



NOR-LEA GENERAL HOSPITAL

FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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**NOR-LEA GENERAL HOSPITAL
OFFICIAL ROSTER
JUNE 30, 2011**

Board of Trustees

Agustin Dorado	Chairman
Archie Cunningham	Member
Julia Myers	Secretary
Leon Faris	Member
Pat Wise	Member
James Wright	Member

Principal Employee

David Shaw	Administrator
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Report of Independent Auditors

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, 2011 and 2010, which collectively comprise the Hospital’s basic financial statements, as listed in the table of contents. We have also audited the Schedule of Revenues and Expenses with Budget Comparison (“budget comparison”) of the Hospital presented as supplemental information for the year ended June 30, 2011. 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 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 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, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally

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

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, 2011 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 17, 2011 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 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 Schedule of Deposits and Investment Accounts, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Mess Adams LLP

Albuquerque, New Mexico
October 17, 2011

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2011 and 2010**

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, 2011 and 2010. 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 \$5,374,558 or 17.4% increase in 2009; a \$6,502,888 or 17.9% increase in 2010; and a \$3,417,537 or 8.0% in 2011
- The Hospital reported an operating income of \$772,653 in 2009; an operating income of \$692,750 in 2010; and an operating loss of \$758,905 in 2011.
- Net patient revenue increased in each of the past three years. The net patient revenue increased in 2009 by \$2,591,583 or 10.7%; in 2010 by \$3,572,633 or 13.3%; and in 2011 by \$5,276,164 or 17.3%.
- Non-operating revenue decreased in 2009 by \$(341,598) or 7.5%; increased in 2010 by \$93,233 or 2.2%; and decreased in 2011 by \$(133,696) or 3.1%.

Using This Annual Report

The Hospital financial statements consist of three statements: Balance Sheets; 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 Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

The Balance Sheet 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 Balance Sheets and the Statements 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 Balance Sheets and the Statements 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 Statements 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 Balance Sheet. The Hospital's net assets increased in each of the past three years by \$5,374,558 (17.4%) in 2009; \$6,502,888 (17.9%) in 2010; and \$3,417,537 (8.0%) as you can see from Table 1.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

Table 1: Assets, Liabilities, and Net Assets

	2011	2010	2009
Assets			
Current assets	\$21,696,563	32,140,543	28,097,856
Capital assets, net	30,509,172	17,550,178	15,021,305
Other non-current assets	<u>202,857</u>	<u>148,945</u>	<u>130,970</u>
Total assets	<u>52,408,592</u>	<u>49,839,666</u>	<u>43,250,131</u>
Liabilities			
Long-term debt outstanding	2,880,769	3,340,414	3,763,644
Other current and non-current liabilities	<u>3,265,118</u>	<u>3,654,084</u>	<u>3,144,207</u>
Total liabilities	<u>6,145,887</u>	<u>6,994,498</u>	<u>6,907,851</u>
Net assets			
Invested in capital assets, net of related debt	27,568,758	14,154,092	11,210,643
Outpatient chemotherapy	84,125	1,572,127	62,822
Unrestricted	<u>18,609,822</u>	<u>27,118,949</u>	<u>25,068,815</u>
Total net assets	<u>\$46,262,705</u>	<u>42,845,168</u>	<u>36,342,280</u>
Total liabilities and net assets	<u>\$52,408,592</u>	<u>49,839,666</u>	<u>43,250,131</u>

A significant component of the change in the Hospital's assets is the increase in net patient revenue for 2009, 2010 and 2011. The net patient revenue increased by \$2,591,583 in 2009, \$3,572,633 in 2010 and by \$5,276,164 in 2011. 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 as compared with the prior years. The gross days in accounts receivable were 70.5 in 2009, 70.7 in 2010 and 62.0 in 2011. The receivable/payable for estimated third party settlements relating to open cost reports has changed in each of the years 2009, 2010 and 2011. There was a net payable in 2009 of \$(180,274), a payable in 2010 of \$(618,435) and a net payable in 2011 of \$(72,535). Cash and cash equivalents decreased in 2011 by \$511,359 and current investments decreased in 2011 by \$8,031,142, as management accumulated and expended funds for the hospital expansion project.

Operating Results and Changes in the Hospital Net Assets

In 2011, the Hospital's net assets increased by \$3,417,537 or 8.0%, as shown in Table 2. This increase is made up of several different components.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

Table 2: Operating Results and Changes in Net Assets

	2011	2010	2009
Operating Revenues			
Net patient service revenues	\$35,695,130	30,418,966	26,846,333
Other operating revenues	<u>1,213,569</u>	<u>731,221</u>	<u>444,850</u>
Total operating revenues	<u>36,908,699</u>	<u>31,150,187</u>	<u>27,291,183</u>
Operating Expenses			
Salaries and benefits	19,072,095	15,745,469	13,639,040
Purchased services and other	7,671,686	5,712,700	5,297,923
Supplies	7,154,365	6,035,837	4,895,432
Professional fees	1,082,364	1,168,554	948,834
Depreciation and amortization	2,147,972	1,329,851	1,334,698
Insurance	<u>539,122</u>	<u>465,026</u>	<u>402,603</u>
Total operating expenses	<u>37,667,604</u>	<u>30,457,437</u>	<u>26,518,530</u>
Operating income/(loss)	<u>(758,905)</u>	<u>692,750</u>	<u>772,653</u>
Non-operating Revenues and Expenses			
Mill levy	3,511,805	3,531,227	3,708,750
Investment income	63,889	69,129	235,325
Gain (loss) on investment	7,781	182,950	(198,765)
Non-capital grants and contributions	606,240	652,981	675,655
Interest expense	<u>(13,273)</u>	<u>(126,149)</u>	<u>(204,060)</u>
Total non-operating revenues	<u>4,176,442</u>	<u>4,310,138</u>	<u>4,216,905</u>
Excess of revenues over expenses before capital grants and contributions	3,417,537	5,002,888	4,989,558
Capital grants and contributions	<u>-</u>	<u>1,500,000</u>	<u>385,000</u>
Increase in net assets	3,417,537	6,502,888	5,374,558
Net assets beginning of year	<u>42,845,168</u>	<u>36,342,280</u>	<u>30,967,722</u>
Net assets end of year	<u>\$46,262,705</u>	<u>42,845,168</u>	<u>36,342,280</u>

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

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 \$772,653 in 2009, income of \$692,750 in 2010 and operating loss of \$758,905 in 2011. Fiscal year end 2003 is the first year in the history of the Hospital that an operating profit was made, and this trend continued with 2008 and 2011 being the only years reporting a loss since 2003. Operating revenues increased in 2011 by 18.5% and operating expenses increased by 23.7%, resulting in an operating loss for the year.

The primary components of operating results are:

- Net patient service revenue increased in each of the past three years. The net service patient revenue increased in 2009 by \$2,591,583 (10.7%); in 2010 by \$3,572,633 (13.3%); and by \$5,276,164 (17.3%) in 2011.
- During 2009, the net patient service revenue increased by 10.7% and operating expenses increased by 6.5%. In 2009, two practitioners were added to the Lovington Medical Clinic and the Hospital continued to increase its presence in the southern part of Lea County which increased lab tests and revenue. In 2010, one additional provider was added to the Lovington Medical Clinic and a neurologist was added to a Professional Physicians Center established to bring a much needed specialty to Lea County and Southeastern New Mexico, while still fitting within the mission of the Hospital District. In 2011, one practitioner was added to the Lovington Medical Clinic and one mid-level practitioner was added to an evening walk-in clinic to help with the patients who need same day appointments but cannot get in with their regular primary care physician. The evening walk-in clinic was opened in May 2011. A cardiologist and a gastroenterologist were added to the Professional Physicians Center which continues to offer much needed specialties to Lea County and Southeastern New Mexico. In 2011, as part of the completion of the new outpatient construction, several new services were added that had initial start up cost in supplies and staffing. These new services include nuclear medicine; cardiac services such as echos and stress testing; outpatient physical therapy and occupational therapy; wound care services and gastroenterology services including surgical procedures. During 2011, operating revenues increased by 18.5% and operating expenses increased by 23.7%, resulting in an operating loss for the year. The increase in operating expenses is primarily related to a 33.4% increase in salaries and benefits, 18.5% increase in supplies, 39.5% increase in purchased services, and a 61.5% increase in depreciation and amortization costs.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

- 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 \$396,922 in 2009; \$682,690 in 2010 and \$1,138,795 in 2011.
- 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 40.1% of the gross revenue in 2009, 39.4% in 2010, and 40.1% in 2011.

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 2009 for 4 years and a 2.5 mill was approved in 2007 for 4 years. The mill levy election for the 2.5 mill was held on June 7, 2011 and was approved for 4 more years. 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 80.4% of the mill levy proceeds in 2009, 76.5% in 2010, and 74.3% in 2011, 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 2009, the Hospital received \$385,000 from the State Legislative Fund for capital equipment, Trauma Grant funding of \$140,572, \$8,282 from a Small Hospital Improvement Grant, smoking cessation funds from the State of \$30,000, county funds for diabetic supplies of \$49,331, \$10,000 for a physician recruitment grant, \$85,000 from the State for the School Based Clinic, and other miscellaneous grants of \$8,945. During 2010, the Hospital recorded \$1,500,000 in grant funding from the State legislature for the expansion of the cancer treatment center. In addition, the Hospital received various other grants including: a trauma grant of \$89,915, a Small Hospital Improvement Grant of \$8,136, smoking cessation funds of \$30,200, diabetic

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

supply funds of \$12,629, school based clinic funds of \$85,000, dental clinic improvement funds of \$75,376, and other grants of \$10,252. During 2011, the Hospital received various grants including: trauma grants totaling \$143,525, a Small Hospital Improvement Grant of \$7,817, diabetic supply funds of \$55,670, school based clinic funds of \$75,000, and other grants of \$6,173.

The Hospital also receives federal grant funding through the state in the form of a RHPCA Grant which is to supplement the rural health clinics for the indigent and uninsured. During 2009 and 2010 the Hospital received \$267,300 each year in RHPCA Grant funds and in 2011 the Hospital received \$242,700.

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, 2009, 2010 and 2011, the Hospital received net donations (restricted and unrestricted) of \$28,043, \$46,753 and \$47,303, 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

In 2008, the Hospital began the architectural design to a planned expansion to the new hospital section, incurring fees of \$307,811 through 2009. The project included a new chemotherapy area, a new dietary area, a new lab area, a new sleep study area and a new respiratory area. It also included space for an outpatient physical rehab, miscellaneous cardiac ancillary services, several hospital based physician clinics, an in house MRI and financial/administrative offices. The majority of the project was completed during December 2010 which added approximately 30,000 square feet to the existing hospital square footage. All departments took part in the development of the final architectural designs. The new expansion was paid for out of excess cash reserves. As of 2011, the Hospital had expended a total of \$16,642,650 on the construction project, in which \$265,448 was still construction in progress related to the unfinished gastroenterology suite and physician clinic. Of the total \$16,642,650 total, \$2,893,466 was expended during 2010 and \$13,442,066 was expended during 2011.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

At the end of 2011, the Hospital had \$30,509,172 invested in capital assets, net of accumulated depreciation; see Note 6 to the financial statements. The Hospital purchased new equipment in the amount of \$1,639,570 and spent \$21,195 in buildings and improvements.

At the end of 2010, the Hospital had \$17,550,178 invested in capital assets, net of accumulated depreciation. The Hospital purchased new equipment in the amount of \$595,164 and spent \$186,313 in building and improvements. During 2010, the Hospital also purchased 20 acres of land adjacent to the Hospital's property for future expansions and needs of the District for \$179,647.

At the end of 2009, the Hospital had \$15,021,305 invested in capital assets, net of accumulated depreciation. The Hospital purchased new equipment in the amount of \$1,220,473 and spent \$892,804 in building and improvements. During 2009, the Hospital purchased 2 properties located next to the main hospital facilities. The building which the Hospital leased from the City of Lovington for the Heritage Program for Senior Adults was purchased as well as the building across the street from the main hospital facility. The building across the street houses the offsite storage, the maintenance warehouse and the Nor-Lea Home Medical showroom and warehouse.

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. Scheduled principal payments through 2011 have brought the outstanding balance on the 2003 bonds to \$800,000. Also, the Hospital had outstanding debt associated with capital leases. The outstanding capital lease debt was \$210,662 in 2009; \$196,086 in 2010 and \$140,414 in 2011.

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, a rural health clinic. As of June 2006, the Hospital had three clinics, located in Lovington, Tatum and Hobbs, which had 5 mid-level

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2011 and 2010**

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 as well as a midlevel practitioner. During 2009, the Hospital added one more physician and an additional mid-level practitioner to its clinic staff, for a total of 7 mid-level practitioners and 7 physicians. During 2010, the Hospital added an additional physician to complete the space in the Lovington Clinic. The District also established an additional clinic to meet the demand for specialists in Lea County. The first physician hired for the Professional Physicians Center was a neurologist in January 2010, and during 2011, a cardiologist and a gastroenterologist were hired by the District. The total for 2010 is 7 mid-level practitioners and 9 physicians. During 2011, the Hospital added one more physician to the Lovington Clinic after moving a midlevel to the new wound care clinic. A midlevel practitioner was also added to the new evening walk-in clinic. The District has 12 physicians and 8 mid-level practitioners as of 2011.

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 2011, the Hospital developed an original budget with gross patient revenue of \$77,618,441 and operating expenses of \$36,562,241. In May 2011, the District amended the budget and ended the year with budgeted gross patient revenue of \$81,024,741 and operating expenses of \$37,833,485.

Contacting the Hospital Financial Management

The financial report is designed to provide our patients, suppliers, 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
BALANCE SHEETS
June 30, 2011 and 2010

	2011	2010
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 2,966,155	3,477,514
Patient accounts receivable, net of estimated uncollectibles of \$4,809,686 in 2011 and \$3,405,689 in 2010	4,937,862	5,260,351
Other receivables	1,111,011	2,426,132
Inventories and prepaid expenses	626,047	889,914
Short-term investments	11,971,363	20,014,505
Short-term investments - restricted	84,125	72,127
Total current assets	21,696,563	32,140,543
Capital assets		
Property and equipment, net	30,509,172	17,550,178
Other assets		
Physician receivables	193,588	135,541
Goodwill and intangibles, net of accumulated amortization, \$78,706 in 2011 and \$74,571 in 2010	9,269	13,404
Total other assets	202,857	148,945
Total assets	\$ 52,408,592	49,839,666
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 1,606,715	1,447,418
Accrued liabilities	751,857	930,835
Estimated third-party payor settlements	72,535	618,435
Current portion of capital leases	59,645	55,672
Compensated absences	774,366	601,724
Total current liabilities	3,265,118	3,654,084
Long-term debt, net of current portion	2,800,000	3,200,000
Capital leases, net of current portion	80,769	140,414
Total liabilities	6,145,887	6,994,498
Net Assets		
Invested in capital assets, net of related debt	27,568,758	14,154,092
Restricted - expendable	84,125	1,572,127
Unrestricted	18,609,822	27,118,949
Total net assets	46,262,705	42,845,168
Total liabilities and net assets	\$ 52,408,592	49,839,666

See Notes to Financial Statements.

**NOR-LEA GENERAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
Years Ended June 30, 2011 and 2010**

	2011	2010
Operating Revenue		
Net patient service revenue, net of provision for bad debts of \$6,492,745 in 2011 and \$5,621,488 in 2010	\$ 35,695,130	30,418,966
Other revenue	1,213,569	731,221
	<hr/>	<hr/>
Total operating revenue	36,908,699	31,150,187
Operating Expenses		
Salaries and wages	14,542,039	11,518,411
Supplies	7,154,365	6,035,837
Employee benefits	4,530,056	4,227,058
Purchased services	5,473,323	3,923,382
Depreciation and amortization	2,147,972	1,329,851
Other	1,244,192	1,182,875
Professional fees	1,082,364	1,168,554
Insurance	539,122	465,026
Leases and rentals	600,942	377,957
Utilities	353,229	228,486
	<hr/>	<hr/>
Total operating expenses	37,667,604	30,457,437
	<hr/>	<hr/>
Operating income (loss)	(758,905)	692,750
Nonoperating revenues		
Mill levy	3,511,805	3,531,227
Investment income	63,889	69,129
Gain on investments	7,781	182,950
Interest expense	(13,273)	(126,149)
Noncapital grants and contributions	606,240	652,981
	<hr/>	<hr/>
Total nonoperating revenues	4,176,442	4,310,138
	<hr/>	<hr/>
Excess of revenues over expenses before capital grants and contributions	3,417,537	5,002,888
Capital grants and contributions	-	1,500,000
	<hr/>	<hr/>
Increase in net assets	3,417,537	6,502,888
Net assets, beginning of year	42,845,168	36,342,280
	<hr/>	<hr/>
Net assets, end of year	\$ 46,262,705	42,845,168

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2011 and 2010

	2011	2010
Cash Flows From Operating Activities		
Receipts from and on behalf of patients	\$ 35,471,719	30,355,739
Payments to suppliers and contractors	(16,024,373)	(13,506,876)
Payments to and on behalf of employees	(19,078,431)	(15,515,297)
Receipts from sole community provider funds	1,138,795	682,690
Other operating receipts	(36,126)	216,538
Net cash provided by operating activities	1,471,584	2,232,794
Cash Flows From Noncapital Financing Activities		
Mill levy support	3,409,926	3,344,756
Noncapital grants and contributions	634,140	695,911
Net cash provided by noncapital financing activities	4,044,066	4,040,667
Cash Flows From Capital and Related Financing Activities		
Payments on long-term debt	(400,000)	(400,000)
Interest paid on long-term debt	(13,273)	(126,149)
Payments on capital leases	(55,672)	(51,626)
Capital grant	1,500,000	-
Capital expenditures	(15,102,831)	(3,817,540)
Net cash used in capital and related financing activities	(14,071,776)	(4,395,315)
Cash Flows From Investing Activities		
Increase in restricted investments	(11,998)	(9,305)
Payments received on physician receivables	(58,047)	(22,109)
Purchase of investments	(17,897,870)	(23,809,570)
Maturities of investments	17,948,793	-
Proceeds from sale of investments	8,000,000	23,700,990
Investment income	63,889	69,129
Net cash provided by (used in) investing activities	8,044,767	(70,865)
(Decrease) increase in cash and cash equivalents	(511,359)	1,807,281
Cash and cash equivalents, beginning of year	3,477,514	1,670,233
Cash and cash equivalents, end of year	\$ 2,966,155	3,477,514

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of operating (loss) income to net cash provided by operating activities		
Operating (loss) income	\$ (758,905)	692,750
Adjustments to reconcile operating (loss) income to net cash provided by operating activities		
Depreciation and amortization	2,147,972	1,329,851
Provision for bad debts	6,492,745	5,621,488
Changes in current assets and liabilities		
Patient accounts receivable	(6,170,256)	(6,122,876)
Other receivables	(110,900)	168,007
Inventories and prepaid expenses	263,867	(20,877)
Accounts payable	159,297	(103,882)
Accrued salaries, wages and benefits	(178,978)	151,948
Estimated third-party payor settlements	(545,900)	438,161
Compensated absences	172,642	78,224
	<hr/>	<hr/>
Net cash provided by operating activities	\$ 1,471,584	2,232,794
	<hr/> <hr/>	<hr/> <hr/>
Noncash Investing, Capital and Financing Activities		
Additions to equipment under capital leases	\$ -	37,050
	<hr/> <hr/>	<hr/> <hr/>

See Notes to Financial Statements.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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 dental clinic, 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.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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. Effective July 1, 2010, the Hospital adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Contained in Pre-November 30, 1989 and AICPA Pronouncements*, which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. The adoption of GASB 62 had no impact on the Hospital's accounting policies, as the Hospital had previously elected to not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, and applicable FASB pronouncements issued on or before November 30, 1989 have now been incorporated into GASB pronouncements.

Cash and Cash Equivalents. Cash and cash equivalents include cash as well as investments 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 102% of the amount in overnight repurchase accounts on deposit with the institution. 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.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets. The Hospital capitalizes property and equipment costing \$5,000 or more. 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. Construction activity on the Hospital expansion project began in 2010. Although the construction is being paid in cash, generally accepted accounting principles require interest capitalization using the rates of any outstanding borrowings and, accordingly, interest costs of \$155,000 and \$58,107 for 2011 and 2010, respectively, has been capitalized.

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, 2013, and a 2.5 mill levy, scheduled to expire on December 31, 2011. The Hospital recorded mill levy revenues of \$3,511,805 in 2011 and \$3,531,227 in 2010. Included in other receivables is \$567,652 and \$465,773 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.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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 \$242,700 and 267,300 in 2011 and 2010 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.

In 2010, the Hospital recognized a \$1.5 million capital grants awarded through the State of New Mexico. The \$1.5 million grant was approved by the State in 2010 and was accrued in *Other receivables* in the accompanying financial statements as of June 30, 2010. The Hospital received the cash payment of \$1.5 million in 2011.

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. Such restrictions are generally comprised of amounts deposited with trustees pursuant to revenue bond indentures, discussed in Note 7. Included in restricted expendable net assets at June 30, 2010 is the \$1.5 million grant, which was restricted for capital purposes, and such restriction was met in fiscal year 2011. As of June 30, 2011 and 2010, restricted expendable net assets were \$84,125 and \$1,572,127, respectively. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 and investment losses.

Compensated Absences. Vacation pay is accrued for employees based on hours paid. Accrual rates of 25 to 35 days per year are based on years of service. Vacation hours vest to the employee as they are earned. As of June 30, 2011 and 2010, the Hospital had accrued \$774,366 and \$601,724 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, 2011 and 2010, 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 injuries 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 2011 and 2010.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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.

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 100% of the asked price on United States treasury bills of the same maturity on the day of deposit.

Excess 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.

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, 2011 and 2010, the Hospital's deposits with Wells Fargo consisted of noninterest bearing deposits. As of June 30, 2011, the Hospital's noninterest deposits with Wells Fargo were fully insured under the Dodd-Frank Wall Street Reform and Consumer Protection Act of the FDIC. As of June 30, 2011 and 2010, the Hospital held certificates of deposit with Wells Fargo Brokerage, all of which were limited to \$250,000 and fully insured. At June 30, 2011, deposits were fully insured and therefore the Hospital had no exposure to custodial credit risk. The following table summarizes the Hospital's exposure to custodial credit risk as of June 30, 2010:

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

	Wells Fargo & Wells Fargo Brokerage	Lea County State Bank	Total
Year ended June 30, 2010			
Total amount of deposits	\$ 6,747,013	200,000	6,947,013
FDIC Coverage	<u>(3,678,008)</u>	<u>(200,000)</u>	<u>(3,878,008)</u>
Total uninsured public funds	3,069,005	-	3,069,005
Collateralized by securities held by the pledging institution or by its trust department or agent in other than the Hospital's name	<u>4,029,107</u>	-	<u>4,029,107</u>
Uninsured and uncollateralized	<u>\$ -</u>	<u>-</u>	<u>-</u>
Collateral requirement (50% of uninsured public funds)	\$ 1,534,503	-	1,534,503
Pledged securities	<u>4,029,107</u>	<u>-</u>	<u>4,029,107</u>
Over (under) collateralization	<u>\$ 2,494,604</u>	<u>-</u>	<u>2,494,604</u>

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 102% of the fair value of the securities underlying overnight repurchase accounts invested with the institution. The Hospital's investments are subject to custodial credit risk if 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. The Hospital's investments with Lea County State Bank and Wells Fargo Brokerage are registered in the name of the Hospital and therefore are not subject to custodial credit risk. At June 30, 2011 and 2010, the Hospital's investment in the New MexiGROW LGIP was exposed to custodial credit risk in the amounts of \$386,604 and \$8,372,191, as of June 30, 2011 and 2010, respectively.

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 LGIP does not have unit shares.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 3. DEPOSITS AND INVESTMENTS (CONTINUED)

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, 2011 and 2010, the Hospital's investments were rated as follows:

LGIP	AAAm	(S&P)
Federal Home Loan Corporation	AAA	(S&P)
Federal National Mortgage Association	AAA	(S&P)
Federal Farm Credit Banks bond	AA	(S&P)
Freddie Mac	AA	(S&P)

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, 2011 and 2010 included the following:

<u>Investments</u>	<u>Maturities</u>	<u>Fair Value</u>	
		2011	2010
Money market	Daily	\$ 204,570	62,220
Federal Home Loan Corporation	Ranges from 12/7/11 to 11/26/13	4,001,621	7,084,873
Federal National Mortgage Assoc.	Ranges from 8/24/12 to 11/26/13	1,301,150	1,001,560
Federal Farm Credit Banks Bond	4/4/2013	1,003,655	-
Freddie Mac	9/23/2013	1,000,239	-
LGIP	***	<u>386,604</u>	<u>8,372,191</u>
		<u>\$7,897,839</u>	<u>16,520,844</u>

***The LGIP's weighted average maturity at June 30, 2011 and 2010 is 36 and 50 days, respectively, 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 concentration of credit risk in the LGIP of \$8,372,191 as of June 30, 2010.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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. As a designated Critical Access Hospital the Hospital is reimbursed for inpatient, inpatient non-acute services, and certain outpatient services related to Medicare beneficiaries based on a cost reimbursement methodology. The Hospital is 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.

Medicaid - Similar to Medicare, 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 40% and 13%, respectively, of the Hospital's patient revenue for the year ended June 30, 2011 and approximately 39% and 13%, respectively, of the Hospital's patient revenue for the year ended June 30, 2010. 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 and Medicaid cost reports for 2011 and 2010 have not been finalized. In management's opinion, estimated Medicare and Medicaid settlements accrued for at June 30, 2011 and 2010 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, health maintenance, preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined daily rates, and cost reimbursement methodology.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 5. RESTRICTED NET ASSETS

Restricted, expendable net assets are restricted according to donor or grantor purpose restrictions. As of June 30, 2011 and 2010, these restrictions are as follows:

	2011	2010
Investments – restricted for outpatient chemotherapy and cardiovascular rehabilitation services	\$ 84,125	72,127
Other receivables – restricted for hospital expansion project	<u>-</u>	<u>1,500,000</u>
	<u>\$ 84,125</u>	<u>1,572,127</u>

NOTE 6. CAPITAL ASSETS

The following summarizes capital asset activity for the years ended June 30, 2011 and 2010:

	Balance 2010	Additions	Deletions	Balance 2011
Non-depreciable assets				
Land	\$ 212,647	-	-	212,647
Construction in progress	<u>3,200,585</u>	<u>13,442,066</u>	<u>(16,377,203)</u>	265,448
	<u>3,413,232</u>	<u>13,442,066</u>	<u>(16,377,203)</u>	478,095
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	16,547,011	16,398,398	-	32,945,409
Equipment	<u>9,797,818</u>	<u>1,639,570</u>	<u>(4,219)</u>	11,433,169
	<u>26,373,489</u>	<u>18,037,968</u>	<u>(4,219)</u>	44,407,238
Accumulated depreciation`				
Land improvements	(28,560)	(100)	-	(28,660)
Building and improvements	(5,018,115)	(1,250,677)	-	(6,268,792)
Equipment	<u>(7,189,868)</u>	<u>(893,060)</u>	4,219	(8,078,709)
	<u>(12,236,543)</u>	<u>(2,143,837)</u>	4,219	(14,376,161)
Capital assets, net	<u>\$17,550,178</u>	<u>29,336,197</u>	<u>(16,377,203)</u>	30,509,172

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 6 CAPITAL ASSETS (CONTINUED)

	Balance 2009	Additions	Deletions	Balance 2010
Non-depreciable assets				
Land	\$ 33,000	179,647	-	212,647
Construction in progress	<u>307,119</u>	<u>2,893,466</u>	-	<u>3,200,585</u>
	<u>340,119</u>	<u>3,073,113</u>	-	<u>3,413,232</u>
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	16,360,698	186,313		16,547,011
Equipment	<u>9,203,855</u>	<u>595,164</u>	<u>(1,201)</u>	<u>9,797,818</u>
	<u>25,593,213</u>	<u>781,477</u>	<u>(1,201)</u>	<u>26,373,489</u>
Accumulated depreciation				
Land improvements	(28,141)	(419)	-	(28,560)
Building and improvements	(4,463,999)	(554,116)	-	(5,018,115)
Equipment	<u>(6,419,887)</u>	<u>(771,182)</u>	<u>1,201</u>	<u>(7,189,868)</u>
	<u>(10,912,027)</u>	<u>(1,325,717)</u>	<u>1,201</u>	<u>(12,236,543)</u>
Capital assets, net	<u>\$ 15,021,305</u>	<u>2,528,873</u>	-	<u>17,550,178</u>

The Hospital began construction of a new outpatient facility in fiscal year 2010, and substantially completed the construction in fiscal year 2011. Depreciation expense, including amortization for equipment held under capital leases for the years ended June 30, 2011 and 2010 was \$2,143,837 and \$1,325,717, respectively. The Hospital acquired equipment under capital leases at a cost of \$0 and \$37,050 for the years ended June 30, 2011 and 2010, respectively.

Amortization expense for this equipment was \$60,539 and \$57,774 for the years ended June 30, 2011 and 2010, respectively, and amortized cost was \$112,235 and \$172,774 for the years ended June 30, 2011 and 2010, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 7. LONG-TERM DEBT AND COMPENSATED ABSENCES

The following summarizes long-term debt activity for the years ended June 30, 2011 and 2010:

	Balance 2010	Additions	Reductions	Balance 2011	Amounts Due Within One Year
Bonds Payable					
2004 Hospital Revenue Bond	\$ 2,000,000	-	-	2,000,000	-
2003 Hospital Revenue Bond	1,200,000	-	(400,000)	800,000	-
Total Long-term debt	3,200,000	-	(400,000)	2,800,000	-
Compensated absences	601,724	1,447,871	(1,275,229)	774,366	774,366
Capital lease obligations	196,086	-	(55,672)	140,414	59,645
Total	<u>\$ 3,997,810</u>	<u>1,447,871</u>	<u>(1,730,901)</u>	<u>3,714,780</u>	<u>834,011</u>

	Balance June 30, 2009	Additions	Reductions	Balance June 30, 2010	Amounts Due Within One Year
Bonds Payable					
2004 Hospital Revenue Bond	\$ 2,000,000	-	-	2,000,000	-
2003 Hospital Revenue Bond	1,600,000	-	(400,000)	1,200,000	-
Total Long-term debt	3,600,000	-	(400,000)	3,200,000	-
Compensated absences	523,500	1,106,505	(1,028,281)	601,724	601,724
Capital lease obligations	210,662	37,050	(51,626)	196,086	55,672
Total	<u>\$ 4,334,162</u>	<u>1,143,555</u>	<u>(1,479,907)</u>	<u>3,997,810</u>	<u>657,396</u>

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

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 7. LONG-TERM DEBT AND COMPENSATED ABSENCES (CONTINUED)

The terms and due dates of the Hospital's long-term debt, including capital lease obligations, at June 30, 2011 and 2010 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, 2011 and 2010, 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 Balance Sheet. 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, 2011, 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, 2011 and 2010, the balance remaining on the 2003 Bond was \$800,000 and \$1,200,000, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 7. LONG-TERM DEBT AND COMPENSATED ABSENCES (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. As of June 30, 2011 and 2010, the Hospital paid the July 1 payments; accordingly, no amounts are reported as current obligations in the accompanying financial statements. 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 2003 Bond 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, 2011 and 2010. 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, 2011, 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
2012	\$ 59,645	145,068
2013	456,630	121,539
2014	421,901	98,895
2015	402,238	78,432
2016	400,000	58,800
Thereafter	<u>1,200,000</u>	<u>58,800</u>
	<u>\$ 2,940,414</u>	<u>561,534</u>

The Hospital incurred \$168,273 and \$184,256 in interest costs related to debt and capital leases during the years ended June 30, 2011 and 2010, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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 \$265,971 in 2011 and \$240,292 in 2010 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, 2011 and 2010 consisted of these amounts:

	2011	2010
Other receivables		
Mill levy receivable	\$ 567,652	465,773
Grants receivable	22,750	1,546,900
Receivable from detention facility clinic	70,830	144,021
Sole community provider funding	226,934	143,998
State of New Mexico	125,285	-
Miscellaneous receivables	<u>97,560</u>	125,440
Total other receivables	<u>\$ 1,111,011</u>	<u>2,426,132</u>
Accounts payable and accrued expenses		
Payable to suppliers	\$ 1,606,715	1,447,418
Payable to employees (including payroll taxes)	<u>751,857</u>	930,835
Total accounts payable and accrued expenses	<u>\$ 2,358,572</u>	<u>2,378,253</u>

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

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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 inquiries 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. Effective June 1, 2006, pursuant to the Federal Risk Retention Act and under the captive insurance Hospital provisions of Vermont law, the Hospital is insured under and is a member subscriber in the Yellowstone Insurance Exchange, Risk Retention Group (Yellowstone) for the purpose of providing insurance for professional and general liability coverage. The Hospital pays member premiums in return for insurance coverage. The Hospital maintains claims-made commercial insurance related to professional and general liability risks. The policy expired on December 31, 2010 and was renewed through January 1, 2012. 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 \$259,226 in 2011 and \$249,844 in 2010 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 \$178,778 in 2011 and \$109,388 in 2010, and are included in insurance expense in the accompanying financial statements. The medical malpractice policies expire on various dates through May 31, 2012.

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 and premiums accrue based on the cost of experience of participating health care entities. The Hospital expensed approximately \$150,150 and \$164,258 in workers'

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

compensation premiums during 2011 and 2010, respectively. Such amounts are included in employee benefits in the accompanying financial statements.

Employee Health Insurance. The Hospital is self-insured with respect to medical insurance coverage offered to eligible employees, up to a maximum of \$50,000 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, 2011 and 2010, the outstanding claims liability was \$154,595 and \$243,539, 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, 2011.

Management Agreement. Covenant Health Systems (Covenant) manages the hospital pursuant to a two-year agreement dated March 1, 2010, whereby the Hospital reimburses Covenant 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 Covenant. This agreement may be terminated by either party upon 60 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 Covenant 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.

Sole Community Provider Funding. The Hospital receives Sole Community Provider Funding to compensate the Hospital for providing health care to the indigent population in Lea County. The funding is subject to annual reviews and approvals by Lea County as well as the State of New Mexico Human Services Department. In fiscal years 2011 and 2010, the Hospital recognized Sole Community Provider Funding of \$1,138,795 and \$682,690, respectively. Such amounts are included in *Other revenue* in the accompanying consolidated financial statements. This funding is essential to the Hospital's financial results and management believes this program will continue to be funded at levels similar to prior years.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Hospital has various operating leases for equipment. Total expense approximated \$69,000 in 2011 and \$0 in 2010 for all operating leases. The following is a schedule by year of future minimum lease payments for the building and equipment under non-cancelable operating leases as of June 30, 2011 which have initial or remaining lease terms in excess of one year:

Year ending June 30:	Minimum Lease Payments
2012	\$ 144,132
2013	144,132
2014	143,317
2015	43,746
2016	<u>17,396</u>
Total minimum lease payments	<u>\$ 492,723</u>

NOTE 11. CONCENTRATIONS OF CREDIT RISK

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

	2011	2010
Medicare	27%	32%
Medicaid	9	11
Commercial insurance	26	25
Private pay and other	38	32
	<u>100%</u>	<u>100%</u>

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 \$698,194 and \$638,028 for June 30, 2011 and 2010, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

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. Such purchases totaled \$9,459 and \$113,267 for the years ended June 30, 2011 and 2009, respectively.

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

	2011	2010
Management fees	\$ 207,342	197,097
Purchase of goods and services	791,204	712,730

No amounts were outstanding at June 30, 2011 or 2010 under the management 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, 2011**

	Original Budget	Final Approved Budget	Actual	Variance with Final Budget
Patient Revenue				
Inpatient	\$ 7,385,200	7,436,500	6,937,791	(498,709)
Outpatient	70,233,241	73,588,241	73,808,312	220,071
Total gross patient revenue	<u>77,618,441</u>	<u>81,024,741</u>	<u>80,746,103</u>	<u>(278,638)</u>
Contractual allowance	(34,735,153)	(37,452,694)	(38,558,228)	(1,105,534)
Provision for bad debts	(6,292,811)	(6,104,738)	(6,492,745)	(388,007)
Net patient service revenue	<u>36,590,477</u>	<u>37,467,309</u>	<u>35,695,130</u>	<u>(1,772,179)</u>
Other Revenue				
Other	976,336	1,168,600	1,213,569	44,969
Total other revenue	<u>976,336</u>	<u>1,168,600</u>	<u>1,213,569</u>	<u>44,969</u>
Total revenue	<u>37,566,813</u>	<u>38,635,909</u>	<u>36,908,699</u>	<u>(1,727,210)</u>
Expenses				
Salaries, wages and employee benefits	19,265,606	19,265,607	19,072,095	193,512
Purchased services and other	7,421,610	7,433,810	7,671,686	(237,876)
Supplies	6,603,596	7,376,796	7,154,365	222,431
Professional fees	1,088,529	991,872	1,082,364	(90,492)
Depreciation and amortization	1,692,000	2,272,000	2,147,972	124,028
Insurance	490,900	493,400	539,122	(45,722)
Total expenses	<u>36,562,241</u>	<u>37,833,485</u>	<u>37,667,604</u>	<u>165,881</u>
Operating Income (Loss)	<u>1,004,572</u>	<u>802,424</u>	<u>(758,905)</u>	<u>(1,561,329)</u>
Nonoperating revenue and expenses				
Mill levy	3,000,000	3,000,000	3,511,805	511,805
Investment income	70,150	55,150	63,889	8,739
Gain on investment	-	-	7,781	7,781
Rental income	25,000	20,000	18,095	(1,905)
Interest expense	(170,403)	(170,403)	(13,273)	157,130
Noncapital grants and contributions	2,007,737	517,737	588,145	70,408
Total nonoperating revenue and expenses	<u>4,932,484</u>	<u>3,422,484</u>	<u>4,176,442</u>	<u>753,958</u>
Excess of revenues over expenses before capital grants and contributions	<u>\$ 5,937,056</u>	<u>4,224,908</u>	<u>3,417,537</u>	<u>(807,371)</u>

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS
Year Ended June 30, 2011

Deposit or Investment Type	Wells Fargo Bank	Wells Fargo Brokerage*	Lea County State Bank	Banco Popular de Puerto Rico	NM State Treasurer Investment Pool	Total
Payroll - Checking	\$ -	-	-	-	-	-
Operating - Checking	2,777,471	-	-	-	-	2,777,471
Claims - Checking	185,348	-	-	-	-	185,348
Construction - Checking	88,911	-	-	-	-	88,911
Certificates of Deposit	-	4,162,219	-	200,000	-	4,362,219
Total deposits	3,051,730	4,162,219	-	200,000	-	7,413,949
Money market	-	96,332	108,238	-	-	204,570
Federal Home Loan Corporation	-	4,001,621	-	-	-	4,001,621
Federal National Mortgage Association	-	1,301,150	-	-	-	1,301,150
Federal Farm Credit Banks bond	-	1,003,655	-	-	-	1,003,655
Freddie Mac	-	1,000,239	-	-	-	1,000,239
Investment in local government investment pool	-	-	-	-	386,604	386,604
Total investments	-	7,402,997	108,238	-	386,604	7,897,839
Reconciling items	(293,495)	-	-	-	-	(293,495)
Carrying value	\$ 2,758,235	11,565,216	108,238	-	386,604	15,018,293
Petty Cash						3,350
Total deposits and investments as of June 30, 2011						<u>\$ 15,021,643</u>
Reconciliation to the Statement of Net Assets						
Cash and cash equivalents						\$ 2,966,155
Investments						11,971,363
Investments - restricted						<u>84,125</u>
Total deposits and investments as of June 30, 2011						<u>\$ 15,021,643</u>

* The Wells Fargo Brokerage investments includes deposits and investments held in a variety of financial institutions yet reported through Wells Fargo Brokerage.

**Report of Independent Auditors on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements in Accordance With *Government Auditing Standards***

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

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, 2011, which collectively comprise the Hospital's basic financial statements, as listed in the table of contents. We also have audited the Schedule of Revenues and Expenses with Budget Comparison ("budget comparison") presented as supplemental information for the year ended June 30, 2011, and have issued our report thereon dated October 17, 2011. 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 of America.

Internal Control Over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective 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 *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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*.

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.

Mess Adams LLP

Albuquerque, New Mexico
October 17, 2011

**NOR-LEA GENERAL HOSPITAL
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2011**

None

**NOR-LEA GENERAL HOSPITAL
SCHEDULE OF STATUS OF PRIOR YEAR FINDINGS
Year Ended June 30, 2011**

None

**NOR-LEA GENERAL HOSPITAL
EXIT CONFERENCE
Year Ended June 30, 2011**

We held an exit conference with management and a member of the Board of Trustees on October 13, 2011. The exit conference was attended by the following individuals:

Management Exit Conference

Nor-Lea General Hospital

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

Moss Adams LLP

Brandon Fryar, Partner
Purvi Mody Harville, Manager

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