REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

DECEMBER 31, 2010 AND AUGUST 31, 2009

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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BOARD OF TRUSTEES AND PRINCIPAL EMPLOYEES
December 31, 2010

Report of Independent Auditors

Board of Trustees and Management of
Rehoboth McKinley Christian Health Care Services, Inc.
and
Mr. Hector H. Balderas, New Mexico State Auditor

We have audited the accompanying consolidated statement of financial position of Rehoboth McKinley Christian Health Care Services, Inc. (the "Hospital"), a not-for-profit corporation, as of December 31, 2010, and the related consolidated statements of activities and cash flows for the sixteen month period then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements of the Hospital as of and for the year ended August 31, 2009, were audited by other auditors whose report dated January 18, 2010, expressed an unqualified opinion on those statements.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2010, and the results of its operations and its cash flows for the sixteen month period then ended in conformity with accounting principles generally accepted in the United States of America.

Board of Trustees and Management of
Rehoboth McKinley Christian Health Care Services, Inc.
and
Mr. Hector H. Balderas, New Mexico State Auditor

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2011, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise the Hospital's basic financial statements as of and for the sixteen month period ended December 31, 2010. The accompanying information identified in the table of contents as Supplementary Information is presented for purposes of additional analysis, and to meet the requirements of the New Mexico Office of the State Auditor, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Moss Adams LLP

Albuquerque, New Mexico
September 20, 2011

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
December 31, 2010 and August 31, 2009

		December 31, 2010	August 31, 2009
ASSETS			
Current assets			
Cash and cash equivalents	$	**10,389,197**	7,274,136
Patient accounts receivable, net of allowance for doubtful accounts of $6,591,643 in 2010 and $10,897,812 in 2009		**6,370,678**	6,366,020
Estimated third party payor settlements		**617,183**	-
Sole community provider and other receivables		**2,993,863**	5,028,260
Inventories		**1,052,875**	866,009
Prepaid expenses and deposits		**484,932**	774,966
Total current assets		**21,908,728**	20,309,391
Property, plant and equipment, net		**15,999,950**	15,729,919
Assets limited as to use			
Cash designated for future use		**-**	1,500,000
Assets held by trustee		**956,398**	724,119
Assets held for 457(b) plan		**208,172**	136,528
Restricted cash and investments - other		**-**	564,316
Investment in risk retention group		**1,903,031**	1,237,125
Bond issuance costs		**619,048**	675,197
Total assets	$	**41,595,327**	40,876,595
LIABILITIES AND NET ASSETS			
Current liabilities			
Accounts payable	$	**3,587,959**	3,135,162
Accrued salaries and benefits		**3,676,776**	4,439,483
Other accrued liabilities		**1,147,002**	136,528
Estimated third party payor settlements		**6,514,126**	9,190,954
Current portion of long-term debt		**578,807**	918,898
Total current liabilities		**15,504,670**	17,821,025
Long-term debt, less current portion		**7,014,368**	7,123,707
Total liabilities		**22,519,038**	24,944,732
Net assets			
Unrestricted		**18,484,269**	15,641,677
Temporarily restricted		**495,432**	184,482
Permanently restricted		**96,588**	105,704
Total net assets		**19,076,289**	15,931,863
Total liabilities and net assets	$	**41,595,327**	40,876,595

See Notes to Consolidated Financial Statements.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CONSOLIDATED STATEMENT OF ACTIVITIES
16 Months Ended December 31, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenue				
Net patient service	$ 76,285,795	-	-	76,285,795
Sole community provider	10,469,369	-	-	10,469,369
Other	3,038,255	478,088	-	3,516,343
Net assets released from restrictions	176,254	(167,138)	(9,116)	-
Total operating revenue	89,969,673	310,950	(9,116)	90,271,507
Operating expenses				
Salaries and payroll taxes	40,844,356	-	-	40,844,356
Supplies and other	11,453,807	-	-	11,453,807
Provision for bad debts	7,742,034	-	-	7,742,034
Purchased services	4,526,322	-	-	4,526,322
Contract labor	3,832,002	-	-	3,832,002
Employee benefits	3,006,484	-	-	3,006,484
Depreciation and amortization	3,331,819	-	-	3,331,819
Professional fees	4,311,548	-	-	4,311,548
Insurance	1,642,146	-	-	1,642,146
Repairs and maintenance	1,196,012	-	-	1,196,012
Utilities	1,569,353	-	-	1,569,353
Pharmaceuticals	1,679,998	-	-	1,679,998
Rentals and leases	1,724,577	-	-	1,724,577
Advertising	169,195	-	-	169,195
Property taxes	151,449	-	-	151,449
Total operating expenses	87,181,102	-	-	87,181,102
Operating income	2,788,571	310,950	(9,116)	3,090,405
Nonoperating income (expense)				
Investment income	691,096	-	-	691,096
Loss on disposal of assets	(6,191)	-	-	(6,191)
Interest expense	(630,884)	-	-	(630,884)
Total nonoperating expense, net	54,021	-	-	54,021
Change in net assets	2,842,592	310,950	(9,116)	3,144,426
Net assets, August 31, 2009	15,641,677	184,482	105,704	15,931,863
Net assets, December 31, 2010	**$ 18,484,269**	**495,432**	**96,588**	**19,076,289**

See Notes to Consolidated Financial Statements.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended August 31, 2009

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenue				
Net patient service	$ 57,167,570	-	-	57,167,570
Sole community provider	7,708,064	-	-	7,708,064
Other	2,718,089	212,732	54	2,930,875
Net assets released from restrictions	529,992	(529,992)	-	-
Total operating revenue	68,123,715	(317,260)	54	67,806,509
Operating expenses				
Salaries and payroll taxes	30,170,865	-	-	30,170,865
Supplies and other	8,053,210	-	-	8,053,210
Provision for bad debts	5,838,438	-	-	5,838,438
Purchased services	4,422,968	-	-	4,422,968
Contract labor	3,363,023	-	-	3,363,023
Employee benefits	2,847,610	-	-	2,847,610
Depreciation and amortization	2,756,903	-	-	2,756,903
Professional fees	2,595,633	-	-	2,595,633
Insurance	1,438,946	-	-	1,438,946
Repairs and maintenance	1,289,843	-	-	1,289,843
Utilities	1,131,993	-	-	1,131,993
Pharmaceuticals	1,123,446	-	-	1,123,446
Rentals and leases	396,545	-	-	396,545
Advertising	164,817	-	-	164,817
Property taxes	102,162	-	-	102,162
Total operating expenses	65,696,402	-	-	65,696,402
Operating income (loss)	2,427,313	(317,260)	54	2,110,107
Nonoperating income (expense)				
Investment income	670,729	-	-	670,729
Loss on sale of dialysis operation	(663,161)	-	-	(663,161)
Interest expense	(602,440)	-	-	(602,440)
Total nonoperating expense, net	(594,872)	-	-	(594,872)
Change in net assets	1,832,441	(317,260)	54	1,515,235
Net assets, August 31, 2008	13,809,236	501,742	105,650	14,416,628
Net assets, August 31, 2009	$ 15,641,677	184,482	105,704	15,931,863

See Notes to Consolidated Financial Statements.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
16 Months Ended December 31, 2010 and Year Ended August 31, 2009

	16 Months Ended December 31, 2010	Year Ended August 31, 2009
Cash flows from operating activities		
Cash received from patients and third-party payors	$ 72,987,126	56,003,632
Other receipts from operations	16,820,109	9,133,498
Cash paid to employees and suppliers	(84,152,355)	(58,985,051)
Interest received	21,707	-
Interest paid	(630,884)	(602,441)
Net cash provided by operating activities	5,045,703	5,549,638
Cash flows from investing activities		
Purchase of property and equipment	(2,919,939)	(1,214,633)
Proceeds from sale of the dialysis operation	-	1,500,000
Proceeds from sale of property and equipment	125,351	711,960
Maturities of bond funds and other investments	335,520	744,345
Net cash (used) provided by investing activities	(2,459,068)	1,741,672
Cash flows from financing activities		
Payment on long-term debt	(971,574)	(1,293,467)
Net cash used for financing activities	(971,574)	(1,293,467)
Net increase in cash and cash equivalents	1,615,061	5,997,843
Cash and cash equivalents, beginning of period	8,774,136	2,776,293
Cash and cash equivalents, end of period	$ 10,389,197	8,774,136

See Notes to Consolidated Financial Statements.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
16 Months Ended December 31, 2010 and Year Ended August 31, 2009

		16 Months Ended December 31, 2010	Year Ended August 31, 2009
Reconciliation of change in net assets to net cash provided by operating activities			
Change in net assets	$	**3,144,426**	1,515,235
Adjustments to reconcile change in net assets to net cash provided by operating activities			
Depreciation and amortization		**3,331,819**	2,756,903
Provision for bad debts		**7,742,034**	5,838,438
Loss on disposal of assets		**6,191**	663,161
Unrealized gains on investments		**(669,389)**	-
Net changes in operating assets and liabilities			
Patient accounts receivable		**(7,746,692)**	(1,940,183)
Sole community provider and other receivables		**2,034,397**	(1,505,441)
Inventories		**(186,866)**	9,298
Prepaid expenses and deposits		**290,034**	93,638
Bond issuance costs		**56,149**	104,010
Accounts payable		**161,488**	(1,703,663)
Accrued salaries and benefits and other		**176,123**	(1,058,004)
Estimated third-party payor settlements		**(3,294,011)**	776,246
Net cash provided by operating activities	$	**5,045,703**	5,549,638
Reconciliation of cash and cash equivalents to the consolidated statements of financial position			
Cash and cash equivalents		**10,389,197**	7,274,136
Cash designated for future use		**-**	1,500,000
Total cash and cash equivalents	$	**10,389,197**	8,774,136
Supplemental schedule of noncash investing and financing activities			
Equipment acquired through capital leases	$	**522,144**	-
Equipment acquired through accounts payable		**291,309**	-
Increase in 457(b) investments recorded to other accrued liabilities		**71,644**	-

See Notes to Consolidated Financial Statements.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization. Rehoboth McKinley Christian Health Care Services, Inc. (the "Hospital") is a not-for-profit acute care hospital located in Gallup, New Mexico. The Hospital provides inpatient, outpatient, and emergency care services to the residents of Gallup, McKinley County and the surrounding area.

These financial statements include the Hospital as well as Rehoboth McKinley Christian Health Care Services Foundation ("RMCHCS Foundation" or the "Foundation"), a wholly-owned not-for-profit subsidiary (see Note 17). The Hospital is the sole stated beneficiary of the Foundation. The Foundation is authorized by the Hospital to solicit contributions on its behalf. Intercompany balances and transactions have been eliminated in consolidation.

This summary of significant accounting policies of the Hospital is presented to assist in the understanding of the Hospital's financial statements. The financial statements and notes are the representations of the Hospital'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. The more significant of the Hospital's accounting policies are described below.

Basis of Presentation. Financial statement presentation follows the requirements of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 958-205, Not-for-Profit Entities–Presentation of Financial Statements. Under this section, the Hospital 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 U.S. generally accepted accounting principles 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 contained in the Hospital's financial statements include the allowance for doubtful accounts, contractual allowance, estimated third party payor settlements and depreciation and amortization.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents. For purposes of reporting cash flows, the Hospital includes all highly liquid debt instruments with original maturities of three months or less to be cash equivalents, which at times may exceed the federally insured limits. The Hospital has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on its cash 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 the Hospital has with these payors. The contractual allowance percentages are updated several times per year by payor class and line of business and are based upon the accounts within that payor category that have been adjusted over the previous six months for which the total of the payments and adjustments recorded to the account were greater than 90% of the original gross charges. Contractual allowances are deducted from gross patient accounts receivable on the consolidated statements of financial position.

The allowance for doubtful patient accounts receivable 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. The Hospital calculates its allowance for doubtful accounts based on percentages of accounts receivable aging categories that consider 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 collectibility 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, the Hospital evaluates patient accounts receivable balances older than six months to determine collectibility. 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 the sixteen month period ended December 31, 2010, and the year ended August 31, 2009, the Hospital wrote off approximately $8.5 and $11 million, respectively, in patient accounts receivable based on these procedures.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Property, Plant and Equipment. Property, plant and equipment are recorded at cost. Property and equipment donated for Hospital operations are recorded at fair value at the date of donation as additions to temporarily restricted net assets when the assets are placed in service. 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 repair and maintenance are expensed as incurred.

In September 1995, the Hospital renewed its facility lease agreement with McKinley County, New Mexico for 25 additional years. The lease was extended in 2006 to a total of 33 years therefore expiring August 31, 2028. The annual rent paid to the County for the use of the Hospital facility was $1 per year. Since the original lease agreement dates back to the 1970s and the original fair value of the building would be almost fully amortized as of August 31, 2009, the net book value of the contribution receivable was considered insignificant to the financial statements as of August 31, 2009. The fair market value of this lease and the offsetting donation income have not historically been recorded since the fair rental value of the hospital facility is not determinable, and management does not believe such amounts, if any, would be material to the financial statements. Effective July 2010, the lease agreement was amended to change the base rent to $1,500,000 per year, and to add a new dialysis building to the lease premises. Prior to July 1, 2015, and every five years thereafter, the base rent will be reevaluated based on updated appraisal that has been reviewed and concurred by Property Tax Division of the NM Taxation and Revenue Department.

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.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Assets limited as to use. Assets limited as to use includes the following:

	December 31, 2010	August 31, 2009
Cash designated for future capital projects	$ -	1,500,000
Held by trustee under indenture agreement related to Series 2007 Revenue Bonds		
Cash and cash equivalents	956,398	724,119
Series 2007 Revenue Bonds Project Fund		
Cash and cash equivalents	-	434,385
Irrevocable trust - 457(b) plan		
Cash and cash equivalents	14,164	7,918
U.S. equity securities	145,822	91,889
U.S. corporate bonds	2,043	36,721
Mutual funds	18,442	-
U.S. government securities	27,701	-
RMCHCS Foundation		
U.S. certificate of deposit	-	105,654
Unexpended mill levy funds	-	24,277
	$ 1,164,570	2,924,963

In 2009, the Hospital designated the proceeds of $1,500,000 from the sale of its dialysis clinics (see Note 14) for the future purchase of property, plant, and equipment based on the requirements of the Refunding and Improvement Bond Master Trust Indenture. As of December 31, 2010, all capital purchases with these designated funds have been made.

Investments. Investments 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 the Hospital's proportionate share of the investee's earnings and any distributions.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net Assets and Changes Therein. 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 the Hospital 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 the Hospital to use or expend the related assets as specified. The restrictions are satisfied either by the passage of time or by the satisfaction of donor specified use.

The Hospital 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 the Hospital to expend part or all of the income and capital appreciation derived from the donated assets for either specified or unspecified purposes.

Debt Issuance Costs. Deferred debt issuance costs are included with other long-term assets on the accompanying consolidated statements of financial position, and are amortized using the straight-line method over the term of the related debt. Amortization of deferred debt issuance costs is included with depreciation and amortization expense in the accompanying consolidated statements of activities. Total debt issuance costs were $789,449. Accumulated amortization of debt issuance costs totaled $170,401 and $114,252 at December 31, 2010 and August 31, 2009, respectively.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Charity Care. The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care provided. Those records include the amount of charges foregone for services and supplies furnished under the Hospital's charity care policy and aggregated approximately $4,013,896 and $1,092,771 for the sixteen months ended December 31, 2010 and the year ended August 31, 2009, respectively.

Income Taxes. The Hospital and the Foundation are not-for-profit corporations, exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. In addition, the Hospital and Foundation have been classified as entities that are a private foundation within the meaning of Section 509 (a) and qualifies for deductible contributions as provided by Section 170(b)(1)(A)(vi). Accordingly, no provision has been made for income taxes in the financial statements.

The Hospital adopted the provision of FASB Accounting Standards (ASC) 740-10, Income Taxes, relating to accounting for uncertain tax positions on September 1, 2009, which had no financial statement impact to the Organization. The Hospital 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.

The Hospital had no unrecognized tax benefits which would require an adjustment to the September 1, 2009 beginning balance of net assets and had no unrecognized tax benefits at December 31, 2010. The Organization files an exempt organization return and applicable unrelated business income tax return in the U.S. Federal jurisdiction, New Mexico Attorney General and New Mexico Department of Revenue. The Organization is no longer subject to income tax examinations by taxing authorities for years before fiscal year 2007 for its federal and state filings.

Advertising Costs. Advertising costs are expensed as incurred. Advertising expense totaled $169,195 and $164,817 for the sixteen months ended December 31, 2010 and the year ended August 31, 2009, respectively.

Reclassifications. Certain reclassifications have been made to the 2009 financial information to conform to the 2010 financial statement presentation.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsequent Events. Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are available to be issued. The Hospital recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Hospital's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before consolidated financial statements were available to be issued.

The Hospital has evaluated subsequent events through September 20, 2011 which is the date the consolidated financial statements were available to be issued.

New Accounting Pronouncements. In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Codification (ASC) Accounting Standards Update (ASU) No. 2010-06, which guidance clarifies certain existing fair value measurement disclosure requirements included in the fair value accounting standards and also requires additional fair value measurement disclosures. Specifically, ASU 2010-06 clarifies that assets and liabilities must be categorized by major class of asset or liability and provides guidance regarding the identification of such major classes. Additionally, disclosures about valuation techniques and the inputs to those techniques for those assets or liabilities designated as Level 2 or Level 3 instruments are required. Disclosures regarding transfers between Level 1 and Level 2 assets and liabilities are required, as well as a deeper level of disaggregation of activity within existing roll-forwards of the fair value of Level 3 assets and liabilities. The additional requirements related to Level 3 roll-forward activity are not required to be adopted until the Hospital's year ending December 31, 2011. The adoption of this guidance has been incorporated into the consolidated financial statements for the sixteen month period ended December 31, 2010 and the year ended August 31, 2009.

In August 2010, the FASB issued a new accounting standard related to the accounting by an insured entity for claims incurred under claims-made insurance and retroactive insurance contracts. Under this accounting standard, unless conditions that allow for the right of offset exist, offsetting prepaid insurance and receivables for expected recoveries from insurers against a recognized incurred but not reported liability or the liability incurred as a result of a past insurable event is

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

no longer appropriate. The application of this guidance will result in claim liabilities and related insurance recoveries being recorded on a gross basis. This accounting guidance will be applied as of the beginning of the period of adoption with a cumulative effect adjustment recorded in equity as of the beginning of the period. The new accounting standard will be effective for the Hospital for its fiscal year ended December 31, 2011. The Hospital is currently evaluating the impact the adoption of this accounting standard will have on its consolidated financial statements and related disclosures.

In August 2010, the FASB issued a new accounting standard that will require the measurement of the amount of charity care provided to be based on the direct and indirect costs of providing that care. This standard will be effective for the Hospital for its fiscal year ended December 31, 2011, with retrospective application to all periods presented. The Hospital does not believe that the adoption of this standard will have a material effect on its consolidated financial statements.

NOTE 2. NET PATIENT SERVICE REVENUE

Agreements with third-party payors provide for payments to the Hospital 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 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.

NOTE 2. NET PATIENT SERVICE REVENUE (CONTINUED)

The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual costs reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid—The State of New Mexico (the "State") administers its Medicaid program through both traditional Medicaid and through contracts with Managed Care Organizations (MCOs). For MCOs, Medicaid beneficiaries are required to enroll with one of the MCOs. The State pays each MCO a per member, per month rate based on their current enrollment. These amounts are allocated by each MCO to separate pools for the hospital, physicians, and ancillary providers. As a result, the MCOs assume the financial risk of providing health care to its members. This arrangement is commonly referred to as "SALUD!."

Through traditional Medicaid and contracts with MCOs, inpatient services are paid at prospectively determined rates per discharge and discounted fee schedules while outpatient services are paid based on interim rates (through October 31, 2010). 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 Medicaid fiscal intermediary.

The New Mexico Medicaid program implemented a new hospital outpatient payment reimbursement based on a simplified Medicare APC method effective November 1, 2010. The prospective payment system (OPPS) reimbursements were set to 100% of the Medicare standard rate. Under the new payment method cost reports will still be required; however, cost report settlements are discontinued.

NOTE 2. NET PATIENT SERVICE REVENUE (CONTINUED)

Medicare and Medicaid cost report receivable (liabilities) are as follows:

	December 31, 2010	August 31, 2009	Current Status
Medicare			
2007	$ -	(50,000)	Settled
2008	-	(61,106)	Settled
2009	-	-	Tentative Settlement
2010	617,183	-	Unaudited
	617,183	(111,106)	
Medicaid			
2004	-	(1,037,519)	Settled
2005	-	(471,244)	Settled
2006	-	(755,083)	Settled
2007	(147,164)	(2,064,944)	Settled
2008	(2,066,327)	(2,375,529)	Settled
2009	(2,362,307)	(2,375,529)	Unaudited
2010	(1,938,328)	-	Unaudited
	(6,514,126)	(9,079,848)	
Total	$ (5,896,943)	(9,190,954)	

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, differences are reflected in current operations.

Settlements of prior-year cost reports and changes in estimates resulted in increases to net patient service revenue of approximately $732,509 and $988,000 for the sixteen month period ended December 31, 2010 and the year ended August 31, 2009, respectively.

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

NOTE 2. NET PATIENT SERVICE REVENUE (CONTINUED)

The following summary details the components of net patient service revenue for the sixteen month period ended December 31, 2010 and the year ended August 31, 2009:

	December 31, 2010	August 31, 2009
Gross charges - inpatient	$ 56,998,577	44,244,860
Gross charges - outpatient	99,476,953	71,786,857
Third party contractual allowances	(76,175,839)	(57,161,588)
Charity care	(4,013,896)	(1,702,559)
Net patient service revenue from continuing operations	$ 76,285,795	57,167,570

NOTE 3. INVESTMENT INCOME

Investment income from cash, cash equivalents, and investments consists of the following for the sixteen months ended December 31, 2010 and the year ended August 31, 2009:

	December 31, 2010	August 31, 2009
Dividends and interest	$ 687,613	683,107
Net unrealized gains (losses)	3,483	(12,378)
	$ 691,096	$ 670,729

NOTE 4. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements used by the Hospital for all financial assets and liabilities that are recognized or disclosed at fair value in the combined 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:

NOTE 4. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

- Level 1 – Quoted process in active markets for identical assets or liabilities on the reporting date. Financial assets and liabilities in Level 1 include cash and cash equivalents, and U.S. and foreign equity securities.

- Level 2 – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include U.S. certificates of deposit, U.S. corporate bonds, U.S. government securities, and interest rate swaps.

- Level 3 – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities classified as Level 1 are valued using unadjusted quoted market prices for identical assets or liabilities in active markets. The Hospital uses techniques consistent with the market approach and income approach for measuring fair value of its Level 2 assets and liabilities. The market approach is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach generally converts future amounts (cash flows or earnings) to a single present value amount (discounted).

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.

NOTE 4. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following table provides information as of December 31, 2010, about the Hospital's financial assets and liabilities measured at fair value on a recurring basis.

		Balance at December 31, 2010	Level 1	Level 2
Assets included in:				
Assets limited as to use				
U.S. equity securities - various sectors		145,822	145,822	-
U.S. corporate bonds		2,043	-	2,043
Mutual fund - Alliance Bernstein CISH		18,442	18,442	-
U.S. Treasury notes		21,268	-	21,268
FNMA notes		6,433	-	6,433
		194,008	164,264	29,744
Total	$	194,008	164,264	29,744

The following table provides information as of August 31, 2009, about the Hospital's financial assets and liabilities measured at fair value on a recurring basis.

		Balance at August 31, 2009	Level 1	Level 2
Assets included in:				
Assets limited as to use				
U.S. equity securities		91,889	91,889	-
U.S. corporate bonds		36,721	-	36,721
		128,610	91,889	36,721
Total	$	128,610	91,889	36,721

NOTE 4. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Transfers to and from Levels 1, 2, and 3 are recognized at the end of the reporting period. There were no transfers between levels during the 16 month period ended December 31, 2010. As of December 31, 2010 and August 31, 2009, the Level 2 instruments were valued as follows:

U.S. Government Securities, FNMA, and Corporate Bonds
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.

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment at December 31, 2010 and August 31, 2009 follows:

	December 31, 2010	August 31, 2009
Equipment	$ 27,365,690	26,529,913
Buildings and improvements	27,692,668	27,500,583
Land improvements	1,548,641	1,431,672
	56,606,999	55,462,168
Accumulated depreciation and amortization	(41,412,574)	(40,467,218)
	15,194,425	14,994,950
Land	734,969	734,969
Construction in progress	70,556	-
	$ 15,999,950	15,729,919

NOTE 6. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31, 2010	August 31, 2009
Series 2007A bonds	$ 6,870,000	7,145,000
Capital lease obligations	723,175	897,605
	7,593,175	8,042,605
Less current portion	(578,807)	(918,898)
Long-term debt, excluding current portion	$ 7,014,368	7,123,707

In March 2007, the Hospital 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 the Hospital to make monthly deposits with a trustee for payment on the bonds. See Note 1 for cash and investment balances related to the 2007A bonds.

The Series 2007A bonds accrue interest at 5.00% until 2017, and thereafter accrue at 5.25%. The bonds mature in 2026, and are collateralized by the lease between the Hospital and the County of McKinley and buildings owned by the Hospital, and are secured by pledged revenues. The bond agreement also places certain limits on the incurrence of additional debt and requires that the Hospital satisfy certain measures of financial performance as long as the bonds are outstanding. At December 31, 2010 and August 31, 2009, the Hospital was in compliance with all applicable requirements and covenants of the bond agreement.

The cost of equipment under capital leases is included in property, plant and equipment in the consolidated statements of financial position and was $2,285,792 and $4,156,746 at December 31, 2010 and August 31, 2009, respectively. Accumulated amortization on the leased equipment at December 31, 2010 and August 31, 2009 was $103,054 and $2,342,389, 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 February 2012; and accrue interest at rates ranging from 3.6% to 10.7%, and are secured by the underlying equipment.

NOTE 6. LONG-TERM DEBT (CONTINUED)

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

	Bonds Payable	Capital Leases
Year ending December 31,		
2011	$ 290,000	317,190
2012	300,000	198,694
2013	320,000	142,485
2014	335,000	118,738
2015	350,000	-
Thereafter	5,275,000	-
	$ 6,870,000	777,107
Less amounts representing interest payments		(53,932)
		$ 723,175

NOTE 7. OPERATING LEASES

The Hospital has noncancelable operating leases consisting of the lease of the hospital building from McKinley County, as described in Note 1, and various equipment. The building lease with McKinley County began in July of 2010 and requires monthly payments of $125,000 through August 31, 2028.

The future minimum lease payments under the leases at December 31, 2010 are as follows:

Year ending December 31,	
2011	$ 2,011,193
2012	1,991,843
2013	1,984,343
2014	1,803,835
2015	1,645,750
Thereafter	19,000,000
Total minimum lease payments	$ 28,436,964

Total rental expense under operating leases was approximately $1,323,704 and $156,000 for the sixteen months ended December 31, 2010 and the year ended August 31, 2009, respectively.

NOTE 8. EMPLOYEE BENEFITS

The Hospital 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 100% employer match contribution of up to 3% of the employee's salary. Additionally, the Hospital will match 50% of additional contributions up to 5% of the employee's salary. At December 31, 2010, a total of $615,179 was accrued for employer contributions, which was applicable to calendar year 2010. At August 31, 2009, a total of $1,178,680 was accrued for employer contributions, of which $715,306 was applicable to calendar year 2008 and $463,374 to the first eight months of calendar year 2009.

Effective January 1, 2003, the Hospital 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 the Hospital and are subject to creditor claims. The amounts funded to the trust for the sixteen months ended December 31, 2010 and for the year ended August 31, 2009 were $208,172 and $136,528, respectively. The funded amounts are included in assets limited as to use in the consolidated statements of financial position – see Note 1. The related liabilities of $208,172 and $136,528 as of December 31, 2010 and August 31, 2009, respectively, are included in accrued salaries and benefits in the accompanying consolidated statements of financial position.

NOTE 9. EMPLOYEE HEALTH INSURANCE BENEFIT PROGRAM

The Hospital 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, 2010 and August 31, 2009 to cover claims which have been incurred but not reported. Such reserves are included in accrued salaries and benefits in the accompanying consolidated statements of financial position.

NOTE 10. SOLE COMMUNITY PROVIDER

The Hospital participates in a sole community provider indigent care program administered by the State of New Mexico. Revenue from this program for the sixteen months ended December 31, 2010 and the year ended August 31, 2009 totaled $10.4 million and $7.7 million, respectively. Approximately $2.2 million and $4.3 million as of December 31, 2010 and August 31, 2009, respectively, is included in sole community provider and other receivables in the consolidated statements of financial position.

NOTE 11. OTHER OPERATING REVENUE

Other operating revenue includes the following:

Ad Valorem Tax Levy. A New Mexico state law adopted in 1980 and amended in 1981 allows for counties to provide tax support to qualifying hospitals. A property tax levy for two mills was approved by the county voters in fiscal year 2004. Revenue from the levy was $1,875,456 and $1,317,292 for the sixteen months ended December 31, 2010 and the year ended August 31, 2009, respectively. The current mill levy expires in July 2012.

Other. Other operating revenue also includes cafeteria, gift shop, donation and grant revenues.

NOTE 12. CONCENTRATIONS OF CREDIT RISK

The Hospital provides credit, in the normal course of business, primarily to residents of the city of Gallup and the county of McKinley, as well as surrounding areas. The Hospital does not require collateral with the extension of credit. The Hospital maintains an allowance for doubtful accounts based on management's assessment of collectibility, current economic conditions, and prior experience. Because of the uncertainty regarding the ultimate collectibility of patient accounts receivable, there is at least a reasonable possibility that recorded estimates of the allowance for doubtful accounts and contractual allowances will change by a material amount in the near term.

NOTE 12. CONCENTRATIONS OF CREDIT RISK (CONTINUED)

The mix of gross accounts receivable from patients and third-party payors was as follows at December 31, 2010 and August 31, 2009:

	December 31, 2010	August 31, 2009
Medicare	32%	26%
Medicaid	19%	15%
Other third-party payors	14%	25%
Patients	35%	34%
	100%	100%

NOTE 13. 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. In recent years, government activity has increased with respect to investigations and 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, the imposition of significant fines and penalties and significant repayments for patient services previously billed.

Management believes that the Hospital is in compliance with applicable government 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.

Litigation. The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. In management's opinion, upon consultation with legal counsel, malpractice coverage is adequate to cover adverse judgments, if any, made against the Hospital.

There is currently on ongoing investigation by CMS into the improper matching for the State's share of Sole Community Provider funding received by the Hospital for the period October 2008 through September 2009. The impact of this investigation is the potential repayment by the Hospital of a portion of the Sole Community

NOTE 13. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Provider funding received during this time period. Management has accrued in the accompanying financial statements an amount they deem adequate to cover the amount of such repayment. However, the ultimate repayment will not be determined until the investigation concludes, and may differ significantly from the amount accrued in the accompanying financial statements as of December 31, 2010.

Malpractice Insurance. Effective March 1, 2003, 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 founding subscriber in the VHA Mountain States Reciprocal Risk Retention Group for the purpose of providing insurance for malpractice and general liability coverage. 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, 2010 and August 31, 2009, the Hospital cannot estimate the additional premiums, if any, which may accrue as a result of the Group's experience to date.

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.

Workers' Compensation Insurance. Pursuant to the New Mexico Self Insurance Act, the Hospital 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, 2010 and August 31, 2009, the Hospital cannot estimate the additional premiums or refunds, if any, which may accrue as a result of the Group's experience to date.

NOTE 14. FUNCTIONAL EXPENSE CLASSIFICATION

In recording the activities of the Hospital, expenses are specifically tracked or allocated on the basis of periodic time and expense studies, and recorded in the following functional categories for the sixteen months ended December 31, 2010, and the year ended August 31, 2009:

NOTE 14. FUNCTIONAL EXPENSE CLASSIFICATION (CONTINUED)

		December 31, 2010	August 31, 2009
Health care services	$	51,915,979	37,671,872
Management general		35,655,272	29,096,337
Fundraising		246,926	193,794
Total expenses	$	87,818,177	66,962,003

NOTE 15. SALE OF DIALYSIS CENTERS

Effective September 1, 2008, the board of trustees approved the sale of the Hospital's outpatient dialysis centers to Red Rocks Dialysis at a price of $1,500,000 and with approval from the Trustee of the Bond Indenture. The sale resulted in a loss to the Hospital of $663,161, which is recorded as a nonoperating expense for the year ended August 31, 2009. For the year ended August 31, 2009, net patient service revenue from the dialysis centers was $723,926.

During the year ended August 31, 2009, the Hospital began partnering with McKinley County to construct a new dialysis center. All expenditures by the Hospital in connection with this project during the year ended August 31, 2009 were reimbursed by the County. During the sixteen months ended December 31, 2010 the Hospital expended approximately $416,000 for construction of a new dialysis center which was not reimbursed by the County, and was recorded as *Purchased services* expense in the accompanying statement of activities. The building is an asset of McKinley County, with all equipment purchased for the dialysis center recorded as an asset of the Hospital.

As described in Notes 1 and 7, the Hospital amended its lease agreement with McKinley County effective July 1, 2010, to change the payment terms and to also add the new dialysis building to the lease. Effective January 10, 2011, the Hospital subleased the building to Red Rocks Dialysis, an unrelated party. The sublease requires monthly payments of $20,076, has a term of fifteen years, and has two five-year renewal options. For lease years beginning January 1, 2015, 2020, and 2025, the monthly rental rate is increased over the prior monthly rental rate for the next succeeding five years by the lesser of 5% or the increase in CPI over the prior rental rate.

NOTE 16. ECONOMIC DEPENDENCY

The Hospital receives a significant amount of revenue from the State's Sole Community Provider program (see Note 10) and from Ad Valorem Tax levies (see Note 11). The Hospital is economically dependent on the continuation of these revenues.

NOTE 17. RMCHCS FOUNDATION SUMMARIZED FINANCIAL STATEMENTS

Summarized financial statements for RMCHCS Foundation as of December 31, 2010 and August 31, 2009, and for the sixteen months ended December 31, 2010 and for the year ended August 31, 2009 are as follows:

	December 31, 2010	August 31, 2009
Assets		
Current assets	$ 715,577	263,872
Investments	-	105,656
Other assets	1,800	2,588
Total assets	717,377	372,116
Liabilities and net assets		
Current liabilities	255,574	179,069
Net assets (deficit)		
Unrestricted	(120,217)	(97,139)
Temporarily restricted	485,432	184,482
Permanentaly restricted	96,588	105,704
Total net assets	461,803	193,047
Total liabilities and net assets	$ 717,377	372,116

NOTE 17. RMCHCS FOUNDATION SUMMARIZED FINANCIAL STATEMENTS (CONTINUED)

	Sixteen Months Ended December 31, 2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Other revenue	$ 41,578	478,088	-	519,666
Net assets released from restrictions	53,513	(167,138)	(9,116)	(122,741)
Total operating revenue	95,091	310,950	(9,116)	396,925
Total operating expenses	118,169	-	-	118,169
Operating income	(23,078)	310,950	(9,116)	278,756
Net assets (deficit), beginning of period	(97,139)	184,482	105,704	193,047
Net assets (deficit), end of period	$ (120,217)	495,432	96,588	471,803

	Year Ended August 31, 2009			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Other revenue	$ 117,027	212,732	54	329,813
Net assets released from restrictions	529,992	(529,992)	-	-
Total operating revenue	647,019	(317,260)	54	329,813
Total operating expenses	529,992	-	-	529,992
Operating income	117,027	(317,260)	54	(200,179)
Net assets (deficit), beginning of year	(214,166)	501,742	105,650	393,226
Net assets (deficit), end of year	$ (97,139)	184,482	105,704	193,047

SUPPLEMENTARY INFORMATION

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
SCHEDULE OF PLEDGED COLLATERAL
December 31, 2010

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	$ 283,558	283,558	-	-	-
Bank of Colorado - Pinnacle Bank	35,097	35,097	-	-	-
Washington Federal	703,846	703,846	-	-	-
Total	$ 1,022,501	1,022,501	-	-	-

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	$ 10,690,821	-	N/A	8,603,462	8,603,462

Pledged Collateral

Type of Security	Custodian	CUSIP Number	Sequence Number	Maturity Date	Fair Value
FEDL HOME LN MTG CRPPOOL	Wells Fargo	3128PTAK1	060211	11/1/2025	$ 4,820,290
FEDL NATL MTG ASSN POOL	Wells Fargo	31415AUU3	060211	6/1/2038	$ 3,783,172

*On October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program. The program provides full deposit insurance coverage for non-interest bearing transaction accounts in FDIC-insured institutions, regardless of the amount. In 2010, this program was extended from 12/31/2010 to 12/31/2012.

**The Hospital is subject to collateralization requirements on the unexpended portion of its mill levy monies, which are considered "Public Monies" per the New Mexico State Audit Rule section 2.2.2.10 N. There were no unexpended mill levy monies at December 31, 2010 beyond the amounts held in deposit accounts, which were fully insured; accordingly, there is no requirement for collateralization on their Repurchase Agreement.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
SCHEDULE OF DEPOSITS AND INVESTMENTS
December 31, 2010

Account Title	Account Type	Bank Balance	Reconciling Items	Book Balance
Cash and cash equivalents				
Wells Fargo Bank				
Operational	Checking	$ 103,682	(35,213)	68,469
Operational	Depository	-	(165,869)	(165,869)
Operational	Accounts payable zero balance account	-	(1,063,602)	(1,063,602)
Operational	Payroll zero balance account	-	(52,903)	(52,903)
Operational	Pension account	179,876	-	179,876
Washington Federal				
Foundation Operational	Checking	12,064	(9,355)	2,709
Foundation Restricted Checking	Checking	691,782	-	691,782
Bank of Colorado - Pinnacle Bank				
Auxiliary - General Account	Checking	4,631	(178)	4,453
Auxiliary - Gift Shop	Checking	21,815	(1,196)	20,619
Auxiliary - Thrift Shop	Checking	8,651	-	8,651
Total deposits		1,022,501	(1,328,316)	(305,815)
Wells Fargo Bank				
Repurchase agreement	Sweep	10,690,821	-	10,690,821
Other				
Petty cash	Cash	-	4,495	4,495
Flex comprehensive cash	Cash	-	(304)	(304)
Total cash and cash equivalents		$ 11,713,322	(1,324,125)	10,389,197
Cash and investments - restricted				
Wells Fargo Bank				
Project Fund	Cash equivalent			-
Improvement Fund	Cash equivalent	254,041	57,035	311,076
Series 2007 Bond Principal Fund	Cash equivalent			-
Series 2007 Bond Reserve Fund	Cash equivalent	645,322	-	645,322
Zia Trust				
Irrevocable trust - 457(b) plan	Cash equivalent	14,005	-	14,005
Irrevocable trust - 457(b) plan	Equity securities	145,822	-	145,822
Irrevocable trust - 457(b) plan	Fixed income securities	48,345	-	48,345
Merrill Lynch				
Hadden Trust Investment	Cash equivalent	-	-	-
Hadden Trust Investment	Equity securities	-	-	-
Total bond funds and other investments		$ 1,107,535	57,035	1,164,570

OTHER INFORMATION

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 Management of
Rehoboth McKinley Christian Health Care Services, Inc.
and
Mr. Hector H. Balderas, New Mexico State Auditor

We have audited the consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. (the "Hospital") as of and for the sixteen months ended December 31, 2010, and have issued our report thereon dated September 20, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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 consolidated 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 Management of
Rehoboth McKinley Christian Health Care Services, Inc.
and
Mr. Hector H. 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. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses as finding 10-5 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's consolidated 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 certain other matters that are required to be reported pursuant to *Government Auditing Standards* paragraphs 5.14 and 5.16, and pursuant to Section 12-6-5, NMSA 1978, which are described in the accompanying schedule of findings and responses as findings 10-1 through 10-4.

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

Board of Trustees and Management of
Rehoboth McKinley Christian Health Care Services, Inc.
and
Mr. Hector H. Balderas, New Mexico State Auditor

This report is intended solely for the information and use of the board of trustees, management, others within the Hospital, the New Mexico Office of the State Auditor, and the New Mexico Legislature, and is not intended to be and should not be used by anyone other than these specified parties.

Moss Adams LLP

Albuquerque, New Mexico
September 20, 2011

REHOBOTH MCKINLEY CHRISTIAN
HEALTH CARE SERVICES, INC.
SCHEDULE OF FINDINGS AND RESPONSES
Sixteen Months Ended December 31, 2010

Finding 10-1: Physical Inventory and Reconciliation of Fixed Assets

Condition

While performing substantive fixed asset test work, we noted the following

- The Hospital does not perform periodic physical inventories of fixed assets.
- There were needed corrections to the fixed assets rollforward prepared by the Hospital. These differences included transfers not netting out to zero and the reflection of calculations of gains / losses on disposal not agreeing to the fixed assets rollforward. Management was subsequently able to reconcile these differences to within an insignificant amount.
- We noted there are occasionally lags on entering fixed assets into the fixed asset software therefore resulting in exceptions in depreciation calculations.

Criteria

Good and sound accounting process should include performance of periodic count of fixed assets and timely reconciliations of fixed asset balances to fixed asset rollforward and fixed asset software.

Effect

Fixed asset records may not be accurately reflected in monthly and annual financial statements.

Cause

Policies and procedures do not require the performance of periodic inventory counts, and reconciliations were not prepared accurately in all cases and management reviews of these reconciliations did not detect the discrepancies.

Recommendation

We recommend the Hospital develop and implement policies and procedures to conduct physical inventory counts on a periodic basis, and to ensure such inventories are reconciled to the fixed asset accounting system. Further, reconciliations between the fixed asset accounting system and the general ledger should be performed monthly, and any reconciling items should be identified and corrected, as appropriate.

Finding 10-1: Physical Inventory and Reconciliation of Fixed Assets (Continued)

Management Response

We will plan and conduct a physical inventory by the end of the year. We currently do a monthly reconciliation of the fixed assets to the general ledger. We will review this process to make it more rigorous.

Finding 10-2: Verification that Payments Received are in Accordance with Terms of Insurance Contracts

Condition

During revenue and accounts receivable testing, we noted there is no review of payments made by commercial payors to determine if such payments are made in agreement with terms of the commercial contracts with those payors.

Criteria

Payment recalculations should be performed, at least on a sample basis, in order to ensure that commercial insurance providers are submitting accurate payments in accordance with terms of contracts.

Effect

The lack of payment reviews on commercial contracts poses the risk that the Hospital is not receiving proper payments from those commercial payors. The Hospital may not be identifying refunds due to these payors, or may not be receiving all payments due the Hospital under the terms of the contracts.

Cause

The Hospital has several initiatives to analyze and improve on existing billing and collections processes within the revenue cycle and has not currently implemented any formal process for reviewing commercial contract compliance.

Recommendation

We recommend the Hospital continue current efforts to improve the revenue cycle and specifically consider implementing commercial contract compliance procedures and processes.

Management Response

We are in the process of implementing software that will give us the capability to verify that payments made by commercial insurers are consistent with current agreements. In the meantime, we will review a sample of accounts each month until the automated system is functional.

Finding 10-3: Reconciliation of Cash, Third-party Payor, and Net Asset Accounts

Condition

During our testing of period-end reconciliations we noted the following areas for improvement:

- We noted a $35,000 reconciling item between the bank balance and the balance per the cash reconciliation that represented an unposted cash receipt.

- During our testing of outstanding checks we noted that although a check for approximately $286,000 had posted to the bank account on 12/31/2010, the check was reported as an outstanding item. The reconciling item was detected by personnel after year-end and adjusted.

- During testing of third party settlements we noted the reconciliation prepared by management included management estimates of potential additional settlement liabilities beyond those included in the third-party cost reports, making reconciliation to the third-party cost reports difficult.

- During testing of restricted net assets, we noted no underlying reconciliation was performed to ensure restricted net asset balances were timely and accurately captured.

Criteria

Account reconciliations represent a key internal control over the complete and accurate accounting and classification of balance sheet accounts and should be designed to enable personnel to timely identify and correct financial statement balances.

Effect

There is a potential that reconciling items are not timely identified and corrected, resulting in misstatements or misclassifications of financial statement balances.

Cause

Certain of the Hospital's reconciliation controls are not sufficiently designed or reconciliations are not being subject to review by someone other than the preparer.

Recommendation

We recommend the Hospital review the design of reconciliations over cash, third-party payor accruals, and net assets and implement needed improvements. Further, such completed reconciliations should be subject to appropriate management review.

Finding 10-3: Reconciliation of Cash, Third-party Payor, and Net Asset Accounts (Continued)

Management Response
We will review and change the design of these reconciliations (particularly the third party settlements) to facilitate the review of these accounts.

Finding 10-4: Review and Analysis of Professional Liability Claims

Condition

In testing professional liability contingencies (medical malpractice liabilities), we noted the Hospital retains $25,000 on its professional liability risks under a claims made insurance policy, and no analysis is performed to assess the need for, and measurement of, an accrual for the ultimate costs of settling those claims.

Criteria

Pursuant to generally accepted accounting principles (GAAP), the ultimate costs of malpractice claims, which includes the costs associated with litigating and settling those claims, should be accrued when the incidents that give rise to the claims occur. Further, under GAAP, a health care entity that is insured under a claims-made insurance policy recognizes the estimated cost of those claims and incidents not reported to the insurance carrier as of the financial statement date, unless the health care entity has purchased tail coverage.

Effect

The financial statements may not include professional liability contingencies in accordance with GAAP, causing liabilities to be understated and net income to be overstated.

Cause

Currently, management does not perform separate review and analysis of professional liability claims.

Recommendation

We recommend management perform an analysis of professional liability claims at least on an annual basis, and accrue estimated liabilities in accordance with GAAP. Given the Hospital does not maintain tail coverage, the full estimated costs associated with claims not reported to the insurance carrier as of December 31, 2010 should be accrued.

Management Response

Management will conduct a more thorough review of outstanding professional liability claims in future periods and ensure documentation is retained to support the accrual for professional liability claims.

REHOBOTH MCKINLEY CHRISTIAN
HEALTH CARE SERVICES, INC.
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Sixteen Months Ended December 31, 2010

Finding 10-5: Review of Journal Entries

Condition
In testing a sample of 8 journal entries, we noted 3 instances where there was no indication of review by someone independent of the person preparing/posting the entry.

Criteria
Internal controls over journal entries are fundamental to a properly designed and implemented system of internal controls over financial reporting processes.

Effect
There is a risk that erroneous journal entries can be posted and not corrected on a timely basis.

Cause
The system allows entries to be posted without a required second review, and procedures over manual approval of journal entries are not consistently followed.

Recommendation
We recommend that either the system configuration be modified to require an independent approval of journal entries prior to posting or that existing procedures requiring all journal entries to be reviewed and approved manually by a person other than the preparer of the journal entry.

Management Response
We will inquire of our accounting system vendor to find out if it can be configured so that staff will not be able to post a journal entry that they initiated so that it can be reviewed and approved/posted by someone other than the preparer.

REHOBOTH MCKINLEY CHRISTIAN
HEALTH CARE SERVICES, INC.
CURRENT STATUS OF PRIOR YEAR FINDINGS
Sixteen Months Ended December 31, 2010

Prior-Year Number	Description	Current Status
SA 09-1	Cash Collateralization	Cleared

REHOBOTH MCKINLEY CHRISTIAN
HEALTH CARE SERVICES, INC.
EXIT CONFERENCE
Sixteen Months Ended December 31, 2010

A closed meeting exit conference was held on September 20, 2011, with the following attending:

Rehoboth McKinley Christian Health Care Services, Inc.:

Board Members
Tony Gonzales, CPA
Eric D. Begay
Priscilla Smith
Barry Butler
David Bischoff
Erwin Elber, MD

Staff
Karen Lautermilch, CEO
Mark Hall, CFO
Bart Hansen, Controller
Mary Poel, MD, CMO
Teresa Lopez, Administrative Assistant
George M. Laurin
Mary Jim Montgomery

Moss Adams LLP:

Brandon Fryar, Partner

Financial Statement Preparation

The Hospital's independent public accountants prepared the accompanying financial statements; however, the Hospital is responsible for the contents of the financial statements and related footnotes.