Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Financial Statements with Supplementary Information
and
Independent Auditor's Report

December 31, 2017 and 2016

REDW LLC
CPAs | Business & Financial Advisors

Rehoboth McKinley Christian
Health Care Services, Inc. and Subsidiary

Table of Contents

Rehoboth McKinley Christian
Health Care Services, Inc. and Subsidiary
Board of Trustees and Principal Employees
December 31, 2017

Independent Auditor's Report

Board of Trustees and Management of
Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary and
Mr. Wayne Johnson, New Mexico State Auditor

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (RMCHCS), a New Mexico not-for-profit corporation, which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit

Albuquerque
7425 Jefferson St NE
Albuquerque, NM 87109
P 505.998.3200
F 505.998.3333

Phoenix
5353 N 16th St, Suite 200
Phoenix, AZ 85016
P 602.730.3600
F 602.730.3699

also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RMCHCS as of December 31, 2017 and 2016, and the change in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of pledged collateral and schedule of deposits and investments required by Section 2.2.2 New Mexico Administrative Code are presented for the purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

The accompanying schedule of vendor information has not been subjected to the auditing procedures applied in the audit for the consolidated financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 25, 2018, on our consideration of RMCHCS'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* in considering RMCHCS's internal control over financial reporting and compliance.

REDW LLC

Albuquerque, New Mexico
May 25, 2018

Consolidated Financial Statements

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Statements of Financial Position

December 31,

		2017		2016
Assets				
Current assets				
Cash and cash equivalents	**$**	**1,381,432**	$	5,749,445
Patient accounts receivable, net of allowance for doubtful accounts of $11,572,000 in 2017 and $11,366,000 in 2016		**7,984,429**		8,120,938
Safety Net Care Pool receivable		**1,943,527**		1,185,110
Mill levy receivable		**733,379**		928,638
Other receivables		**648,955**		262,472
Inventories		**1,131,460**		1,082,047
Prepaid expenses and deposits		**237,272**		227,528
Total current assets		**14,060,454**		17,556,178
Property, plant and equipment, net		**12,659,822**		11,505,280
Assets limited as to use				
Assets held by trustee		**927,109**		953,989
Assets held for 457(b) plan		**548,184**		444,795
Investment in risk retention group		**1,811,236**		2,158,682
Total assets	**$**	**30,006,805**	$	32,618,924
Liabilities and Net Assets				
Current liabilities				
Accounts payable	**$**	**10,048,004**	$	7,538,924
Accrued salaries and related liabilities		**4,355,423**		4,089,635
Safety Net Care Pool payback		**2,183,148**		4,530,503
Other accrued liabilities		**1,304,613**		1,197,370
Estimated third-party payor settlements		**1,619,435**		1,370,924
Current portion of long-term debt		**3,495,838**		2,303,709
Total current liabilities		**23,006,461**		21,031,065
Long-term debt, less current portion, net of unamortized debt issuance costs		**4,405,156**		4,629,420
Total liabilities		**27,411,617**		25,660,485
Net assets				
Unrestricted		**2,242,550**		5,703,912
Temporarily restricted		**352,638**		1,254,527
Total net assets		**2,595,188**		6,958,439
Total liabilities and net assets	**$**	**30,006,805**	$	32,618,924

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

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Statement of Activities

For the Year Ended December 31, 2017

	Unrestricted	Temporarily Restricted	Total
Operating Revenue			
Net patient service revenue	$ 59,583,770	$ -	$ 59,583,770
Provision for uncollectible accounts	4,427,074	-	4,427,074
Net patient service revenue less provision for uncollectible accounts	55,156,696	-	55,156,696
Safety Net Care Pool revenue	3,873,628	-	3,873,628
Mill levy tax revenue	2,477,388	-	2,477,388
Other operating revenue	3,160,669	474,646	3,635,315
Net assets released from restrictions	1,376,535	(1,376,535)	-
Total operating revenue	66,044,916	(901,889)	65,143,027
Operating Expenses			
Salaries, benefits, contract labor, and payroll taxes	38,363,487	-	38,363,487
Supplies	7,385,391	-	7,385,391
Professional fees	7,130,111	-	7,130,111
Purchased services	5,940,222	-	5,940,222
Rentals and leases	2,390,253	-	2,390,253
Other operating expenses	2,318,993	-	2,318,993
Depreciation and amortization	1,803,221	-	1,803,221
Utilities	1,543,703	-	1,543,703
Repairs and maintenance	731,475	-	731,475
Insurance	711,390	-	711,390
Licenses, permits, and fees	322,770	-	322,770
Total operating expenses	68,641,016	-	68,641,016
Operating loss	(2,596,100)	(901,889)	(3,497,989)
Nonoperating expense			
Investment loss in risk retention group	(347,446)	-	(347,446)
Interest income	51,938	-	51,938
Interest expense	(569,754)	-	(569,754)
Total nonoperating expense, net	(865,262)	-	(865,262)
Change in net assets/revenues and gains over expenses and losses	(3,461,362)	(901,889)	(4,363,251)
Net assets, beginning of year	5,703,912	1,254,527	6,958,439
Net assets, end of year	$ 2,242,550	$ 352,638	$ 2,595,188

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

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Statement of Activities

For the Year Ended December 31, 2016

	Unrestricted	Temporarily Restricted	Total
Operating Revenue			
Net patient service revenue	$ 63,374,679	$ -	$ 63,374,679
Provision for uncollectible accounts	5,913,656	-	5,913,656
Net patient service revenue less provision for uncollectible accounts	57,461,023	-	57,461,023
Safety Net Care Pool revenue	1,936,178	-	1,936,178
Mill levy tax revenue	2,558,764	-	2,558,764
Other operating revenue	3,889,650	1,061,826	4,951,476
Net assets released from restrictions	530,353	(530,353)	-
Total operating revenue	66,375,968	531,473	66,907,441
Operating Expenses			
Salaries, benefits, contract labor, and payroll taxes	36,866,611	-	36,866,611
Supplies	7,184,221	-	7,184,221
Professional fees	6,053,175	-	6,053,175
Purchased services	6,865,373	-	6,865,373
Rentals and leases	2,240,496	-	2,240,496
Depreciation and amortization	1,913,759	-	1,913,759
Other operating expenses	2,325,636	-	2,325,636
Utilities	1,313,919	-	1,313,919
Repairs and maintenance	1,121,104	-	1,121,104
Insurance	765,034	-	765,034
Licenses, permits, and fees	345,851	-	345,851
Total operating expenses	66,995,179	-	66,995,179
Operating income (loss)	(619,211)	531,473	(87,738)
Nonoperating expense			
Investment loss in risk retention group	(510,878)	-	(510,878)
Interest expense	(446,365)	-	(446,365)
Total nonoperating expense	(957,243)	-	(957,243)
Change in net assets/revenues and gains over expenses and losses	(1,576,454)	531,473	(1,044,981)
Net assets, beginning of year, as restated	7,280,366	723,054	8,003,420
Net assets, end of year (restated)	$ 5,703,912	$ 1,254,527	$ 6,958,439

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

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Statements of Cash Flows

For the Year Ended December 31,

	2017	2016
Cash flows from operating activities		
Cash received from patients and third-party payors	**$ 55,541,716**	$ 53,611,445
Cash received from Safety Net Care Pool and other operating receipts	**8,841,431**	10,002,804
Cash paid to employees and suppliers	**(66,243,446)**	(60,864,830)
Net cash (used in)/provided by operating activities	**(1,860,299)**	2,749,419
Cash flows from investing activities		
Purchase of property, plant and equipment	**(2,385,944)**	(1,552,141)
Interest received (paid)	**51,357**	(9,738)
Net cash used in investing activities	**(2,334,587)**	(1,561,879)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	**1,491,410**	1,830,087
Interest paid	**(532,674)**	(436,127)
Payments on long-term debt	**(1,131,863)**	(2,078,389)
Net cash used in financing activities	**(173,127)**	(684,429)
Net (decrease)/increase in cash and cash equivalents	**(4,368,013)**	503,111
Cash and cash equivalents, beginning of year	**5,749,445**	5,246,334
Cash and cash equivalents, end of year	**$ 1,381,432**	$ 5,749,445

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

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Consolidated Statements of Cash Flows — continued

For the Year Ended December 31,

	2017	2016
Reconciliation of change in net assets to net cash (used in) provided by operating activities		
Change in net assets	**$ (4,363,251)**	$ (1,044,981)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities		
Depreciation	**1,803,221**	1,913,759
Amortization of debt issuance costs	**36,499**	19,061
Provision for uncollectible accounts	**4,427,074**	5,913,656
Interest paid	**569,754**	446,365
Unrealized loss on investments	**259,009**	510,878
Net changes in operating assets and liabilities		
Patient accounts receivable	**(4,290,565)**	(9,887,274)
Safety Net Care Pool receivable	**(758,417)**	268,793
Mill levy receivable	**195,259**	-
Other receivables	**(386,483)**	287,593
Inventories	**(49,413)**	286,866
Prepaid expenses and deposits	**(9,744)**	58,388
Accounts payable	**2,509,080**	3,672,967
Safety Net Care Pool payback	**(2,347,355)**	-
Lease payable to McKinley County	**-**	(1,500,000)
Accrued salaries and related liabilities	**265,788**	1,282,588
Other accrued liabilities	**30,734**	396,720
Estimated third-party payor settlements	**248,511**	124,040
Net cash (used in)/provided by operating activities	**$ (1,860,299)**	$ 2,749,419
Supplemental schedule of noncash investing and financing activities		
Equipment acquired through capital lease	**$ 571,819**	$ 217,937
Increase (decrease) in 457(b) investments recorded to other accrued liabilities	**$ 76,509**	$ (11,753)

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

1) Organization and Summary of Significant Accounting Policies

Organization

Rehoboth McKinley Christian Health Care Services, Inc. (RMCHCS) is a not-for-profit healthcare system located in Gallup, New Mexico. RMCHCS provides inpatient and outpatient hospital care, emergency care services, physician clinics, and home care and hospice services to the residents of Gallup, McKinley County and the surrounding area. RMCHCS is not required to legally adopt an annual budget.

These financial statements include RMCHCS, as well as Western Health Foundation ("RMCHCS Foundation" or the "Foundation"), formerly known as Rehoboth McKinley Christian Health Care Services Foundation, a not-for-profit subsidiary. RMCHCS is the sole stated beneficiary of the Foundation, and the Foundation is authorized by RMCHCS to solicit contributions on its behalf. The financial statements have been consolidated given that RMCHCS meets the criteria of having an economic interest in the Foundation. Intercompany balances and transactions have been eliminated in consolidation.

This summary of significant accounting policies is presented to assist in the understanding of RMCHCS's financial statements. The financial statements and notes are the representations of RMCHCS's management who is responsible for their integrity and objectivity. The financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as applied to not-for-profit entities.

Basis of Presentation

Financial statement presentation follows the requirements of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-205, *Not-for-Profit Entities-Presentation of Financial Statements*. Under this guidance, RMCHCS is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Use of Estimates

Financial statement preparation in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the financial statement date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates for RMCHCS include patient accounts receivable, contractual allowances, estimated third party payor settlements, Safety Net Care Pool receivable/payable, and depreciation expense.

Cash and Cash Equivalents

RMCHCS considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Management does not believe RMCHCS is exposed to any significant credit risk on its cash and cash equivalent balances.

Accounts Receivable Allowances

Contractual allowances represent the amounts which reduce patient accounts receivable to amounts that are considered to be due from third-party payors based on existing contracts RMCHCS has with these payors. The contractual allowance percentages are updated periodically by payor class and line of business.

The allowance for doubtful accounts is that amount which, in management's judgment, is considered adequate to reduce patient accounts receivable to an amount that is considered to be ultimately collectible. RMCHCS calculates its allowance for doubtful accounts based on management's estimate of historical write-offs by major payor categories over the past several years.

Management believes that the allowances for doubtful accounts and contractual allowances are adequate. Because of the uncertainty regarding the ultimate collectability of patient accounts receivable, there is a possibility that recorded estimates of the allowance for doubtful accounts and contractual allowances will change by a material amount in the near term.

On a monthly basis, RMCHCS evaluates patient accounts receivable balances older than six months to determine collectability. Accounts are considered uncollectible when there has been no recent payment activity and no other indication that payment will be received. Those balances that are considered uncollectible are written off upon approval from the Director of Patient Financial Services, Chief Financial Officer and Chief Executive Officer, depending on the balance of the account. During 2017 and 2016, RMCHCS wrote off approximately $4.4 million and $5.9 million, respectively, to the provision for uncollectible accounts. RMCHCS's allowance for doubtful accounts was approximately 58% of patient accounts receivable at December 31, 2017 and 2016. RMCHCS did not change its charity care or uninsured discount policies during fiscal years 2017 or 2016.

Other Receivables

Other receivables consist primarily of a Department of Health Services receivable and other receivables related to deposits etc.

Inventories

Inventories are stated at lower of cost or market (first-in, first-out method) and consist primarily of medical, surgical, and maintenance supplies, and pharmaceuticals.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Additions, improvements and other capital outlays that significantly extend the useful life of an asset and are greater than $1,000 are capitalized. Costs incurred for repairs and maintenance are expensed as incurred.

Depreciation is computed using the straight-line method over the assets' estimated useful lives ranging from 3 to 40 years. Leasehold improvements are amortized over their useful lives not to exceed the term of the related lease.

Assets Limited as To Use

Assets limited as to use includes the following at December 31:

	2017	2016
Held by trustee under indenture agreement related to Series 2007 Revenue Bond - cash equivalents	**$ 927,109**	$ 953,989
Irrevocable trust – 457(b) plan		
Cash and cash equivalents	**40,271**	31,982
U.S. equity securities	**303,141**	262,768
Mutual funds	**77,578**	60,770
U.S. government securities	**127,194**	89,275
Total of irrevocable trust – 457(b) plan	**548,184**	444,795
	$ 1,475,293	$ 1,398,784

Plan Assets Invested

Plan assets invested in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Investment income or loss includes realized and unrealized gains and losses on investments, interest, and dividends.

The investment in risk retention group is recorded on the equity method of accounting. Under the equity method, the investment is initially recorded at cost, and thereafter, the carrying amount is adjusted for RMCHCS's proportionate share of the investee's earnings and any distributions.

<u>Other Accrued Liabilities</u>
Other accrued liabilities primarily consist of the estimated liability for malpractice and other claims outstanding.

		2017		2016
Other accrued liabilities				
Deferred compensation payable - 457B Plan	**$**	**548,184**	$	444,795
Malpractice claims estimated liability		**450,000**		465,000
Other liabilities		**306,429**		287,575
Total other accrued liabilities	**$**	**1,304,613**	$	1,197,370

<u>Net Assets and Changes Therein</u>
Net assets and income, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of RMCHCS and changes therein are classified and reported as follows:

- *Unrestricted*—Unrestricted net assets represent those resources that are not restricted by donors, or for which donor-imposed restrictions have expired.
- *Temporarily Restricted*—Temporarily restricted net assets reflect donor-imposed restrictions that require RMCHCS to use or expend the related assets as specified by donors. The restrictions are satisfied either by the passage of time or by the satisfaction of donor specified use. RMCHCS records contributions as temporarily restricted if they are received with donor stipulations that limit their use through either purpose or time restrictions. When donor restrictions expire, that is, when a time restriction ends or a purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets. Temporarily restricted contributions received and expended in the same accounting period are recorded in the unrestricted net asset category.
- *Permanently Restricted*—Permanently restricted net assets reflect donor-imposed restrictions which stipulate that the related resources be maintained in perpetuity, but which permit RMCHCS to expend part or all of the income and capital appreciation derived from the donated assets for either specified or unspecified purposes. RMCHCS had no permanently restricted net assets at December 31, 2017 and 2016.

<u>New Mexico Electronic Health Record Incentive Program Revenue</u>
In 2011, RMCHCS joined the New Mexico Electronic Health Record (EHR) Incentive Program whose purpose is to encourage eligible Medicaid providers to adopt and meaningfully use certified EHR technology by offering payments to offset some of the costs incurred by the providers. RMCHCS accounts for EHR incentive payments in

accordance with FASB ASC 450-30, *Gain Contingencies*. In accordance with FASB ASC 450-30, RMCHCS recognizes EHR incentive payments when all contingencies relating to the incentive payment have been satisfied with no subsequent payment adjustment. Certain contingencies require the demonstration of meaningful use which is based on meeting a series of objectives. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services (CMS). The amounts recorded are subject to audit by CMS. RMCHCS recognized $644,976 of revenue related to EHR in 2017. No revenue was recognized in 2016.

Charity Care

RMCHCS provides charity care to patients who are financially unable to pay for health care services they receive. RMCHCS's policy is not to pursue collection of amounts determined to qualify as charity care. RMCHCS maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. The estimated total direct and indirect costs of charity care services and unpaid cost of services were $1,483,754 and $1,968,830 during the years ended December 31, 2017 and 2016, respectively.

Other Operating Revenue

Other operating revenue includes Disproportionate Share Hospital (DSH) payments, meaningful use payments, state grant revenues, and other gift shop cafeteria and donation revenue.

Income Taxes

RMCHCS and the Foundation are not-for-profit organizations, exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. In addition, RMCHCS and the Foundation have been classified as entities that are not private foundations within the meaning of Section 509 (a) and qualify for deductible contributions as provided by Section 170(b)(l)(A)(vi). Accordingly, no provision has been made for income taxes in the financial statements.

RMCHCS recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. RMCHCS had no unrecognized tax benefits or obligations at December 31, 2017 and 2016. RMCHCS and the Foundation file an exempt organization return and, if applicable, unrelated business income tax or other returns with the U.S. Internal Revenue Service, New Mexico Attorney General and New Mexico Department of Taxation and Revenue. RMCHCS and the Foundation are no longer subject to income tax examinations by taxing authorities for years before fiscal year 2015 for its federal and state filings.

<u>Advertising Costs</u>
Advertising costs are expensed as incurred. Advertising expense totaled $152,085 and $180,128 for the years ended December 31, 2017 and 2016, respectively.

<u>Recent Accounting Pronouncements</u>
In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *Leases*, to make leasing activities more transparent and comparable. This new standard will require all leases with terms of more than 12 months be recognized by lessees as a right-of-use asset and a corresponding lease liability on the balance sheet. It will apply to both capital (or finance) leases and operating leases. In addition, ASU 2016-02 requires retrospective application to leases that exist at the beginning of the earliest comparative period presented. Management expects this new standard to have a significant effect on the RMCHCS's balance sheet. For nonpublic companies, the standard is effective for fiscal years beginning after December 15, 2019 (i.e. RMCHCS's fiscal year ending December 31, 2020). Early application is permitted.

Additionally, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, to make the information in the financial statements more meaningful. The new standard will no longer require not-for-profit entities to distinguish between resources with temporary and permanent restrictions on the face of the financial statements, meaning only two classes will be presented, instead of three. The guidance will also change how not-for-profit entities report certain expenses and provide information about available resources and liquidity. This guidance is effective for fiscal years beginning after December 15, 2017 (i.e. RMCHCS's fiscal year ending December 31, 2018). Early application is permitted. Management does not expect this new standard to have a significant effect on RMCHCS's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to create a single comprehensive framework for revenue recognition. The purpose of the new standard was to do away with industry specific revenue recognition guidance and better align with international standards. The new standard requires revenue to be recognized at various points within a transaction. RMCHCS will be required to make significant judgments regarding collectability and estimations for variable consideration, and will also have to change aspects of their financial statement presentation and expand disclosures on judgments used in determining transaction pricing. This guidance is effective for periods beginning after December 15, 2017 (i.e. RMCHCS's fiscal year ending December 31, 2018).

Reclassifications
Certain reclassifications have been made to the 2016 financial information to conform to the 2017 financial statement presentation. Such reclassifications had no effect on 2016 net assets or change in net assets.

Subsequent Events
Subsequent events through May 25, 2018, the date which the financial statements were made available to be issued, were evaluated for recognition and disclosure in the December 31, 2017, financial statements.

2) Net Patient Service Revenue

Agreements with third-party payors provide for payments to RMCHCS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on the estimated basis in the period the related services are rendered and adjusted in future periods as more information is available to improve estimates or when final settlements are determined.

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

Medicare
Services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services, behavioral inpatient services, certain outpatient services, and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. RMCHCS is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual costs reports by RMCHCS and audits thereof by the Medicare fiscal intermediary.

Medicaid
Effective January 1, 2014, New Mexico Medicaid went to a new managed care system. Throughout 2017 and 2016, there were four managed care organizations (MCOs), Blue

Cross Blue Shield of New Mexico (BCBS), Molina Health Care of New Mexico (Molina), Presbyterian Health Plan (Presbyterian) and United Healthcare (United), who are responsible for approving and processing payments. Each MCO negotiates a rate with RMCHCS and pays using a prospective payment system, often referred to as the PPS rate, similar to the traditional Medicaid program described below.

Through traditional Medicaid and contracts with MCOs, inpatient and outpatient services are paid at prospectively determined rates per discharge and discounted fee schedules. RMCHCS is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by RMCHCS and audits thereof by the Medicaid fiscal intermediary.

Through the New Mexico Medicaid program, outpatient payment reimbursements are based on a simplified Medicare Ambulatory Payment Classification (APC) method. The outpatient prospective payment system (OPPS) reimbursements are set to 100% of the Medicare standard rate.

Revenue from the Medicare and Medicaid programs accounted for approximately 69% and 71%, respectively, of RMCHCS's net patient service revenue for the years ended December 31, 2017 and 2016.

RMCHCS recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, RMCHCS recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of RMCHCS's uninsured patients will be unable or unwilling to pay for the services provided. Thus, RMCHCS records a significant provision for uncollectable accounts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectable accounts), recognized in the period from these major payor sources, is as follows:

	Third-Party Payors	Self-Pay	Total All Payors
Year ended December 31, 2017	$ 54,958,271	$ 4,625,499	$ 59,583,770
Year ended December 31, 2016	$ 59,030,421	$ 4,344,258	$ 63,374,679

Estimated third-party payor settlement liabilities are as follows:

	December 31,		Current
	2017	2016	Status
Medicare			
2013	**$ -**	$ (616,913)	Settled
2014	**(251,130)**	-	In progress
2015	**(370,886)**	(737,731)	In progress
2016	**(544,256)**		In progress
2017	**(296,232)**	-	In progress
	(1,462,504)	(1,354,644)	
Medicaid			
2014	**(16,280)**	(16,280)	Tentative
2016	**(140,651)**	-	In progress
	(156,931)	(16,280)	
Total	**$ (1,619,435)**	$ (1,370,924)	

Management believes that these estimates are adequate. 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. Estimates are continually monitored and reviewed and as settlements are made or more information is available to improve estimates, changes are reflected in current operations.

Other Third-Party Payors
RMCHCS has also entered into payment agreements with certain commercial insurance carriers. The basis for payment to RMCHCS under these agreements include prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

The following summary details the components of net patient service revenue for the years ended December 31:

	2017	2016
Gross charges – inpatient	**$ 62,139,385**	$ 50,968,336
Gross charges – outpatient	**146,218,070**	127,138,292
Charity care	**(1,483,754)**	(1,968,830)
Third party contractual allowances	**(147,289,931)**	(112,763,119)
Net patient service revenue	**$ 59,583,770**	$ 63,374,679

3) Fair Value Measurements

Fair value measurements used by RMCHCS for all financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements are based on the premise that fair value represents an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the following three-tier fair value hierarchy has been used in determining the input used in measuring fair value:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that RMCHCS has the ability to access.

Level 2: Quoted prices in markets that are not considered to be active or financial instruments without quoted market prices, but for which all significant inputs are observable, either directly or indirectly.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. RMCHCS has no Level 3 fair value measurements. In addition, RMCHCS had no transfers between levels during the years ended December 31, 2017 and 2016.

The investment in the risk retention group, as described in Note 13, is accounted for under the equity method of accounting and, accordingly, does not require a fair value measurement.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2017 and 2016.

- U.S. equity securities and mutual funds are valued using quoted market prices in active markets. They are classified within Level 1 of the fair value hierarchy.
- U.S. treasury notes, FNMA mortgage backed securities, and U.S. Corporate Bonds: These fixed income securities are valued using a bid evaluation or a mid-evaluation. A bid evaluation is an estimated price at which a dealer would pay for a security. A mid-evaluation is the average of the estimated price at which a dealer would sell a security and the estimated price at which a dealer would pay for a security. These evaluations are based on quoted prices, if available, or models that use observable inputs and, as such, are classified within Level 2 of the fair value hierarchy.

The following table provides information as of December 31, 2017, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at December 31, 2017	Level 1	Level 2
Assets limited as to use			
Cash and cash equivalents	$ 967,380	$ 967,380	$ -
U.S. equity securities – various sectors	303,141	303,141	-
U.S. treasury notes	127,194	-	127,194
Mutual funds	77,578	77,578	-
	$ 1,475,293	$ 1,348,099	$ 127,194

The following table provides information as of December 31, 2016, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at December 31, 2016	Level 1	Level 2
Assets limited as to use			
Cash and cash equivalents	$ 985,971	$ 985,971	$ -
U.S. equity securities – various sectors	262,768	262,768	-
U.S. treasury notes	89,275	-	89,275
Mutual funds	60,770	60,770	-
	$ 1,398,784	$ 1,309,509	$ 89,275

4) Property, Plant and Equipment

A summary of property, plant and equipment at December 31, as follows:

	2017	2016
Equipment	**$ 29,855,176**	$ 31,059,216
Buildings and improvements	**31,116,604**	29,464,288
Land improvements	**1,964,583**	1,868,790
	62,936,363	62,392,294
Accumulated depreciation and amortization	**(51,568,504)**	(52,253,530)
	11,367,859	10,138,764
Land	**788,219**	788,219
Construction in progress	**503,744**	578,297
	$ 12,659,822	$ 11,505,280

5) Long-Term Debt

Long-term debt consists of the following at December 31:

	2017	2016
Series 2007A bonds, net of unamortized debt issuance costs	**$ 4,170,131**	$ 4,479,612
Notes payable and lines of credit	**2,952,335**	1,965,639
Capital lease obligations	**778,528**	487,878
	7,900,994	6,933,129
Less current portion	**(3,495,838)**	(2,303,709)
	$ 4,405,156	$ 4,629,420

Series 2007A Bonds
In March 2007, RMCHCS issued the Series 2007A New Mexico Hospital Equipment Loan Council Hospital Facility Refunding and Improvement Bonds to refund the outstanding Series 1996 and Series 2000 bonds, to finance the costs of the acquisition of certain equipment, to fund a project fund, and to pay certain costs of issuance for the Series 2007A bonds. The Refunding and Improvement Bond Master Trust Indenture (the "Indenture") requires RMCHCS to make monthly deposits with a trustee for payment on the bonds. See Note 1 for the amounts held by the trustee under the indenture agreement related to the 2007A bonds.

The Series 2007A bonds accrued interest at 5.00% through 2017, and thereafter accrue at 5.25%. The bonds mature in August 2026, and are collateralized by the lease between RMCHCS and McKinley County, New Mexico, and buildings, equipment, machinery and fixtures owned by RMCHCS, and are secured by pledged revenues.

RMCHCS is subject to certain bond covenant requirements specified in the Series 2007A bond agreements, including limits on the incurrence of additional debt and certain measures of financial performance. As of December 31, 2017, RMCHCS was not in compliance with bond covenant requirements. RMCHCS received a waiver from the bond holders documenting that the debt would not be called before December 31, 2018. In 2018, RMCHCS intends to obtain new financing to pay off the bonds. Refer to Note 17 for more information. As of December 31, 2016, RMCHCS was in compliance with the covenant requirements.

Notes Payable and Lines of Credit
On May 11, 2015, RMCHCS entered into a line of credit loan agreement with a financial institution totaling $750,000 to provide financing for the electronic health record system implementation. Under this agreement, the principal balance must be reduced by $150,000 every six months starting on June 15, 2015, and paid in full by December 15, 2017. The line of credit bore an interest rate of 4.25%. As of December 31, 2016, RMCHCS had drawn $449,914 on the line of credit. As of December 31, 2017, this line was paid in full.

On February 15, 2016, RMCHCS entered into a line of credit agreement with a financial institution totaling $1,200,000 to provide additional financing for the EHR system implementation. The line of credit bears an interest rate of 4.5% and must be paid in full on December 31, 2018. As of December 31, 2016, RMCHCS had drawn $1,198,350.This balance remained unchanged during 2017.

On October 11, 2017, RMCHCS entered into a line of credit agreement with a financial institution totaling $1,500,000 to help with day-to-day operations and assist in payment of loans coming due. This agreement bears an interest rate of 4.75% and principal payments are due every six months in the amount of $375,000 beginning June 20, 2019, with the final payment due on or before December 2020. As of December 31, 2017, RMCHCS had drawn $1,491,410 on the line of credit.

On July 15, 2016, RMCHCS entered into a purchase agreement for equipment and real property in addition to an assumption of two loans with Dr. Flor Gonzaga for a total of $330,000. The agreement assigns a different interest rate for each of the following:

- Assignment of loan #1 Bank of Colorado – 5.25%
- Assignment of loan #2 Cibola Medical Foundation – 2.5%
- Real property – 3.5%
- Equipment -10.28%

As of December 31, 2017 and 2016, the total balance related to these loans was $262,575 and $314,461, respectively.

Capital Lease Obligations
The cost of equipment under capital leases is included in property, plant and equipment in the consolidated statements of financial position and was $780,120 and $505,489 at December 31, 2017 and 2016, respectively. Amortization of assets under capital leases is included in depreciation and amortization expense in the consolidated statements of activities. The capital leases expire at various dates through 2021, accrue interest at rates ranging from 3.31% to 10.95%, and are secured by the related equipment.

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

	Series 2007A Bonds	Notes Payable and Lines of Credit	Capital Lease Obligations
Year ending December 31,			
2018	$ 405,000	$ 2,755,011	$ 335,827
2019	425,000	59,745	233,784
2020	450,000	55,471	159,747
2021	475,000	80,035	49,170
2022	500,000	2,073	-
Thereafter	1,915,131	-	-
	$ 4,170,131	$ 2,952,335	$ 778,528

6) Operating Leases

RMCHCS has a facility lease agreement with McKinley County, New Mexico extending through August 31, 2028, for use of the hospital building and dialysis building. The annual rent paid to the County for the use of the Hospital facility is $1,500,000 and requires monthly payments of $125,000. Every five years the base rent will be re-evaluated based on updated appraisals reviewed and concurred by the Property Tax Division of the New Mexico Taxation and Revenue Department. As of December 31, 2017 and 2016, RMCHCS had no unpaid rent under this agreement.

In addition to the facility lease agreement with McKinley County above, RMCHCS also has noncancelable operating leases for various equipment. The future minimum lease payments under the facility lease agreement and the equipment leases at December 31, 2017, are as follows:

	Operating Leases
Year ending December 31,	
2018	$ 2,136,824
2019	2,138,574
2020	2,138,574
2021	2,063,469
2022	1,745,840
Thereafter	10,233,687
Total minimum lease payments	$ 20,456,968

7) Employee Benefits

RMCHCS has established a Section 403(b) retirement plan (the "plan"). There is no minimum period of service or age in order to be eligible to participate; however, employees must make a minimum contribution to be eligible for a discretionary contribution. RMCHCS matches 30% of contributions up to 3% of the employee's salary. At December 31, 2017 and 2016, accrued employer contributions of $114,042 and $99,868 were included in accrued salaries and related liabilities in the accompanying consolidated statements of financial position.

Effective January 1, 2003, RMCHCS adopted a nonqualified deferred compensation plan under Section 457(b) of the Internal Revenue Code. The plan enables certain key employees to enhance their retirement security by deferring compensation in addition to 403(b) deferrals. An irrevocable trust was established to satisfy the financial obligations to provide benefits to participants under the plan. Participants do not have a secured interest in the assets held in the trust; as such, assets remain the property of RMCHCS and are subject to creditor claims. The amount funded to the trust as of December 31, 2017 and 2016, was $548,184 and $444,795, respectively. The funded amount is included in assets limited as to use in the consolidated statements of financial position. The related liabilities of $548,184 and $444,795 as of December 31, 2017 and 2016, respectively, are included in other accrued liabilities in the accompanying consolidated statements of financial position.

8) Employee Health Insurance Benefit Program

RMCHCS has retained liability for certain employee health claims up to $100,000 per claim and has purchased insurance for claims in excess of these amounts. Management believes that adequate reserves have been established as of December 31, 2017 and 2016, to cover claims which have been incurred but not reported. Such reserves were $499,170 and $420,000 at December 31, 2017 and 2016, respectively, and are included in accrued salaries and related liabilities in the accompanying consolidated statements of financial position.

9) Safety Net Care Pool Revenue

RMCHCS participates the Safety Net Care Pool (SNCP) program, previously known as the sole community provider indigent care program, administered by the State of New Mexico. Revenue from this program for the years ended December 31, 2017 and 2016, totaled approximately $3.9 million and $4.9 million, respectively. Of this balance approximately $1.9 and $1.2 million was a receivable as of December 31, 2017 and 2016, respectively.

10) Ad Valorem Tax Revenue

The Hospital Funding Act, a New Mexico state law, was adopted in 1980 and amended in 1981 and allowed for counties to provide tax support to qualifying hospitals. Through June 2012, McKinley County voters approved an ad valorem tax levy of two mills. Effective July 1, 2013, voters approved an ad valorem tax levy of four mills. The McKinley County Board of Commissioners ultimately approved an ad valorem tax levy of three mills effective for the tax year 2013. Revenue from the ad valorem tax levy was approximately $2.5 and $2.6 million in 2017 and 2016, respectively.

11) Concentrations of Risk

RMCHCS provides credit, in the normal course of business, primarily to residents of the City of Gallup, McKinley County and the surrounding areas. RMCHCS does not require collateral with the extension of credit.

The mix of gross accounts receivable from patients and third-party payors was as follows at December 31:

	2017	2016
Medicaid	**43%**	40%
Medicare	**25%**	28%
Other third-party payors	**24%**	23%
Self-pay	**8%**	9%
	100%	100%

12) Commitments and Contingencies

Healthcare Regulatory Environment
The healthcare industry is subject to laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. The government continues to conduct reviews and investigations of allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that RMCHCS is in compliance with fraud and abuse as well as other applicable laws and regulations. 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.

The Health Insurance Portability and Accountability Act (HIPAA) was enacted to assure health insurance portability, guarantee security and privacy of health information, and enforce standards for health information. Under the Health Information Technology for Economic and Clinical Health (HITECH) Act, several of the HIPAA security and privacy requirements were expanded, including business associates being subject to civil and criminal penalties and enforcement proceedings for violations of HIPAA. Management believes that RMCHCS is in compliance with all applicable provisions of HIPAA and HITECH.

Malpractice Insurance

Effective March 1, 2003, pursuant to the Federal Risk Retention Act and under the captive insurance Hospital provisions of Vermont law, RMCHCS is insured under and is a founding subscriber in the VHA Mountain States Reciprocal Risk Retention Group. The purpose of this group is to provide malpractice and general liability coverage. RMCHCS recognizes annual changes in valuation through allocations. RMCHCS's allocation was a decrease of $347,446, from a total pool of $4,362,526, for 2017 and a decrease of $511,378, from a total pool of $2,670,060, for 2016. The policy is on a claims-made basis with a per occurrence deductible of $25,000, with maximum coverage per occurrence of $1,000,000 and an aggregate of $3,000,000 for professional liability and $1,000,000 for general liability. The premiums accrue based on the ultimate experience of the group of health care entities. At December 31, 2017 and 2016, RMCHCS cannot estimate the additional premiums, if any, which may accrue as a result of the Group's experience to date. Effective January 1, 2018, RMCHCS entered into a new agreement with UMIA Insurance and it is unclear whether there will be significant valuation changes in 2018. As of the date of the audit issuance no additional information could be provided for assessment of valuation changes.

Employed physicians are covered under the same risk retention group on a claims-made basis with maximum coverage of $1,000,000 per occurrence and an aggregate of $3,000,000.

Litigation

In the normal course of business, RMCHCS is subject to allegations that may or do result in litigation. RMCHCS evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each claim. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on RMCHCS's future financial position or results of operations and should be covered by the malpractice insurance. Accordingly, no accrual for such claims is included on the accompanying consolidated statements of financial position.

Workers' Compensation Insurance

Pursuant to the New Mexico Self Insurance Act, RMCHCS is insured under the New Mexico Hospital Workers Compensation Group for the purpose of providing insurance for workers' compensation coverage. The policy is retrospectively rated; premiums accrue based on the ultimate cost of the experience of a group of health care entities. At December 31, 2017 and 2016, RMCHCS cannot estimate the additional premiums or refunds, if any, which may accrue as a result of the Group's experience to date. Additional premiums, if any, are not expected to be significant.

13) Functional Expense Classification

In recording the activities of RMCHCS, expenses are specifically tracked or allocated on the basis of periodic time and expense studies, and recorded in the following functional categories for the years ended December 31:

	2017	2016
Health care services	**$ 49,538,646**	$ 44,344,263
Management and general	**18,949,385**	22,440,951
Fundraising	**152,985**	209,965
	$ 68,641,016	$ 66,995,179

14) Economic Dependency

As previously described, RMCHCS receives a significant amount of revenue from the State's Safety Net Care Pool program (see Note 9) and from ad valorem tax levies (see Note 10). RMCHCS is economically dependent on the continuation of these revenues and significant reductions in either source of funds from current levels could negatively impact the ability of RMCHCS to continue its existing levels of service.

15) Management Service Agreement and Anticipated Sale

In April 2014, the RMCHCS Board of Trustees made a decision to enter into an agreement to sell the assets of RMCHCS to Healthcare Integrity, LLC (HCI, LLC) wholly owned by David Conejo of Gallup, New Mexico. On August 29, 2014, the RMCHCS Board of Trustees entered into a management services agreement with NewLight Healthcare LLC to employ David Conejo as Chief Executive Officer of RMCHCS. On September 1, 2016, the RMCHCS Board of Trustees entered into a management agreement directly with HCI, LLC. Under this agreement, HCI, LLC provides management and administrative services for RMCHCS. The management services agreement costs $23,500 per month plus wages of the administrative staff employed by HCI, LLC. Currently, only the RMCHCS Chief Executive Officer is a HCI, LLC employee. RMCHCS incurred expenses of $638,719 and $914,764 respectively in 2017 and 2016 under these management agreements. These expenses are reported as portion of purchased services in the accompanying consolidated statements of activities. At December 31, 2017 and 2016, RMCHCS owed $51,247 and $0, respectively for management services which is reported as a portion of accounts payable in the accompanying consolidated statements of financial position. In conjunction with the Management Agreement RMCHCS gave HCI, LCC an option to purchase RMCHCS and the right of first refusal. The right of first refusal continues but due to processing required because of RMCHCS tax-exempt bonds no acquisition has transpired. In September 2016, RMCHCS entered a five-year management agreement with HCI while evaluating available options to HCI.

16) Future Operations

RMCHCS has experienced significant operating losses in recent years. The operating losses are a result of the following events throughout recent years:

- A reduction in revenue receipt from the Safety Net Care Pool (SNCP) and a payback for SNCP revenue of $3.9 million that was recorded in 2016. In 2016, RMCHCS had structured a repayment plan for the SNCP liability. After meeting with the State of New Mexico, RMCHCS developed a plan to satisfy this obligation through the State’s recoupment of the following three quarterly SNCP installments and monthly remittances of approximately $184,000. The repayment of this liability and reduction in SNCP revenue receipts to due budget cuts has been a major contributor to the cash flow concerns throughout 2017.
- An increase in operating expenses at a higher rate than revenue earned and cash received. In May 2017, to try and reduce expenses, RMCHCS cut salaries for all employees by 10%; however, this reduction was too late in the year to capture significant savings and did not contain costs related to physician contracts.

In October 2017, RMCHCS management received a directive from the Board of Directors to address the year-to-date losses and the plan for the future of RMCHCS. One of the first items completed was obtaining a waiver from the bondholders for the failure to comply with debt covenants. This agreement waives the covenants and documents that the bonds will not be called through April 30, 2019. Also, on March 16, 2018, RMCHCS received a Conditional Commitment letter from the United States Department of Agriculture for a $4,951,734 loan guarantee program. The intent is to use this cash infusion to pay off the bonds so that RMCHCS will no longer have highly restrictive debt covenants related to the bonds.

Additionally, management met with all department directors about the financial situation of RMCHCS. The results were multiple ideas to reduce expense and increase revenues including:

- Continued adoption of a staffing productivity system, which will better monitor staffing to volume, evaluate appropriate staffing mix, and reduce contract-staffing expense.
- Supply chain and other nonpatient care cost containment measures.
- Revenue enhancing initiatives including:
  - Implementation of a clinic facility fee;
  - Improved scheduling and monitoring of physician productivity;
  - Increasing Safety Net Care Pool fund requests to previous levels;
  - Implementing revenue cycle revisions to the utilization review and case management processes to reduce denials; and,
  - An application for Medicare's Low Volume Adjustment payment based on 2018 revised rules.

The cost savings and revenue initiatives were incorporated into the 2018 budget, which yielded a projected positive $5,000,000 net income. Management is confident that RMCHCS' cost containment and revenue generating measurers will be sufficient to ensure continued operations through 2018.

New Mexico State Auditor’s Supplementary Information

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
Schedule of Pledged Collateral
December 31, 2017

Deposits

Financial Institution	Total Amount of Deposit in Bank	Insured Portion	Required Collateralization 50% of Uninsured Portion	Collateral Pledged	Over/ (Under) Collateralized
Wells Fargo Bank	$ 137,830	$ 137,830	$ -	$ -	$ -
U.S. Bank	145,960	145,960	-	-	-
Bank of Colorado – Pinnacle Bank Western Foundation Accounts	326,883	250,000	38,442	-	(38,442)
Bank of Colorado – Pinnacle Bank RMCHCS Accounts	16,668	16,668	-	1,148,308	1,148,308
Total	$ 627,341	$ 550,458	$ 38,442	$ 1,148,308	$ 1,109,866

Repurchase Agreement

Financial Institution	Total Amount of Repurchase Agreement	Insured Portion	Required Collateralization 102% of Uninsured Portion	Collateral Pledged	Over/ (Under) Collateralized
Wells Fargo Bank	$ 1,746,064	$ -	$ 1,780,985	$ 1,694,312	$ (86,673)

Pledged Collateral

Type of Security	Type of Security	CUSIP Number	Maturity Date	Fair Value
GN-IIMA1449	Wells Fargo	36179NTEB	11/1/2043	$ 1,694,312
FNMA AT 1887	Pinnacle Bank	3138WPCZ5	12/1/2026	646,067
FNMA MA 1357	Pinnacle Bank	31418AQK7	5/1/2045	502,241
				$ 2,842,620

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
Schedule of Deposits and Investments
December 31, 2017

Account Title	Account Type	Bank Balance	Reconciling Items	Book Balance
Cash and Cash Equivalents				
Wells Fargo Bank				
Operational	Operating	$ 103,919	$ 2,885	$ 106,804
Operational	Depository	-	757	757
Operational	Accounts payable	-	(996,458)	(996,458)
Operational	Payroll	-	(5,246)	(5,246)
Operational	Pension	33,911	-	33,911
U.S. Bank				
Athena Account	Checking	109,715	-	109,715
East Campus Projects	Checking	22,727	-	22,727
Urgent Care	Checking	13,518	-	13,518
Bank of Colorado – Pinnacle Bank				
Foundation Restricted Checking	Checking	1,693	-	1,693
Foundation Restricted	Money market account	257,153	-	257,153
Foundation Unrestricted Checking	Checking	1,290	-	1,290
Foundation Unrestricted Checking	Money market account	66,247	-	66,247
Grants	Checking	500	-	500
Mill Levy Proceeds	Checking	-	-	-
Auxiliary – Gift Shop	Checking	10,905	-	10,905
Auxiliary – General Account	Checking	5,763	-	5,763
Total deposits		627,341	(998,062)	(370,721)
Wells Fargo Bank				
Repurchase agreement	Sweep	1,746,064	-	1,746,064
Other				
Petty cash	Cash	6,089	-	6,089
Total cash and cash equivalents		$ 2,379,494	$ (998,062)	$ 1,381,432
Bond Funds and Other Investments				
Wells Fargo Bank				
Series 2007 Bond Improvement Fund	Money market account	$ 65,292	$ -	$ 65,292
Series 2007 Bond Principal Fund	Money market account	215,267	-	215,267
Series 2007 Bond Reserve Fund	Money market account	646,550	-	646,550
Zia Trust				
Irrevocable trust – 457(b) plan	Cash equivalent	40,271	-	40,271
Irrevocable trust – 457(b) plan	U.S. treasury securities	303,141	-	303,141
Irrevocable trust – 457(b) plan	Equity securities	77,578	-	77,578
Irrevocable trust – 457(b) plan	Fixed income securities and mutual funds	127,194	-	127,194
Total bond funds and other investments		$ 1,475,293	$ -	$ 1,475,293

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
Indigent Care Cost and Funding Report
For the Year Ended December 31, 2017

		For the Year Ended December 31,		
		2017	2016	2015
A	**Funding for Indigent Care**			
A1	State appropriations specified for indigent care	**$ -**	$ -	$ -
A2	County indigent funds received	**-**	-	-
A3	Out of county indigent funds received	**-**	-	-
A4	Payments and copayments received from uninsured patients qualifying for indigent care	**-**	-	-
A5	Reimbursement received for services provided to patients qualifying for coverage under EMSA	**-**	-	-
A6	Charitable contributions received from donors that are designated for funding indigent care	**-**	-	-
	Other sources			
A7	Other source 1 (if applicable)	**-**	-	-
	Total Funding for Indigent Care	**-**	-	-
B	**Cost of Providing Indigent Care**			
	Total cost of care for providing services to:			
B1	Uninsured patients qualifying for indigent care	**2,142,596**	1,330,014	1,128,204
B2	Patients qualifying for coverage under EMSA	**-**	-	-
B3	Cost of care related to patient portion of bill for insured patients qualifying for indigent care	**23,569**	10,640	10,944
B4	Direct costs paid to other providers on behalf of patients qualifying for indigent care	**-**	-	-
B5	Other costs of providing Indigent Care (please specify)			
	Total Cost of Providing Indigent Care	**2,166,165**	1,340,654	1,139,148
	Excess (Shortfall) of Funding for Charity Care to Cost of Providing Indigent Care	**$ (2,166,165)**	$ (1,340,654)	$ (1,139,148)
C	**Patients Receiving Indigent Care Services**			
C1	Total number of patients receiving indigent care	**2,339**	1,467	1,518
C2	Total number of patient encounters receiving indigent care	**2,339**	1,467	1,518

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Calculations of Cost of Providing Indigent Care

For the Year Ended December 31, 2017

	For the Year Ended December 31,					
		2017		2016		2015
Uninsured patients qualifying for indigent care						
Charges for these patients	**$**	**2,142,596**	$	1,330,014	$	1,128,204
Ratio of cost to charges		**1.1%**		0.8%		1.0%
Cost for uninsured patients qualifying for indigent care	**$**	**23,569**	$	10,640	$	11,282
Patients qualifying for coverage under Emergency Medical Services for Aliens (EMSA)						
Charges for these patients	**$**	**-**	$	-	$	-
Ratio of cost to charges		**0.0%**		0.0%		0.0%
Cost for Patients qualifying for coverage under Emergency Medical Services for Aliens (EMSA)	**$**	**-**	$	-	$	-
Cost of care related to patient portion of bill for insured patients qualifying for indigent care						
Indigent care adjustments for these patients	**$**	**2,142,596**	$	1,330,014	$	1,128,204
Ratio of cost to charges		**1.1%**		0.8%		1.0%
Cost of care related to patient portion of bill for insured patients qualifying for indigent care	**$**	**23,569**	$	10,640	$	11,282
Direct costs paid to other providers on behalf of patients qualifying for indigent care						
Payments to other providers for care of these patients	**$**	**-**	$	-	$	-
	$	**-**	$	-	$	-

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

Board of Trustees and Management of
Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary and
Mr. Wayne Johnson, New Mexico State Auditor

We have audited, in accordance with the 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, the consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. (RMCHCS), a New Mexico nonprofit organization, which comprise the consolidated statement of financial position as of December 31, 2017, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated May 25, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered RMCHCS's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of RMCHCS's internal control. Accordingly, we do not express an opinion on the effectiveness of RMCHCS's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Albuquerque
7425 Jefferson St NE
Albuquerque, NM 87109
P 505.998.3200
F 505.998.3333

Phoenix
5353 N 16th St, Suite 200
Phoenix, AZ 85016
P 602.730.3600
F 602.730.3699

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses as 2017-001, that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether RMCHCS'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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2017-002 through 2017-005.

RMCHCS's Responses to Findings

RMCHCS's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. RMCHCS's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of RMCHCS's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering RMCHCS's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

REDW LLC

Albuquerque, New Mexico
May 25, 2018

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Schedule of Findings and Responses
For the Year Ended December 31, 2017

Section I — Financial Statement Findings

2017–001 – Accuracy and Timeliness of Account Reconciliation (Material Weakness)

Criteria: All accounts in RMCHCS's trial balance should be reconciled on a regular basis and adjustments should be made, as needed, to accurately reflect RMCHCS's current financial position.

Condition: Account reconciliations for multiple accounts within the trial balance were not prepared prior to the beginning of audit fieldwork in March 2018. Additionally, account reconciliations required significant modification by management during fieldwork or lacked adequate support. Instances of account reconciliation issues are as follows:

- The December 31, 2017, Depository cash account reconciliation was not completed until after the audit began. Given RMCHCS's cash flow issues during 2017, it is vital that RMCHCS know their exact cash availability to better plan for upcoming debt payments and operating expenses. The Depository cash account reconciliation, when provided, resulted in a $313,000 adjustment to cash, expense, and unposted receivables accounts.
- The liability accruals for Paid-Time-Off (PTO) were understated by approximately $105,000.
- Third-party payor settlement liabilities were understated by approximately $331,000.
- The property, plant and equipment reconciliation did not properly record transfers from construction in progress to equipment accounts, nor did it properly record the addition of a capital lease recorded on the financial statements during the 2016 audit.

Cause: Inadequate review and supervision over accounting functions allowed for inaccurate and untimely account reconciliations, which resulted in many audit adjustments.

Effect: Without appropriate reporting capabilities and timely analysis of accounts, the trial balance and related financial reporting used by management and the Board of Trustees was not accurate. Inaccurate financials may have affected management or Board decisions.

Auditor's Recommendation: Management should develop a timeline and designate responsibilities for the reconciliation and analysis of all significant accounts.

Management's Response: Management has developed a monthly closing calendar that identifies balance sheet accounts to be analyzed and reconciled. The account analysis is to be approved by the accounting manager and CFO quarterly.

Section II — Section 12-6-5 NMSA 1978 Findings

2017-002 – Segregation of Duties (Finding That Does Not Rise to the Level of a Significant Deficiency) (Repeated and Modified)

Criteria or Specific Requirement: A fundamental concept in a good system of internal control is proper segregation of duties. Without adequate segregation of duties, the risk of an error or fraud occurring and not being detected or corrected in the normal course of management and employees performing their assigned duties increases. The basic premise is that no one employee should have access to both physical assets and the related accounting records or to all phases of a transaction. In situations where segregation of duties is not feasible, a higher level of management oversight is appropriate.

Condition: One of the 10 travel and expense reimbursements tested, totaling approximately $2,126, were approved by the same individual who submitted the reimbursement request. In addition, the same employee signed the reimbursement check. It appears there has been lack of progress in implementing 2016 corrective action as noted in the above current year finding.

Cause: There was a lack of controls in place to separate the submission, review, and approval process of certain travel reimbursements.

Effect: Due to the lack of controls in place there were approximately $2,126 in travel reimbursements that were submitted and approved by the same individual.

Auditor's Recommendation: RMCHCS should implement controls to ensure expense reimbursements are reviewed and approved by someone independent of the initiation/submission process. In addition, consider adding an additional level of review when situations result in someone signing a check made payable to themselves.

Management's Response: RMCHCS has implemented adequate controls as of March 31, 2018, to assure that requested expense reimbursements are approved independently by the initiator of the request. Also, an additional level of review has been added for situations whereby the check could be made payable to the initiator.

Section II — Section 12-6-5 NMSA 1978 Findings — continued

2017-003 – Untimely Cash Deposits (Other Noncompliance) (Repeated and Modified)

Criteria or Specific Requirement: The Public Money Act [Chapter 6-10-3 New Mexico Statutes Annotated (NMSA) 1978] requires that cash received by RMCHCS must be deposited before the close of the next succeeding business day after the receipt of money.

Condition: Eight of the 25 deposits tested were not deposited within the required timeframe. Exceptions were identified at the College Clinic, Cardiology Clinic, and Customer Service department. It appears there has been lack of progress in implementing 2016 corrective action as noted in the above current year finding.

Cause: The clinics and certain departments did not have adequate controls in place to ensure that deposits of cash received were made within the required timeframe.

Effect: RMCHCS did not comply with the Public Money Act.

Auditor's Recommendation: RMCHCS should establish controls to ensure that deposits are made within 24 hours of receipt.

Management's Response: RMCHCS will establish a reporting process and controls to assure that deposits are made within 24 hours of receipt.

Section II — Section 12-6-5 NMSA 1978 Findings — continued

2017-004 – Travel and Per Diem (Other Noncompliance)

Criteria or Specific Requirement: According to the Per Diem and Mileage Act (Subsection 2.42.2.11) mileage must be charged according to the most recently approved mileage rate. Additionally, if actual expenses for travel are to be reimbursed in lieu of a standard per diem rate, receipts must be provided to support the charges (Subsection 2.42.2.12).

Condition: Three of the eighteen transactions tested were not in compliance with the State Audit Rule. Two mileage reimbursement transactions were calculated using the 2016 approved rate instead of the 2017 mileage rate. One travel expense reimbursement lacked adequate support.

Cause: A lack of oversight in calculating mileage and travel expense reimbursement allowed reimbursements be made that were not in accordance with the State Audit Rule.

Effect: RMCHCS was found to be not in compliance with the Per Diem and Mileage Act.

Auditor's Recommendation: RMCHCS should establish more stringent review and approval procedures to ensure employees are being reimbursed at the appropriate rates and that no employee can be reimbursed without proper support of travel reimbursement requests.

Management's Response: RMCHCS has established stronger controls and approval procedures to adhere to the Per diem and Mileage Act.

Section II — Section 12-6-5 NMSA 1978 Findings — continued

2017-005 – Collateralization of Public Funds (Other Noncompliance) (Repeated and Modified)

Criteria or Specific Requirement: According to the Audit Rule 2016 (Subsection M 2.2.2.10 NMAC "Public Monies"), Public Monies is defined as all monies coming into all agencies. Any funds considered public monies must be collateralized at 50% of the deposit amount. Since RMCHCS is considered an "agency" of the State of New Mexico, all money held by RMCHCS must be collateralized at 50% and repurchase agreements held by RMCHCS must be collateralized at 102%.

Condition: At December 31, 2017, RMCHCS had uninsured bank deposits of $76,883. State law requires that $39,087 of these bank deposits be collateralized. In addition, at December 31, 2017, RMCHCS held a repurchase agreement in the amount of $1,746,064. State law requires that $1,890,985 be collateralized. At December 31, 2017, RMCHCS held collateral for this agreement of $1,694,312, which was $86,673 below the state requirements. It appears there has been lack of progress in implementing 2016 corrective action as noted in the above current year finding.

Cause: RMCHCS lacked proper oversight and/or management reviews to ensure the Hospital was in compliance with all collateralization coverage requirements.

Effect: RMCHCS deposits were not collateralized appropriately, and RMCHCS was not in compliance with the public money requirements for amounts held in a financial institution exceeding the Federal Deposit Insurance Coverage (FDIC) overage of $250,000.

Auditor's Recommendation: RMCHCS should work with its financial institutions to ensure adequate collateral is in place over all deposits.

Management's Response: RMCHCS will comply with adequate collateral being in place for all deposits.

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Current Status Schedule of 2016 Audit Findings
For the Year Ended December 31, 2017

Prior-Year Number	Description	Current Status
2016-001	Allowance Methodology for Accounts Receivable (Material Weakness)	Resolved
2016-002	Segregation of Duties	Unresolved—See management response at 2017-002
2016-003	Inventory Count Discrepancies	Resolved
2016-004	Untimely Cash Deposits	Unresolved—See management response at 2017-003
2016-005	Capital Asset Physical Inventory Count Not Performed	Resolved
2016-006	Collateralization of Public Funds	Unresolved—See management response at 2017-005

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

Corrective Action Plan

For the Year Ended December 31, 2017

Audit Findings	Management's Corrective Action Plan	Person Responsible	Estimated Completion Date
2017-001 Accuracy and Timeliness of Account Reconciliation	There has been a change in position within the Finance Department with new reconciliation assignments. All accounts will be reconciled and reviewed no later than 90 days after quarter end.	Controller	These will be completed on a quarterly basis beginning June 30, 2018
2017-002 Segregation of Duties	RMCHCS has implemented a new workflow to ensure that approvals and check signing authority are properly segregated from the initiation functions.	AP Manager	Implemented 3/31/2018
2017-003 Untimely Cash Deposits	RMCHCS will establish a reporting process and controls to assure that deposits are made within 24 hours of receipt.	G/L Accountant	Implemented 7/31/2018
2017-004 Travel and Per Diem	Travel forms will be updated with current mileage and per diem rates. These will be verified prior to checks being disbursed.	AP Manager	Implemented 6/30/2018
2017-005 Collateralization of Public Funds	RMCHCS is working with the Financial institutions to correct.	Accountant	Target date 9/30/2018

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
Exit Conference and Board of Trustees Presentation

An exit conference was held on May 10, 2018, with the following attending:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary:
Gregg Majors, Interim Chief Financial Officer

REDWLLC:
Halie Garcia, Principal

A presentation was made to a closed session of the Special Finance Committee on May 10, 2018, with the following attendees:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (includes 2017 Board members and titles):
Joe Wright, Director of Clinics
Randy Myers, Chief Information Officer
Laura Hammons, Board Member
David Bischoff, Chair
Greg Majors, Interim Chief Financial Officer

REDWLLC:
Halie Garcia, Principal

Financial Statement Preparation
RMCHCS's independent public accountants prepared the accompanying financial statements; however, RMCHCS is responsible for the contents of the financial statements and related footnotes.