vested when made. Employees may also elect to make contributions to the Plan.

NOTE 9. ACCOUNTS RECEIVABLE AND PAYABLE

Other receivables, accounts payable and accrued expenses reported as current assets and liabilities by the Hospital at June 30, 2008 and 2007 consisted of these amounts:

	2008	2007
Other receivables		
Mill levy receivable	$ **577,581**	378,338
Grants receivable	**20,500**	27,000
Receivable from detention facility clinic	**62,610**	190,157
Sole community provider funding	-	98,533
Miscellaneous receivables	**247,261**	125,993
Total other receivables	**$ 907,952**	820,021
Accounts payable and accrued expenses		
Payable to suppliers	**$ 1,360,893**	1,490,401
Payable to employees (including payroll taxes)	**556,497**	388,005
Total accounts payable and accrued expenses	**$ 1,917,390**	1,878,406

Other receivables are considered fully collectible and therefore no provision for bad debt has been recorded for these amounts.

NOTE 10. COMMITMENTS AND CONTINGENCIES

Compliance with Laws and Regulations. 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 patient services, and Medicare and Medicaid fraud and abuse. Government activity continues to increase 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. Management believes that the Hospital is in compliance with fraud and abuse laws and regulations as well as other applicable government regulations. While no regulatory inquires have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

Professional Liability Insurance. The Hospital maintains claims-made commercial insurance related to professional and general liability risks. The policy expired on December 31, 2007 and was renewed through January 1, 2009. The policy covers individual losses of up to $1,000,000 subject to a $3,000,000 aggregate and a $25,000 deductible. Premiums incurred under this policy were $195,727 in 2008 and $176,317 in 2007 and are included in insurance expense in the accompanying financial statements. The Hospital also maintains medical malpractice coverage for its physicians. The coverage is claims-made and covers individual physician claims of up to $200,000, subject to a $600,000 aggregate. Premiums incurred under these policies were $103,165 in 2008 and $82,302 in 2007, and are included in insurance expense in the accompanying financial statements. The medical malpractice policies expire on various dates through June 30, 2009. Management expects to renew all policies at rates and coverage commensurate with 2008 levels.

Workers' Compensation Insurance. The Hospital is insured under the New Mexico Hospital Workers' Compensation Group for the purpose of providing insurance coverage for workers' compensation. The policy is a retrospectively rated policy whose premiums accrue based on the ultimate cost of the experience of a group of participating heath care entities. The Hospital expensed approximately $188,770 and $138,648 in workers' compensation premiums during 2008 and 2007, respectively. Such amounts are included in employee benefits in the accompanying financial statements.

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employee Heath Insurance. Effective July 1, 2004, the Hospital became self-insured with respect to medical insurance coverage offered to eligible employees, up to a maximum of $25,000 per participant. Once the annual aggregate expense exceeds $1,000,000 annually, excess loss reinsurance is in place that will cover 100% of covered claims not to exceed $1,000,000. In connection with the self-insured portion, the Hospital maintains a liability for claims that are in the process of being paid. At June 30, 2008 and 2007 the outstanding claims liability was $125,388 and $98,609, respectively, and is included in accounts payable in the accompanying financial statements.

Commitment to Maintain Working Capital. As a condition of the Nor-Lea Special Hospital Revenue Bonds, Series 2004 and 2003, the Hospital has agreed to maintain a minimum of $1,000,000 working capital as of each of the years ending during the term of the bond. The Hospital was in compliance with this condition as of June 30, 2008.

Management Agreement. Covenant Health Systems (System) manages the hospital pursuant to a four-year agreement dated July 1, 2006, whereby the Hospital reimburses the System for the appointed administrator's salary, including but not limited to social security payments, retirement benefits and other benefits accruing to executive-level employees of the System. This agreement may be terminated by either party upon 30 day's written notice. As part of this agreement, the Hospital is able to purchase medical supplies from various vendors at more favorable prices than the Hospital could negotiate on its own. An unexpected termination of this contract with the System could have an adverse effect on the operations of the Hospital due to the loss of key management personnel and the favorable purchasing agreements until such time a new contract could be negotiated with an alternate management firm. The Hospital is not aware of and does not anticipate any termination of the existing contract.

NOTE 11. CONCENTRATIONS OF CREDIT RISK

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

	2008	2007
Medicare	**28%**	24%
Medicaid	**10**	8
Commercial insurance	**23**	32
Private pay and other	**39**	36
	100%	100%

NOTE 12. CHARITY CARE

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is anticipated. Charges excluded from revenue under the Hospital's charity care policy were $433,645 and $447,343 for June 30, 2008 and 2007, respectively.

NOTE 13. RELATED PARTY TRANSACTIONS AND BALANCES

From time to time, the Hospital will purchase goods and services from businesses owned by associates and employees of the Hospital. Following is a summary of the transactions:

		2008	2007
Purchase of goods and services	$	27,488	8,935

As described above, the Hospital is managed by Covenant. The Hospital incurred the following expenses under this management relationship:

		2008	2007
Management fees	$	180,508	170,904
Purchase of goods and services		351,405	472,299

No amounts were outstanding at June 30, 2008 or 2007 under the management agreement agreement.

All related party transactions were made in the normal course of business at prices similar to those in transactions with third parties.

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF REVENUES AND EXPENSES
WITH BUDGET COMPARISON
Year Ended June 30, 2008

	Original Budget	Final Approved Budget	Actual	Variance with Final Budget
Patient Revenue				
Inpatient	$ 4,263,800	4,263,800	4,919,980	656,180
Outpatient	46,199,206	46,199,206	41,463,055	(4,736,151)
Total gross patient revenue	50,463,006	50,463,006	46,383,035	(4,079,971)
Contractual allowance	(19,610,282)	(19,610,282)	(18,250,368)	1,359,914
Provision for bad debts	(4,485,144)	(4,485,144)	(3,877,917)	607,227
Net patient service revenue	26,367,580	26,367,580	24,254,750	(2,112,830)
Other Revenue				
Other	424,795	424,795	402,235	(22,560)
Total other revenue	424,795	424,795	402,235	(22,560)
Total revenue	26,792,375	26,792,375	24,656,985	(2,135,390)
Expenses				
Salaries, wages and employee benefits	14,059,054	14,059,054	12,481,891	1,577,163
Purchased services and other	4,821,261	4,821,261	5,332,633	(511,372)
Supplies	4,508,189	4,508,189	4,319,327	188,862
Professional fees	995,372	995,372	1,000,649	(5,277)
Depreciation and amortization	1,444,200	1,444,200	1,400,483	43,717
Insurance	350,810	350,810	357,446	(6,636)
Total expenses	26,178,886	26,178,886	24,892,429	1,286,457
Operating Income	613,489	613,489	(235,444)	(848,933)
Nonoperating revenue and expenses				
Mill levy	3,000,000	3,000,000	3,717,497	717,497
Investment income	490,208	490,208	560,933	70,725
Interest expense	(212,200)	(212,200)	(212,858)	(658)
Noncapital grants and contributions	418,493	418,493	492,931	74,438
	3,696,501	3,696,501	4,558,503	862,002
Excess of revenues over expenses before capital grants and contributions	$ 4,309,990	4,309,990	4,323,059	13,069

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF COLLATERAL PLEDGED BY
DEPOSITORY FOR PUBLIC FUNDS
June 30, 2008

Name of Depository	Description of Pledged Collateral	Fair Market Value June 30, 2008	Location of Safekeeper
Wells Fargo Bank, N.A.	FNIONP #256258, Due 05/01/36		Federal Reserve Bank
	CUSIP #31371MTP2	$ 251,179	San Francisco, CA
Wells Fargo Bank, N.A.	FNCL #831630, Due 06/01/36		Federal Reserve Bank
	CUSIP #31407H3T1	233,186	San Francisco, CA
Wells Fargo Bank, N.A.	FNCL #842140, Due 11,01/35		Federal Reserve Bank
	CUSIP #31407VS55	399,857	San Francisco, CA
Pledged to meet 50% collateral requirements		884,222	
Wells Fargo Bank, N.A.	FNCL #00545277, Due 11/01/31		Wells Fargo Bank, N.A.
	CUSIP #31385HXE7	647,302	Minneapolis, MN
Pledged to meet 102% collateral requirements		647,302	
		$ 1,531,524	

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS
Year Ended June 30, 2008

Deposit or Investment Type		Wells Fargo Bank	Wells Fargo Investments	Lea County State Bank	NM State Treasurer Investment Pool	Total
Payroll - Checking	$	-	-	-	-	-
Operating - Checking		858,604	-	55,154	-	913,758
Claims - Checking		302,180	-	-	-	302,180
Construction - Checking		3,995	-	-	-	3,995
Money Market		-	8,201	-	-	8,201
Certificates of Deposit		-	-	130,985	-	130,985
Total deposits		1,164,779	8,201	186,139	-	1,359,119
Operational - Overnight repurchase		634,610	-	-	-	634,610
Investment in US Government Sponsored Enterprise Securities		-	6,937,575	-	-	6,937,575
Investment in local government investment pool		-	-	-	8,273,753	8,273,753
Total investments		634,610	6,937,575	-	8,273,753	15,845,938
Reconciling items		(46,810)	-	-	16,374	(30,436)
Carrying value	$	1,752,579	6,945,776	186,139	8,290,127	17,174,621
Petty Cash						2,551
Total deposits and investments as of June 30, 2008						$ 17,177,172

Reconciliation to the Statement of Net Assets		
Cash and cash equivalents	$	1,818,485
Investments		15,299,008
Investments - restricted		59,679
Total deposits and investments as of June 30, 2008	$	17,177,172

MOSS-ADAMS LLP

CERTIFIED PUBLIC ACCOUNTANTS | BUSINESS CONSULTANTS

www.mossadams.com

T 505-830-6200
F 505-830-6282

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*

Board of Trustees and the Management of
Nor-Lea General Hospital
and
Mr. Hector Balderas
New Mexico State Auditor

We have audited the accompanying financial statements of the business-type activities of Nor-Lea General Hospital (Hospital), a political subdivision of the State of New Mexico, as of and for the year ended June 30, 2008, which collectively comprise the Hospital's basic financial statements, as listed in the table of contents. We also have audited the budget comparison presented as supplemental information for the year ended June 30, 2008, and have issued our report thereon dated October 14, 2008. 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 of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital'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 Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital'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 Hospital's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that

6100 Uptown Blvd NE, Suite 400
Albuquerque, NM 87110

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Board of Trustees and the Management of
Nor-Lea General Hospital
and
Mr. Hector Balderas
New Mexico State Auditor

there is more than a remote likelihood that a misstatement of the Hospital's financial statements that is more than inconsequential will not be prevented or detected by the Hospital'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 Hospital's internal control.

Our consideration of 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 Hospital'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*.

Board of Trustees and the Management of
Nor-Lea General Hospital
and
Mr. Hector Balderas
New Mexico State Auditor

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

Moss Adams LLP

Albuquerque, New Mexico
October 14, 2008

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2008

None

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF STATUS OF PRIOR YEAR FINDINGS
Year Ended June 30, 2008

2007-01	Process for Estimation of Contractual Discounts and Bad Debt Allowances	Cleared

NOR-LEA GENERAL HOSPITAL
EXIT CONFERENCE
Year Ended June 30, 2008

We held an exit conference with management and a member of the Board of Trustees on October 13, 2008. The exit conference was attended by the following individuals:

Management Exit Conference

Nor-Lea Hospital

David Shaw, Chief Executive Officer
Allyson Roberts, Chief Financial Officer
Archie Cunningham, Board Member

Moss Adams LLP

Brandon Fryar, Partner
Julie Clover, Manager

The financial statements were prepared with the assistance of Moss Adams LLP.