



NOR-LEA GENERAL HOSPITAL

**Report of Independent Auditors and
Financial Statements with Supplementary
Information**

June 30, 2012 and 2011

MOSS-ADAMS^{LLP}

Certified Public Accountants | Business Consultants

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**NOR-LEA GENERAL HOSPITAL
OFFICIAL ROSTER
JUNE 30, 2012**

Board of Trustees

Agustin Dorado	Chairman
Julia Myers	Secretary
Leon Faris	Member
Pat Wise	Member
James Wright	Member
Rita Staton	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, 2012 and 2011, 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 supplementary information for the year ended June 30, 2012. 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 audits 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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally

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New Mexico State Auditor

accepted in the United States of America. In addition, in our opinion, the budget comparison referred to above presents fairly, in all material respects, the budgetary comparison of the Hospital for the year ended June 30, 2012 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 12, 2012 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the basic financial statements and budget 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 financial statements.

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

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, Schedule of Deposits and Investment Accounts is fairly stated in all material respects in relation to the financial statements as a whole.

Mess Adams LLP

Albuquerque, New Mexico
October 12, 2012

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

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, 2012 and 2011. 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 \$6,502,888 or 17.9% increase in 2010; a \$3,417,537 or 8.0% increase in 2011; and a \$7,025,192 or 15.2% in 2012
- The Hospital reported an operating income of \$692,750 in 2010; an operating loss of \$758,905 in 2011; and an operating income of \$2,071,427 in 2012.
- Net patient revenue increased in each of the past three years. The net patient revenue increased in 2010 by \$3,572,633 or 13.3%; in 2011 by \$5,276,164 or 17.3%; and in 2012 by \$8,186,618 or 22.9%.
- Non-operating revenue increased in 2010 by \$93,233 or 2.2%; decreased in 2011 by \$(133,696) or 3.1%; and increased in 2012 by \$777,323 or 18.6%.

Using This Annual Report

The Hospital financial statements consist of three statements: Statements of Net Asset; 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, 2012 and 2011**

The Statements of Net Assets and Statements 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 Statements of Net Assets 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 Statements of Net Assets 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 Statements of Net Assets. The Hospital's net assets increased in each of the past three years by \$6,502,888 (17.9%) in 2010; \$3,417,537 (8.0%) in 2011; and \$7,025,192 (15.2%) in 2012 as you can see from Table 1.

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

Table 1: Assets, Liabilities, and Net Assets

	2012	2011	2010
Assets			
Current assets	\$ 26,853,739	21,696,563	32,140,543
Capital assets, net	32,801,067	30,509,172	17,550,178
Other non-current assets	<u>168,618</u>	<u>202,857</u>	<u>148,945</u>
Total assets	<u>59,823,424</u>	<u>52,408,592</u>	<u>49,839,666</u>
Liabilities			
Long-term debt outstanding	2,500,269	2,880,769	3,340,414
Other current and non-current liabilities	<u>4,035,258</u>	<u>3,265,118</u>	<u>3,654,084</u>
Total liabilities	<u>6,535,527</u>	<u>6,145,887</u>	<u>6,994,498</u>
Net assets			
Invested in capital assets, net of related debt	30,188,779	27,568,758	14,154,092
Restricted – expendable	103,233	84,125	1,572,127
Unrestricted	<u>22,995,885</u>	<u>18,609,822</u>	<u>27,118,949</u>
Total net assets	<u>\$ 53,287,897</u>	<u>46,262,705</u>	<u>42,845,168</u>
Total liabilities and net assets	<u>\$ 59,823,424</u>	<u>52,408,592</u>	<u>49,839,666</u>

A significant component of the change in the Hospital's assets is the increase in net patient revenue for 2010, 2011 and 2012. The net patient revenue increased by \$3,572,633 in 2010, \$5,276,164 in 2011 and by \$8,186,618 in 2012. 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 70.7 in 2010, 62.0 in 2011 and 60.6 in 2012. The receivable/payable for estimated third party settlements relating to open cost reports has changed in each of the years 2010, 2011 and 2012. There was a net payable in 2010 of \$(618,435), a net payable in 2011 of \$(72,535) and a net payable of \$927,867 in 2012. Cash and cash equivalents increased in 2012 by \$3,909,737 and current investments increased in 2012 by \$225,951, as management completed the hospital expansion project during fiscal year end 2012.

Operating Results and Changes in the Hospital Net Assets

In 2012, the Hospital's net assets increased by \$7,025,192 or 15.2%, 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, 2012 and 2011**

Table 2: Operating Results and Changes in Net Assets

	2012	2011	2010
Operating Revenues			
Net patient service revenues	\$ 43,881,748	35,695,130	30,418,966
Other operating revenues	<u>1,604,424</u>	<u>1,213,569</u>	<u>731,221</u>
Total operating revenues	<u>45,486,172</u>	<u>36,908,699</u>	<u>31,150,187</u>
Operating Expenses			
Salaries and benefits	21,711,289	19,072,095	15,745,469
Purchased services and other	8,683,663	7,671,686	5,712,700
Supplies	8,492,445	7,154,365	6,035,837
Professional fees	1,504,016	1,082,364	1,168,554
Depreciation and amortization	2,481,782	2,147,972	1,329,851
Insurance	<u>541,550</u>	<u>539,122</u>	<u>465,026</u>
Total operating expenses	<u>43,414,745</u>	<u>37,667,604</u>	<u>30,457,437</u>
Operating income/(loss)	<u>2,071,427</u>	<u>(758,905)</u>	<u>692,750</u>
Non-operating Revenues and Expenses			
Mill levy	4,088,310	3,511,805	3,531,227
Investment income	32,842	63,889	69,129
Gain (loss) on investment	-	7,781	182,950
State Appropriations	327,000	-	-
Non-capital grants and contributions	534,435	606,240	652,981
Interest expense	<u>(28,822)</u>	<u>(13,273)</u>	<u>(126,149)</u>
Total non-operating revenues	<u>4,953,765</u>	<u>4,176,442</u>	<u>4,310,138</u>
Excess of revenues over expenses before capital grants and contributions	7,025,192	3,417,537	5,002,888
Capital grants and contributions	<u>-</u>	<u>-</u>	<u>1,500,000</u>
Increase in net assets	7,025,192	3,417,537	6,502,888
Net assets beginning of year	<u>46,262,705</u>	<u>42,845,168</u>	<u>36,342,280</u>
Net assets end of year	<u>\$ 53,287,897</u>	<u>46,262,705</u>	<u>42,845,168</u>

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

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 \$692,750 in 2010, operating loss of \$758,905 in 2011 and operating income of \$2,071,427 in 2012. 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 2012 by 23.2% and operating expenses increased by 15.3%, resulting in an operating income 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 2010 by \$3,572,633 (13.3%); by \$5,276,164 (17.3%) in 2011; and by \$8,186,618 (22.9%) in 2012.
- 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 echoes 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. In 2012, the hospital implemented a charge master increase that averaged approximately 10.43% annualized keeping the hospital charges at the 75th percentile nationally. The last increase was done July 2009. With the completion of the endoscopy area of the hospital and the addition of an urologist to the Professional Physicians Center, significant growth (118.3%) was seen in the operating room and endoscopy suite procedures. There was also growth in the Neurology

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

procedures (42.0%), the cardiac procedures (78.6%), the physical rehab procedures (86.2%), the hospital based clinics including the Professional Physicians Center and the Evening Clinic (139.8%).

- 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 \$682,690 in 2010; \$1,138,795 in 2011 and \$1,121,571 in 2012.
- 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 39.4% of the gross revenue in 2010, 40.1% in 2011, and 39.7% in 2012.

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 2011 for 4 years. The next mill levy election is in 2013. 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 76.5% of the mill levy proceeds in 2010, 74.3% in 2011, and 76.6% in 2012, 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

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

Hospital Improvement Grant of \$8,136, smoking cessation funds of \$30,200, diabetic 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. During 2012, the Hospital received the following grants: trauma grants totaling \$65,156, a Small Hospital Improvement Grant of \$7,769, diabetic supply funds of \$18,871, school based clinic funds of \$75,000, and HRSA grant funds of \$47,654. 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 2010 the Hospital received \$267,300 in RHPCA Grant funds, in 2011 the Hospital received \$242,700 and in 2012 the Hospital received \$225,000 in RHPCA Grant funds

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, 2010, 2011 and 2012, the Hospital received net donations (restricted and unrestricted) of \$46,753, \$47,303 and \$72,123, 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 \$307,118 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. In

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

2012 the final completion of the expansion project was realized. The total expended was \$20,530,407 with \$2,893,466 expended during 2010, \$13,442,066 expended during 2011 and \$3,887,757 expended during 2012.

At the end of 2012, the Hospital had \$32,801,067 invested in capital assets, net of accumulated depreciation; see Note 6 to the financial statements. The Hospital purchased new equipment in the amount of \$883,736 and spent \$3,887,757 in buildings and improvements.

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.

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 2012 have brought the outstanding balance on the 2003 bonds to \$400,000. Also, the Hospital had outstanding debt associated with capital leases. The outstanding capital lease debt was \$196,086 in 2010; \$140,414 in 2011 and \$212,288 in 2012.

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 practitioners and 5 physicians. In 2007, the Hospital added the school-based clinic,

**NOR-LEA GENERAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
June 30, 2012 and 2011**

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. The total for 2010 was 7 mid-level practitioners and 9 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. 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 had 12 physicians and 8 mid-level practitioners as of 2011. At the end of 2012 the District had 13 physicians and 8 mid-level practitioners; however, during 2012 one of the physicians in the Lovington Clinic left and the position was temporarily filled by a contract physician with recruitment for a full time physician continuing. An urologist was hired for the Professional Physicians Center in July 2011 as well.

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 2012, the Hospital developed an original budget with gross patient revenue of \$97,288,067 and operating expenses of \$45,123,630.

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
STATEMENTS OF NET ASSETS
June 30, 2012 and 2011**

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 6,875,892	2,966,155
Patient accounts receivable, net of estimated uncollectibles of \$6,526,346 in 2012 and \$4,809,686 in 2011	5,455,549	4,937,862
Other receivables	1,564,419	1,111,011
Inventories and prepaid expenses	676,440	626,047
Short-term investments	12,178,206	11,971,363
Short-term investments - restricted	103,233	84,125
Total current assets	26,853,739	21,696,563
Noncurrent Assets		
Property and equipment, net	32,801,067	30,509,172
Physician receivables	161,533	193,588
Goodwill and intangibles, net of accumulated amortization of \$80,890 in 2012 and \$78,706 in 2011	7,085	9,269
Total assets	\$ 59,823,424	\$ 52,408,592
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 1,477,311	1,606,715
Accrued liabilities	636,662	751,857
Estimated third-party payor settlements	927,867	72,535
Current portion of capital leases	112,019	59,645
Compensated absences	881,399	774,366
Total current liabilities	4,035,258	3,265,118
Noncurrent Liabilities		
Long-term debt	2,400,000	2,800,000
Capital leases, net of current portion	100,269	80,769
Total liabilities	6,535,527	6,145,887
Net Assets		
Invested in capital assets, net of related debt	30,188,779	27,568,758
Restricted - expendable	103,233	84,125
Unrestricted	22,995,885	18,609,822
Total net assets	53,287,897	46,262,705
Total liabilities and net assets	\$ 59,823,424	52,408,592

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
Years Ended June 30, 2012 and 2011

	2012	2011
Operating Revenue		
Net patient service revenue, net of provision for bad debts of \$8,323,863 in 2012 and \$6,492,745 in 2011	\$ 43,881,748	35,695,130
Other revenue	<u>1,604,424</u>	<u>1,213,569</u>
Total operating revenue	<u>45,486,172</u>	<u>36,908,699</u>
Operating Expenses		
Salaries and wages	16,384,363	14,542,039
Supplies	8,492,445	7,154,365
Purchased services	6,139,015	5,473,323
Employee benefits	5,326,926	4,530,056
Depreciation and amortization	2,481,782	2,147,972
Professional fees	1,504,016	1,082,364
Other	1,432,648	1,244,192
Leases and rentals	718,278	600,942
Insurance	541,550	539,122
Utilities	<u>393,722</u>	<u>353,229</u>
Total operating expenses	<u>43,414,745</u>	<u>37,667,604</u>
Operating income (loss)	<u>2,071,427</u>	<u>(758,905)</u>
Nonoperating revenues		
Mill levy	4,088,310	3,511,805
State appropriations	327,000	-
Investment income	32,842	63,889
Gain on investments	-	7,781
Interest expense	(28,822)	(13,273)
Noncapital grants and contributions	<u>534,435</u>	<u>606,240</u>
Total nonoperating revenues	<u>4,953,765</u>	<u>4,176,442</u>
Excess of revenues over expenses	<u>7,025,192</u>	<u>3,417,537</u>
Increase in net assets	7,025,192	3,417,537
Net assets, beginning of year	<u>46,262,705</u>	<u>42,845,168</u>
Net assets, end of year	<u>\$ 53,287,897</u>	<u>46,262,705</u>

See Notes to Financial Statements.

**NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2012 and 2011**

	2012	2011
Cash Flows From Operating Activities		
Receipts from and on behalf of patients	\$ 44,219,393	35,471,719
Payments to suppliers and contractors	(19,401,471)	(16,024,373)
Payments to and on behalf of employees	(21,719,451)	(19,078,431)
Receipts from sole community provider funds	1,121,571	1,138,795
Other operating receipts	20,588	(36,126)
Net cash provided by operating activities	<u>4,240,630</u>	<u>1,471,584</u>
Cash Flows From Noncapital Financing Activities		
Mill levy support	4,126,692	3,409,926
State appropriations	327,000	-
Noncapital grants and contributions	504,910	634,140
Net cash provided by noncapital financing activities	<u>4,958,602</u>	<u>4,044,066</u>
Cash Flows From Capital and Related Financing Activities		
Payments on long-term debt	(400,000)	(400,000)
Interest paid on long-term debt	(28,822)	(13,273)
Payments on capital leases	(100,911)	(55,672)
Capital grant	-	1,500,000
Capital expenditures	(4,598,708)	(15,102,831)
Net cash used in capital and related financing activities	<u>(5,128,441)</u>	<u>(14,071,776)</u>
Cash Flows From Investing Activities		
Increase in restricted investments	(19,108)	(11,998)
Payments received on physician receivables	32,055	(58,047)
Purchase of investments	(397,801)	(17,897,870)
Maturities of investments	190,958	17,948,793
Proceeds from sale of investments	-	8,000,000
Investment income	32,842	63,889
Net cash (used in) provided by investing activities	<u>(161,054)</u>	<u>8,044,767</u>
Increase (decrease) in cash and cash equivalents	<u>3,909,737</u>	<u>(511,359)</u>
Cash and cash equivalents, beginning of year	<u>2,966,155</u>	<u>3,477,514</u>
Cash and cash equivalents, end of year	<u>\$ 6,875,892</u>	<u>2,966,155</u>

See Notes to Financial Statements.

NOR-LEA GENERAL HOSPITAL
STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended June 30, 2012 and 2011

	2012	2011
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income (loss)	\$ 2,071,427	(758,905)
Adjustments to reconcile operating (loss) income to net cash provided by operating activities		
Depreciation and amortization	2,481,782	2,147,972
Provision for bad debts	8,323,863	6,492,745
Changes in current assets and liabilities		
Patient accounts receivable	(8,841,550)	(6,170,256)
Other receivables	(462,265)	(110,900)
Inventories and prepaid expenses	(50,393)	263,867
Accounts payable	(129,404)	159,297
Accrued salaries, wages and benefits	(115,195)	(178,978)
Estimated third-party payor settlements	855,332	(545,900)
Compensated absences	107,033	172,642
	<hr/>	<hr/>
Net cash provided by operating activities	\$ 4,240,630	1,471,584
	<hr/>	<hr/>
Noncash Investing, Capital and Financing Activities		
Additions to equipment under capital leases	\$ 172,785	-
	<hr/>	<hr/>

See Notes to Financial Statements.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 a healing touch, generous hand, caring services and community wellness to Nor-Lea Hospital District and its patients, supporters and community. Nor-Lea Foundation will always exist to assist Nor-Lea Hospital District in the provision of quality, compassionate healthcare in order to raise the standard of care and wellness in Lea County and the surrounding communities. Nor-Lea Foundation accepts and manages gifts from individuals and corporations in order to continue this exemplary healthcare. 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 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, 2012 and 2011**

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 GASB's authoritative literature and 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, 2012 and 2011**

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 was in cash, generally accepted accounting principles required interest capitalization using the rates of any outstanding borrowings and, accordingly, interest costs of \$136,000 and \$155,000 for 2012 and 2011, respectively, have 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, expired on December 31, 2015. The Hospital recorded mill levy revenues of \$4,088,310 in 2012 and \$3,511,805 in 2011. Included in other receivables is \$529,270 and \$567,652 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, 2012 and 2011**

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 \$225,000 and \$242,700 in 2012 and 2011 in federal grant awards. These amounts are included in noncapital 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 noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. As of June 30, 2012 and 2011, restricted expendable net assets were comprised of donations and funds held by the Nor-Lea Foundation in the amount of \$103,233 and \$84,125, 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, 2012 and 2011**

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Revenues and Expenses. The Hospital's statements of revenues, expenses and changes in net assets distinguish 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, state appropriations 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, 2012 and 2011, the Hospital had accrued \$881,399 and \$774,366 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, 2012 and 2011, 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 2012 and 2011.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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, 2012 and 2011, the Hospital's deposits with Wells Fargo consisted of noninterest bearing deposits. As of June 30, 2012, 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, 2012 and 2011, the Hospital held certificates of deposit with Wells Fargo Brokerage, all of which were limited to \$250,000 and fully insured. At June 30, 2012 and 2011, deposits were fully insured and therefore the Hospital had no exposure to custodial credit risk.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 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, 2012 and 2011, the Hospital's investment in the New MexiGROW LGIP was exposed to custodial credit risk in the amounts of \$387,477 and \$386,604, as of June 30, 2012 and 2011, 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 6-10-10P 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, 2012 and 2011**

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, 2012 and 2011, 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, 2012 and 2011 included the following:

<u>Investments</u>	<u>Maturities</u>	<u>Fair Value</u>	
		<u>2012</u>	<u>2011</u>
Money market	Daily	\$ 479,243	204,570
Federal Home Loan Corporation	Ranges from 12/7/11 to 3/12/14	1,000,072	4,001,621
Federal National Mortgage Assoc.		-	1,301,150
Federal Farm Credit Banks Bond	Ranges from 8/22/13 To 6/19/14	5,299,167	1,003,655
Freddie Mac		-	1,000,239
LGIP	***	<u>387,477</u>	<u>386,604</u>
		<u>\$7,165,959</u>	<u>7,897,839</u>

***The LGIP's weighted average maturity at June 30, 2012 and 2011 is 60 and 36 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.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 12%, respectively, of the Hospital's patient revenue for the year ended June 30, 2012 and approximately 40% and 13%, respectively, of the Hospital's patient revenue for the year ended June 30, 2011. 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 2012 have not been finalized. In management's opinion, estimated Medicare and Medicaid settlements accrued for at June 30, 2012 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, 2012 and 2011**

NOTE 5. RESTRICTED NET ASSETS

Restricted, expendable net assets are restricted according to donor or grantor purpose restrictions. As of June 30, 2012 and 2011, these restrictions are as follows:

	2012	2011
Investments – restricted for outpatient chemotherapy and cardiovascular rehabilitation services	<u>\$ 103,233</u>	<u>84,125</u>

NOTE 6. CAPITAL ASSETS

The following summarizes capital asset activity for the years ended June 30, 2012 and 2011:

	Balance 2011	Additions	Deletions	Balance 2012
Non-depreciable assets				
Land	\$ 212,647	-	-	212,647
Construction in progress	265,448	3,887,757	(4,153,205)	-
	<u>478,095</u>	<u>3,887,757</u>	<u>(4,153,205)</u>	<u>212,647</u>
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	32,945,409	4,153,205	-	37,098,614
Equipment	11,433,169	883,736	-	12,316,905
	<u>44,407,238</u>	<u>5,036,941</u>	<u>-</u>	<u>49,444,179</u>
Accumulated depreciation				
Land improvements	(28,660)	-	-	(28,660)
Building and improvements	(6,268,792)	(1,519,190)	-	(7,787,982)
Equipment	(8,078,709)	(960,408)	-	(9,039,117)
	<u>(14,376,161)</u>	<u>(2,479,598)</u>	<u>-</u>	<u>(16,855,759)</u>
Capital assets, net	<u>\$ 30,509,172</u>	<u>6,445,100</u>	<u>(4,153,205)</u>	<u>32,801,067</u>

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE 6 CAPITAL ASSETS (CONTINUED)

	Balance 2010	Additions	Deletions	Balance 2011
Non-depreciable assets				
Land	\$ 212,647	-	-	212,647
Construction in progress	3,200,585	13,442,066	(16,377,203)	265,448
	<u>3,413,232</u>	<u>13,442,066</u>	<u>(16,377,203)</u>	<u>478,095</u>
Depreciable assets				
Land improvements	28,660	-	-	28,660
Building and improvements	16,547,011	16,398,398	-	32,945,409
Equipment	9,797,818	1,639,570	(4,219)	11,433,169
	<u>26,373,489</u>	<u>18,037,968</u>	<u>(4,219)</u>	<u>44,407,238</u>
Accumulated depreciation`				
Land improvements	(28,560)	(100)	-	(28,660)
Building and improvements	(5,018,115)	(1,250,677)	-	(6,268,792)
Equipment	(7,189,868)	(893,060)	4,219	(8,078,709)
	<u>(12,236,543)</u>	<u>(2,143,837)</u>	<u>4,219</u>	<u>(14,376,161)</u>
Capital assets, net	<u>\$ 17,550,178</u>	<u>29,336,197</u>	<u>(16,377,203)</u>	<u>30,509,172</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, 2012 and 2011 was \$2,479,598 and \$2,143,837, respectively. The Hospital acquired equipment under capital leases at a cost of \$172,785 and \$0 for the years ended June 30, 2012 and 2011, respectively.

Amortization expense for this equipment was \$112,945 and \$60,539 for the years ended June 30, 2012 and 2011, respectively, and amortized cost was \$172,075 and \$225,180 for the years ended June 30, 2012 and 2011, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE 7. LONG-TERM DEBT AND COMPENSATED ABSENCES

The following summarizes long-term debt activity for the years ended June 30, 2012 and 2011:

	Balance 2011	Additions	Reductions	Balance 2012	Amounts Due Within One Year
Bonds Payable					
2004 Hospital Revenue Bond	\$ 2,000,000	-	-	2,000,000	-
2003 Hospital Revenue Bond	800,000	-	(400,000)	400,000	-
Total Long-term debt	2,800,000	-	(400,000)	2,400,000	-
Compensated absences	774,366	1,636,835	(1,529,802)	881,399	881,399
Capital lease obligations	140,414	171,819	(99,945)	212,288	112,019
Total	\$ 3,714,780	1,808,654	(2,029,747)	3,493,687	993,418

	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	\$ 3,997,810	1,447,871	(1,730,901)	3,714,780	834,011

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, 2012 and 2011**

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, 2012 and 2011 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, 2012 and 2011, 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 Statements 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, 2012, 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, 2012 and 2011, the balance remaining on the 2003 Bond was \$400,000 and \$800,000, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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, 2012 and 2011, 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 Statements of Net Assets as of June 30, 2012 and 2011. 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, 2012, 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
2013	\$ 112,019	158,501
2014	486,925	123,260
2015	413,344	96,902
2016	400,000	77,200
2017	400,000	57,600
Thereafter	<u>800,000</u>	<u>95,600</u>
	<u>\$ 2,612,288</u>	<u>609,063</u>

The Hospital incurred \$164,822 and \$168,273 in interest costs related to debt and capital leases during the years ended June 30, 2012 and 2011, respectively.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 \$375,666 in 2012 and \$265,971 in 2011 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, 2012 and 2011 consisted of these amounts:

	2012	2011
Other receivables		
Mill levy receivable	\$ 529,270	567,652
Grants receivable	81,708	22,750
Receivable from detention facility clinic	146,700	70,830
Sole community provider funding	407,501	226,934
Appropriations for the State of New Mexico	327,000	125,285
Miscellaneous receivables	<u>72,240</u>	<u>97,560</u>
Total other receivables	<u>\$ 1,564,419</u>	1,111,011
Accounts payable and accrued expenses		
Payable to suppliers	\$ 1,477,311	1,606,715
Payable to employees (including payroll taxes)	<u>636,662</u>	<u>751,857</u>
Total accounts payable and accrued expenses	<u>\$ 2,113,973</u>	2,358,572

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, 2012 and 2011**

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, 2012 and was renewed through January 1, 2013. 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 \$256,629 in 2012 and \$259,226 in 2011 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 \$191,128 in 2012 and \$178,778 in 2011, and are included in insurance expense in the accompanying financial statements. The medical malpractice policies expire on various dates through May 31, 2013.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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 \$158,740 and \$150,150 in workers' compensation premiums during 2012 and 2011, 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, 2012 and 2011, the outstanding claims liability was \$244,790 and \$154,595, 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, 2012 and 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. The agreement was amended on March 1, 2012 to extend the term to February 28, 2014. 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.

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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 2012 and 2011, the Hospital recognized Sole Community Provider Funding of \$1,121,571 and \$1,138,795, 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.

The Hospital has various operating leases for equipment. Total expense was \$330,901 in 2012 and \$52,883 in 2011 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, 2012 which have initial or remaining lease terms in excess of one year:

Year ending June 30:	Minimum Lease Payments
2013	\$ 509,701
2014	506,807
2015	188,955
2016	<u>6,109</u>
Total minimum lease payments	<u>\$ 1,211,572</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:

	2012	2011
Medicare	19%	27%
Medicaid	11	9
Commercial insurance	27	26
Private pay and other	<u>43</u>	<u>38</u>
	<u>100%</u>	<u>100%</u>

**NOR-LEA GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 \$967,795 and \$698,194 for June 30, 2012 and 2011, 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. Such purchases totaled \$0 and \$9,459 for the years ended June 30, 2012 and 2010, respectively.

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

	2012	2011
Management fees	\$ 214,917	207,342
Purchase of goods and services	1,030,646	791,204

No amounts were outstanding at June 30, 2012 or 2011 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, 2012**

	Original Budget	Final Approved Budget	Actual	Variance with Final Budget
Patient Revenue				
Inpatient	\$ 8,015,037	\$ 8,015,037	7,816,353	(198,684)
Outpatient	89,273,030	89,273,030	97,304,549	8,031,519
Total gross patient revenue	<u>97,288,067</u>	<u>97,288,067</u>	<u>105,120,902</u>	<u>7,832,835</u>
Contractual allowance	(45,373,444)	(45,373,444)	(52,915,291)	(7,541,847)
Provision for bad debts	(7,526,102)	(7,526,102)	(8,323,863)	(797,761)
Net patient service revenue	<u>44,388,521</u>	<u>44,388,521</u>	<u>43,881,748</u>	<u>(506,773)</u>
Other Revenue				
Other	1,669,300	1,669,300	1,604,424	(64,876)
Total other revenue	<u>1,669,300</u>	<u>1,669,300</u>	<u>1,604,424</u>	<u>(64,876)</u>
Total revenue	<u>46,057,821</u>	<u>46,057,821</u>	<u>45,486,172</u>	<u>(571,649)</u>
Expenses				
Salaries, wages and employee benefits	22,756,845	22,756,845	21,711,289	1,045,556
Purchased services and other	8,420,522	8,420,522	8,683,663	(263,141)
Supplies	9,519,083	9,519,083	8,492,445	1,026,638
Professional fees	1,020,680	1,020,680	1,504,016	(483,336)
Depreciation and amortization	2,822,150	2,822,150	2,481,782	340,368
Insurance	584,350	584,350	541,550	42,800
Total expenses	<u>45,123,630</u>	<u>45,123,630</u>	<u>43,414,745</u>	<u>1,708,885</u>
Operating Income (Loss)	<u>934,191</u>	<u>934,191</u>	<u>2,071,427</u>	<u>1,137,236</u>
Nonoperating revenue and expenses				
Mill levy	3,000,000	3,000,000	4,088,310	1,088,310
Other grant revenue and state appropriations	500,400	500,400	766,450	266,050
Contributions	73,400	73,400	87,765	14,365
Investment income	53,550	53,550	32,842	(20,708)
Rental income	7,500	7,500	7,220	(280)
Interest expense	(145,199)	(145,199)	(28,822)	116,377
	<u>3,489,651</u>	<u>3,489,651</u>	<u>4,953,765</u>	<u>1,464,114</u>
Excess of revenues over expenses before capital grants and contributions	<u>\$ 4,423,842</u>	<u>4,423,842</u>	<u>7,025,192</u>	<u>2,601,350</u>

**NOR-LEA GENERAL HOSPITAL
SCHEDULE OF DEPOSIT AND INVESTMENT ACCOUNTS
Year Ended June 30, 2012**

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	7,573,232	-	1,455	-	-	7,574,687
Claims - Checking	-	-	-	-	-	-
Construction - Checking	64,965	-	-	-	-	64,965
Certificates of Deposit	-	4,894,562	-	300,000	-	5,194,562
Total deposits	7,638,197	4,894,562	1,455	300,000	-	12,834,214
Money market	-	400,161	79,082	-	-	479,243
Federal Home Loan Corporation	-	1,000,072	-	-	-	1,000,072
Federal Farm Credit Banks bond	-	5,299,167	-	-	-	5,299,167
Investment in local government investment pool	-	-	-	-	387,477	387,477
Total investments	-	6,699,400	79,082	-	387,477	7,165,959
Reconciling items	(845,592)	-	-	-	-	(845,592)
Carrying value	\$ 6,792,605	11,593,962	80,537	300,000	387,477	19,154,581
Petty Cash						2,750
Total deposits and investments as of June 30, 2012						\$ 19,157,331
Reconciliation to the Statement of Net Assets						
Cash and cash equivalents						\$ 6,875,892
Investments						12,178,206
Investments - restricted						103,233
Total deposits and investments as of June 30, 2012						\$ 19,157,331

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

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**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 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, 2012, 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 supplementary information for the year ended June 30, 2012, and have issued our report thereon dated October 12, 2012. 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*.

We noted one matter that is required to be reported per section 12-6-5 NMSA 1978 that is described in the accompanying schedule of findings and responses as item 2012-01.

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

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 12, 2012

**NOR-LEA GENERAL HOSPITAL
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2012**

2012 – 01 – Employee Benefits Review and Reconciliation

Condition

For the one payroll period tested, January 22-February 4, 2012 pay period with a pay date on February 11, 2012, the third-party administrators invoiced amounts did not reconcile to the payroll supporting documentation and to general ledger.

Criteria

A properly designed system of internal controls over financial reporting includes an appropriate balance of reconciliation controls and management review and authorization controls over all potentially significant accounts.

Effect

There is an increased risk of error or fraud in the financial records.

Cause

Employee benefit elections are not timely communicated to third-party administrators, therefore the invoiced amounts do not capture the employee's correct premium amounts. Additionally, the payroll register is not reconciled to invoiced amounts from third-party administrators invoiced amounts and there was no second review prior to booking the amounts in the general ledger.

Recommendation

We recommend management implement procedures to ensure any discrepancies between third-party invoices are investigated, corrected on a timely basis, and reconciled to the payroll reports and general ledger. We also recommend that all required employee benefit forms be reviewed or authorized by appropriate personnel under the Hospital's policies and procedures.

Response

Currently the hospital district has enlisted the services of a third party individual to review all processes and procedures in the human resource department to determine the appropriate documentation and processes needed to accurately maintain and monitor employee benefits.

Invoices and payroll registers will be reconciled by a member of the finance department and any discrepancies will be referred to human resources for the appropriate corrections to be made to either the employee's pay information or the third-party administrator's future billing. Any action by human resources will be reported back to finance so that the corrections can be monitor for future reconciliations.

The finance department will continue to reconcile the payroll payables and will implement the monitoring of the hospital benefit expenses reported on the financial statement per the benefit invoice reconciliations.

NOR-LEA GENERAL HOSPITAL
SCHEDULE OF STATUS OF PRIOR YEAR FINDINGS
Year Ended June 30, 2012

None

**NOR-LEA GENERAL HOSPITAL
EXIT CONFERENCE
Year Ended June 30, 2012**

We held an exit conference with management and a member of the Board of Trustees on October 11, 2012. 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
Pat Wise, Board Member

Moss Adams LLP

Brandon Fryar, Partner
Purvi Mody Harville, Senior Manager

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