Report of Independent Auditors
and Consolidated Financial Statements
with Supplementary Information for

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

December 31, 2011 and 2010

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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REHOBOTH MCKINLEY CHRISTIAN
HEALTH CARE SERVICES, INC. AND SUBSIDIARY
BOARD OF TRUSTEES AND PRINCIPAL EMPLOYEES
December 31, 2011

Report of Independent Auditors

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

We have audited the accompanying consolidated statements of financial position of Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (the "Hospital"), a New Mexico not-for-profit corporation, as of December 31, 2011 and 2010, and the related consolidated statements of activities and cash flows for the year ended December 31, 2011 and for the sixteen month period ended December 31, 2010. 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 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 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 audits provide a reasonable basis for our opinions.

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, 2011 and 2010, and the changes in its net assets and its cash flows for the year ended December 31, 2011 and for the sixteen month period ended December 31, 2010 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 Subsidiary
and
Mr. Hector H. Balderas, New Mexico State Auditor

In accordance with *Government Auditing Standards*, we have also issued our report dated July 18, 2012, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise the Hospital's financial statements. The schedule of pledged collateral and schedule of deposits and investments are presented for 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. The schedule of pledged collateral and schedule of deposits and investments have been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain other 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 schedule of pledged collateral and schedule of deposits and investments are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Moss Adams LLP

Albuquerque, New Mexico
July 18, 2012

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	December 31, 2011	December 31, 2010
CURRENT ASSETS		
Cash and cash equivalents	$ 911,269	$ 10,389,197
Patient accounts receivable, net of allowance for doubtful accounts of $7,035,365 in 2011 and $6,591,643 in 2010	8,177,233	6,370,678
Estimated third party payor settlements	836,051	617,183
Sole community provider and other receivables	3,581,997	2,993,863
Inventories	1,006,337	1,052,875
Prepaid expenses and deposits	465,178	484,932
Total current assets	14,978,065	21,908,728
Property, plant, and equipment, net	16,631,089	15,999,950
Assets limited as to use		
Assets held by trustee	953,851	956,398
Assets held for 457(b) plan	208,172	208,172
Investment in risk retention group	2,281,920	1,903,031
Bond issuance costs	580,956	619,048
Total assets	$ 35,634,053	$ 41,595,327

LIABILITIES AND NET ASSETS

	2011	2010
CURRENT LIABILITIES		
Accounts payable	$ 6,505,430	$ 3,436,227
Accrued salaries and benefits	4,071,692	3,676,776
Other accrued liabilities	502,526	1,298,734
Estimated third party payor settlements	5,094,020	6,514,126
Current portion of long-term debt	486,337	578,807
Total current liabilities	16,660,005	15,504,670
LONG-TERM DEBT, less current portion	6,530,618	7,014,368
Total liabilities	23,190,623	22,519,038
COMMITMENTS AND CONTINGENCIES (Note 14)		
NET ASSETS		
Unrestricted	11,998,078	18,494,269
Temporarily restricted	348,764	485,432
Permanently restricted	96,588	96,588
Total net assets	12,443,430	19,076,289
Total liabilities and net assets	$ 35,634,053	$ 41,595,327

See accompanying notes.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF ACTIVITIES

	Year Ended December 31, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUE				
Net patient service	$ 54,389,871	$ -	$ -	$ 54,389,871
Sole community provider and other	9,652,943	341,530	-	9,994,473
Net assets released from restrictions	478,198	(478,198)	-	-
Total operating revenue	64,521,012	(136,668)	-	64,384,344
OPERATING EXPENSES				
Salaries, benefits, contract labor, and payroll taxes	37,997,008	-	-	37,997,008
Supplies and pharmaceuticals	10,597,954	-	-	10,597,954
Other operating expenses	6,076,998	-	-	6,076,998
Provision for bad debts	5,118,460	-	-	5,118,460
Purchased services	4,688,566	-	-	4,688,566
Professional fees	4,155,375	-	-	4,155,375
Depreciation and amortization	2,364,353	-	-	2,364,353
Total operating expenses	70,998,714	-	-	70,998,714
Operating loss	(6,477,702)	(136,668)	-	(6,614,370)
NONOPERATING INCOME (EXPENSE)				
Investment income	385,155	-	-	385,155
Gain on disposal of capital assets	2,622	-	-	2,622
Interest expense	(406,266)	-	-	(406,266)
Total nonoperating expense, net	(18,489)	-	-	(18,489)
CHANGE IN NET ASSETS	(6,496,191)	(136,668)	-	(6,632,859)
NET ASSETS, December 31, 2010	18,494,269	485,432	96,588	19,076,289
NET ASSETS, December 31, 2011	$ 11,998,078	$ 348,764	$ 96,588	$ 12,443,430

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS 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 and other	13,507,624	478,088	-	13,985,712
Net assets released from restrictions	186,254	(177,138)	(9,116)	-
Total operating revenue	89,979,673	300,950	(9,116)	90,271,507
OPERATING EXPENSES				
Salaries, benefits, contract labor, and payroll taxes	47,682,842	-	-	47,682,842
Supplies and pharmaceuticals	13,133,805	-	-	13,133,805
Provision for bad debts	7,742,034	-	-	7,742,034
Other operating expenses	6,396,583	-	-	6,396,583
Purchased services	4,526,322	-	-	4,526,322
Professional fees	4,311,548	-	-	4,311,548
Depreciation and amortization	3,387,968	-	-	3,387,968
Total operating expenses	87,181,102	-	-	87,181,102
Operating income (loss)	2,798,571	300,950	(9,116)	3,090,405
NONOPERATING INCOME (EXPENSE)				
Investment income	691,096	-	-	691,096
Loss on disposal of capital assets	(6,191)	-	-	(6,191)
Interest expense	(630,884)	-	-	(630,884)
Total nonoperating income, net	54,021	-	-	54,021
CHANGE IN NET ASSETS	2,852,592	300,950	(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	$ 18,494,269	$ 485,432	$ 96,588	$ 19,076,289

 See accompanying notes.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2011	16 Months Ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from patients and third-party payors	$ 50,944,342	$ 72,987,126
Other receipts from operations	9,406,339	16,820,109
Cash paid to employees and suppliers	(65,900,158)	(84,152,355)
Interest and dividends received	6,266	21,707
Interest paid	(406,266)	(630,884)
Net cash (used in) provided by operating activities	(5,949,477)	5,045,703
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(2,957,580)	(2,919,939)
Proceeds from sale of property and equipment	2,802	125,351
Maturities of bond funds and other investments	2,547	335,520
Net cash used in investing activities	(2,952,231)	(2,459,068)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment on long-term debt	(576,220)	(971,574)
Net cash used in financing activities	(576,220)	(971,574)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(9,477,928)	1,615,061
CASH AND CASH EQUIVALENTS, beginning of period	10,389,197	8,774,136
CASH AND CASH EQUIVALENTS, end of period	$ 911,269	$ 10,389,197

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2011	16 Months Ended December 31, 2010
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
CHANGE IN NET ASSETS	$ (6,632,859)	$ 3,144,426
ADJUSTMENTS TO RECONCILE CHANGE IN NET ASSETS TO NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES		
Depreciation and amortization	2,364,353	3,387,968
Provision for bad debts	5,118,460	7,742,034
(Gain) loss on disposal of assets	(2,622)	6,191
Unrealized gains on investments	(378,889)	(669,389)
Net changes in operating assets and liabilities		
Patient accounts receivable	(6,925,015)	(7,746,692)
Sole community provider and other receivables	(588,134)	2,034,397
Inventories	46,538	(186,866)
Prepaid expenses and deposits	19,754	290,034
Accounts payable	3,069,203	161,488
Accrued salaries and benefits	394,916	(762,707)
Other accrued liabilities	(796,208)	938,830
Estimated third-party payor settlements	(1,638,974)	(3,294,011)
Net cash (used in) provided by operating activities	$ (5,949,477)	$ 5,045,703
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 accompanying notes.

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 16). 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.

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, 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.

Recent Accounting Pronouncements – During the year ended December 31, 2011, the Hospital adopted FASB ASU 2010-23, *Health Care Entities (Topic 954) Measuring Charity Care for Disclosure,* and FASB ASU 2010-24, *Health Care Entities (Topic 954) Presentation of Insurance Claims and Related Insurance Recoveries.* In accordance with FASB ASU 2010-23, charity care has been disclosed in Note 12 at the cost of providing the related services for the years ended December 31, 2011 and 2010. In accordance with FASB ASU 2010-24, as of December 31, 2011, the amount for unpaid professional liability claims has been recorded in the consolidated balance sheet based on the gross estimated liability and is not reported net of anticipated insurance recoveries, which are separately reported in the statement of financial position. FASB ASU 2010-24 does not require retroactive application and accordingly, the estimated liability for unpaid professional liability claims are recorded net of anticipated insurance recoveries at December 31, 2010. The adoptions of FASB ASU 2010-23 and 2010-24 had no impact to the amounts reported in the consolidated statements of changes in activities and cash flows.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents – The Hospital includes all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. The Hospital is not 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 the Hospital has with these payors. The contractual allowance percentages are updated several times per year by payor class and line of business. 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 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, the Hospital 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 the year ended December 31, 2011 and the sixteen month period ended December 31, 2010, the Hospital wrote off approximately $5.1 and $7.7 million, respectively, in patient accounts receivable based on these procedures.

Inventories – Inventories are stated at lower of cost or market (the 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. 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.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

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:

	December 31, 2011	December 31, 2010
Held by trustee under indenture agreement related to Series 2007 Revenue Bonds - cash equivalents	$ 953,851	$ 956,398
Irrevocable trust - 457(b) plan		
Cash and cash equivalents	14,269	14,164
U.S. equity securities	140,520	145,822
U.S. corporate bonds	1,004	2,043
Mutual funds	21,566	18,442
U.S. government securities	30,813	27,701
Total of irrevocable trust - 457(b) plan	208,172	208,172
	$ 1,162,023	$ 1,164,570

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.

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

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

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.

Bond Issuance Costs – Deferred bond issuance costs are amortized using the straight-line method over the term of the related debt. Amortization of deferred bond issuance costs is included in the accompanying consolidated statements of activities. Total bond issuance costs were $580,956 and $619,048 at December 2011 and 2010, respectively.

Charity Care – The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Hospital does not pursue collection of amounts determined to qualify as charity care; therefore, they are deducted from gross revenue.

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 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 at December 31, 2011 and 2010. The Hospital and the Foundation 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 Hospital and the Foundation are no longer subject to income tax examinations by taxing authorities for years before fiscal year 2008 for its federal and state filings.

Advertising Costs – Advertising costs are expensed as incurred. Advertising expense totaled $106,192 and $169,195 for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010, respectively.

Reclassifications – Certain reclassifications have been made to the 2010 financial information to conform to the 2011 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. Note 17 provides disclosure of certain subsequent events that did not result in recognition in the financial statements.

The Hospital has evaluated subsequent events through July 18, 2012 which is the date the consolidated financial statements were available to be issued.

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. 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!"

Note 2 – Net Patient Service Revenue (continued)

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.

Revenue from the Medicare and Medicaid programs accounted for approximately 33% and 29%, respectively, of the Hospital's patient revenue for the years ended December 31, 2011 and 2010.

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

	December 31, 2011	December 31, 2010	Current Status
Medicare			
2010	$ 836,051	$ 617,183	Tentative settlement
2011	-	-	Tentative settlement
	836,051	617,183	
Medicaid			
2007	-	(147,164)	Settled
2008	(1,205,357)	(2,066,327)	Settled
2009	(1,710,335)	(2,362,307)	Settled
2010	(1,938,328)	(1,938,328)	Tentative settlement
2011	(240,000)	-	Tentative settlement
	(5,094,020)	(6,514,126)	
Total	$ (4,257,969)	$ (5,896,943)	

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.

Note 2 – Net Patient Service Revenue (continued)

Settlements of prior-year cost reports and changes in estimates resulted in increases to net patient service revenue of approximately $27,398 and $732,509 for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010, 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.

The following summary details the components of net patient service revenue for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010:

	2011	2010
Gross charges - inpatient	$ 43,084,713	$ 56,998,577
Gross charges - outpatient	76,929,820	99,476,953
Third party contractual allowances	(61,720,193)	(76,175,839)
Charity care	(3,904,469)	(4,013,896)
Net patient service revenue from continuing operations	$ 54,389,871	$ 76,285,795

Note 3 – Investment Income

Investment income from cash, cash equivalents, and investments consists of the following for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010:

	December 31, 2011	16 Months Ended December 31, 2010
Interest and dividends	$ 6,266	$ 21,707
Net unrealized gains (losses)	378,889	669,389
	$ 385,155	$ 691,096

Note 4 – Fair Value Measurements

Fair value measurements used by the Hospital 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:

Basis of Fair Value Measurement –

Level 1	Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan 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. The Hospital has no Level 3 fair value measurements. In addition, the Hospital had no transfers between levels during the years ended December 31, 2011 and 2010.

The investment in the risk retention group, as described in Note 14, 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, 2011 and 2010.

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.

Note 4 – Fair Value Measurements (continued)

The following table provides information as of December 31, 2011, about the Hospital's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at December 31, 2011	Level 1	Level 2
Assets included in:			
Assets limited as to use			
U.S. equity securities - various sectors	$ 140,520	$ 140,520	$ -
U.S. Treasury Notes	28,124	-	28,124
Mutual funds	21,566	21,566	-
FNMA mortgage backed securities	2,689	-	2,689
U.S. corporate bonds	1,004	-	1,004
Total	$ 193,903	$ 162,086	$ 31,817

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. Treasury Notes	21,268	-	21,268
Mutual funds	18,442	18,442	-
FNMA mortgage backed securities	6,433	-	6,433
U.S. corporate bonds	2,043	-	2,043
Total	$ 194,008	$ 164,264	$ 29,744

Note 5 – Property, Plant and Equipment

A summary of property, plant and equipment at December 31, 2011 and 2010 follows:

	December 31, 2011	December 31, 2010
Equipment	$ 28,846,423	$ 27,365,690
Buildings and improvements	28,824,212	27,692,668
Land improvements	1,804,422	1,548,641
	59,475,057	56,606,999
Accumulated depreciation and amortization	(43,722,378)	(41,412,574)
	15,752,679	15,194,425
Land	734,969	734,969
Construction in progress	143,441	70,556
	$ 16,631,089	$ 15,999,950

Note 6 – Long-Term Debt

Long-term debt consists of the following:

	December 31, 2011	December 31, 2010
Series 2007A bonds	$ 6,580,000	$ 6,870,000
Capital lease obligations	436,955	723,175
	7,016,955	7,593,175
Less current portion	(486,337)	(578,807)
Long-term debt, excluding current portion	$ 6,530,618	$ 7,014,368

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 the amounts held by the trustee under the Indenture agreement related to the 2007A bonds.

Note 6 – Long-Term Debt (continued)

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. The Hospital is in technical default of the debt service coverage ratio covenant as of December 31, 2011. However, management has classified the debt in accordance with the amortization schedule between current and long-term debt in the accompanying consolidated statements of financial position at December 31, 2011, as the Hospital cured its default of the debt service coverage ratio within the specified grade period (as of March 31, 2012). At December 31, 2010, 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 $1,189,862 and $2,285,792 at December 31, 2011 and 2010, respectively. Accumulated amortization on the leased equipment at December 31, 2011 and 2010 was $492,548 and $103,054, 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 2014; and accrue interest at rates ranging from 3.6% to 10.7%, and are secured by the underlying equipment.

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

	Bonds Payable	Capital Leases
Year ending December 31,		
2012	$ 300,000	$ 201,286
2013	320,000	142,485
2014	335,000	118,738
2015	350,000	-
2016	370,000	-
Thereafter	4,905,000	-
	$ 6,580,000	462,509
Less amounts representing interest payments		(25,554)
		$ 436,955

Note 7 – Operating Leases

In September 1995, the Hospital renewed its facility lease agreement with McKinley County, New Mexico for 25 additional years. The annual rent paid to the County for the use of the Hospital facility was $1 per year. 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. The building lease with McKinley County began in July of 2010 and requires monthly payments of $125,000 through August 31, 2028.

The Hospital has noncancelable operating leases consisting of the lease of the hospital building and various equipment. As of December 31, 2011 and 2010, the Hospital had unpaid rent and leases of $336,271 and $0 included in accounts payable in the accompanying consolidated statements of financial positions. Total rental expense under operating leases was approximately $2,458,092 and $1,724,577 for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010, respectively.

The future minimum lease payments under the leases at December 31, 2011 are as follows:

	Operating Leases
Year ending December 31,	
2012	$ 2,007,951
2013	1,999,701
2014	1,803,503
2015	1,637,898
2016	1,500,000
Thereafter	17,500,000
Total minimum lease payments	$ 26,449,053

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, 2011 and 2010, accrued employer contributions of $570,240 and $615,179, was included in accrued salaries and benefits in the accompanying consolidated statements of financial positions.

Note 8 – Employee Benefits (continued)

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 amount funded to the trust as of December 31, 2011 and 2010 was $208,172. The funded amount is included in assets limited as to use in the consolidated statements of financial position – see Note 1. The related liabilities of $208,172 as of December 31, 2011 and 2010 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, 2011 and 2010 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 year ended December 31, 2011 and the sixteen month period ended December 31, 2010 totaled $7.0 million and $10.4 million, respectively. Approximately $2.9 million and $2.2 million as of December 31, 2011 and 2010, respectively, are 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 $1,612,368 and $1,875,456 for the years ended December 31, 2011 and 2010, respectively. The current mill levy expires in July 2012.

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

Note 12 – Charity Care

The Hospital provides charity care to patients who are financially unable to pay for health care services they receive. The Hospital's policy is not to pursue collection of amounts determined to qualify as charity care. The Hospital 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. The following information measures the level of charity care provided during the years ended:

	December 31, 2011	16 Months Ended December 31, 2010
Charges foregone, based on established rates	$ 3,904,469	$ 4,013,896
Estimated costs and expenses incurred to provide charity care	1,765,308	1,639,833
Equivalent percentage of charity care charges forgone to total gross revenue	3.3%	2.6%

Note 13 – Concentrations of 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.

The mix of gross accounts receivable from patients and third-party payors was as follows at December 31, 2011 and 2010:

	December 31,	
	2011	2010
Medicare	28%	32%
Medicaid	23%	19%
Other third-party payors	37%	35%
Self pay	12%	14%
	100%	100%

Note 13 – Concentrations of Risk (continued)

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 14 – 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.

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, 2011 and 2010, the Hospital cannot estimate the additional premiums, 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.

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 – 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.

Note 14 – Commitments and Contingencies (continued)

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, 2011 and 2010, the Hospital 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.

Note 15 – 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 year ended December 31, 2011 and the sixteen month period ended December 31, 2010:

	December 31, 2011	16 Months Ended December 31, 2010
Health care services	$ 45,023,481	$ 51,915,979
Management general	26,229,467	35,655,272
Fundraising	152,032	246,926
Total expenses	$ 71,404,980	$ 87,818,177

Note 16 – RMCHCS Foundation Summarized Financial Statements

Summarized financial statements for RMCHCS Foundation as of December 31, 2011 and 2010, and for the year ended December 31, 2011 and the sixteen month period ended December 31, 2010 are as follows:

	December 31,	
	2011	2010
Assets		
Current assets	$ 556,966	$ 715,577
Other assets	437	1,800
Total assets	$ 557,403	$ 717,377
Liabilities and net assets		
Current liabilities	$ 261,003	$ 255,574
Net assets (deficit)		
Unrestricted	(148,952)	(120,217)
Temporarily restricted	348,764	485,432
Permanently restricted	96,588	96,588
Total net assets	296,400	461,803
Total liabilities and net assets	$ 557,403	$ 717,377

Note 16 – RMCHCS Foundation Summarized Financial Statements (continued)

	December 31, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Other revenue	$ 33,303	$ 341,530	$ -	$ 374,833
Net assets released from restrictions	-	(478,198)	-	(478,198)
Total operating revenue	33,303	(136,668)	-	(103,365)
Total operating expenses	62,038		-	62,038
Total operating loss	(28,735)	(136,668)	-	(165,403)
Net assets (deficit), beginning of period	(120,217)	485,432	96,588	461,803
Net assets (deficit), end of period	$ (148,952)	$ 348,764	$ 96,588	$ 296,400

	16 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	(177,138)	(9,116)	(132,741)
Total operating revenue	95,091	300,950	(9,116)	386,925
Total operating expenses	118,169	-	-	118,169
Total operating income (loss)	(23,078)	300,950	(9,116)	268,756
Net assets (deficit), beginning of period	(97,139)	184,482	105,704	193,047
Net assets (deficit), end of period	$ (120,217)	$ 485,432	$ 96,588	$ 461,803

Note 17 – Subsequent Event

On June 25, 2012, Fitch Ratings downgraded the rating on the Series 2007A New Mexico Hospital Equipment Loan Council Hospital Facility Refunding and Improvement Bonds from BB- to B. Management believes the downgrade has no impact on the financial statements as of December 31, 2011 and 2010.

SUPPLEMENTARY INFORMATION

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC. AND SUBSIDIARY
SCHEDULE OF PLEDGED COLLATERAL
DECEMBER 31, 2011

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	$ 145,129	$ 145,129	$ -	$ -	$ -
Bank of Colorado - Pinnacle Bank	560,776	560,776	-	-	-
Washington Federal	1,212	1,212	-	-	-
Total	$ 707,117	$ 707,117	$ -	$ -	$ -

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	$ 797,975	$ -	N/A	$ 782,667	$ 782,667

Pledged Collateral

Type of Security	Custodian	CUSIP Number	Sequence Number	Maturity Date	Fair Value
FEDL HOME LN MTG CRPPOOL	Wells Fargo	3128UG5S2	123,011	9/1/2041	$ 782,667

*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.

**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, 2011 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. AND SUBSIDIARY
SCHEDULE OF DEPOSITS AND INVESTMENTS
DECEMBER 31, 2011

Account Title	Account Type	Bank Balance	Reconciling Items	Book Balance
Cash and cash equivalents				
Wells Fargo Bank				
Operational	Checking	$ 111,218	$ (37,276)	$ 73,942
Operational	Accounts payable zero balance account	-	(485,546)	(485,546)
Operational	Payroll zero balance account	-	(74,073)	(74,073)
Operational	Pension account	33,911	-	33,911
Washington Federal				
Foundation Operational	Checking	1,212	(632)	580
Bank of Colorado - Pinnacle Bank				
Foundation Restricted Checking	Checking	24,882	-	24,882
Foundation Restricted	Money market account	482,684	-	482,684
Foundation Unrestricted Checking	Checking	14,882	-	14,882
Foundation Unrestricted	Money market account	15,592	-	15,592
Auxiliary - Gift Shop	Checking	12,911	-	12,911
Auxiliary - General Account	Checking	5,177	(455)	4,722
Auxiliary - Thrift Shop	Checking	4,648	-	4,648
Total deposits		707,117	(597,982)	109,135
Wells Fargo Bank				
Repurchase agreement	Sweep	797,975	-	797,975
Other				
Petty cash	Cash	-	4,570	4,570
Flex comprehensive cash	Cash	-	(411)	(411)
Total cash and cash equivalents		$ 1,505,092	$ (593,823)	$ 911,269
Cash and investments - restricted				
Wells Fargo Bank				
Project Fund	Cash equivalent			
Improvement Fund	Cash equivalent	$ 41,088	$ (917)	$ 40,171
Series 2007 Bond Principal Fund	Cash equivalent	213,770	54,594	268,364
Series 2007 Bond Reserve Fund	Cash equivalent	645,316	-	645,316
Zia Trust				
Irrevocable trust - 457(b) plan	Cash equivalent	14,269	-	14,269
Irrevocable trust - 457(b) plan	Equity securities	140,520	-	140,520
Irrevocable trust - 457(b) plan	Fixed income securities	53,383	-	53,383
Total bond funds and other investments		$ 1,108,346	$ 53,677	$ 1,162,023

OTHER INFORMATION

MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

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 Subsidiary
and
Mr. Hector H. Balderas, New Mexico State Auditor

We have audited the consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (the "Hospital") as of and for the year ended December 31, 2011, and have issued our report thereon dated July 18, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the 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 Subsidiary
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.

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 consolidated 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 Section 12-6-5, NMSA 1978, which are described in the accompanying schedule of findings and responses as findings 10-01 through 10-04 and 11-01 through 11-03.

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
July 18, 2012

11-01 – Information Technology

Condition
During our testing over Information Technology (IT) we noted the following:

- User accounts are not locked after a number of failed attempts.
- Passwords expire after 180 days.
- The Hospital does not have an IT disaster recovery plan in place in the event of a disaster.

Criteria
A properly designed system of internal controls requires proper system access and security. Given the sensitive nature of information and the stringent healthcare regulation concerning the continued safekeeping of such information, effective security controls are an integral part of good internal controls.

In the event of system failure and need for data restoral, a disaster recovery plan should be in place to ensure that patient data and financial information can be restored completely and accurately in the event of destruction of not only program and data files but also processing capacities.

Cause
IT Policies and procedures do not require system access and security consistent with the best practices of the healthcare industry and general access controls.

Effect
Insufficient controls over system access and security could result in the loss of sensitive information.

In the event of a disaster, having no disaster recovery plan could result data loss or delay in recreation of important patient and financial data.

Recommendation
We recommend management perform an analysis of policies regarding system access and security in accordance with current best practices.

We recommend that the Hospital implement a disaster recovery plan.

Management Response

As a result of these findings, RMCHCS has implemented the following:
- User accounts are locked after five failed attempts.
- Passwords expire after 90 days.
- The disaster recovery plan is now in place.

Finding 11-02: Timely Verification of Patient Insurance

Condition
While performing internal control test work over the revenue cycle, there were two out of eighteen patients whose insurance was not verified prior to services being provided.

Criteria
Good and sound accounting process should include timely verification of patient insurance prior to or within a reasonable time of services being provided.

Effect
Insufficient controls over patient insurance verification could result in a delay in payment receipts or incorrect insurance information being billed.

Cause
Policies and procedures were not adhered to.

Recommendation
We recommend management adhere to the policies and procedures in place for verifying insurance prior to services being provided.

Management Response
Policy requires all scheduled appointments to be pre-verified. In addition, the patients are contacted with their benefits information prior to services being performed. Management will ensure that all verification policies will be followed in the future.

11-03: Late Audit Report

Condition
The audit report as of and for the year ended December 31, 2011 was not submitted to the State Auditor's office by the deadline of May 31, 2012.

Criteria
2.2.2 NMAC, Audit Rule 2011, specifies the deadline for submission of audit reports. Section 2.2.2.9 A stipulates that the Hospital's report is due no later than May 31. Further, Section 2.2.2.9 A requires that submission of a late audit report be reported as a current year audit finding in the audit report.

Cause
The Hospital had to obtain a waiver from Wells Fargo, Bond Trustee, as a result of not meeting their debt covenants. Although the waiver process was initiated shortly after year end, it was not completed until June 2012.

Effect
The Medical Center is not in compliance with Section 2.2.2.9 A of the NMAC, Audit Rule 2011.

Recommendation
We recommend the Hospital implement processes to enable the audited financial statements to be submitted to the State Auditor's Office by May 31 of each year.

Management Response
Management will ensure that appropriate resources are in place to meet the audit deadline in the future.

Finding 10-01: Physical Inventory and Reconciliation of Fixed Assets (Repeat and Modified)

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.
- There was an asset that was being capitalized in an amount before any discounts. This resulted in an overstatement of $5,930 in capitalized costs.

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.

Management Response
Management will ensure that fixed assets are inventoried on a routine basis.

The fixed asset roll forward was reviewed and reconciled with the trial balance for two fiscal years, 2010 and 2011 prior to field work. Trial balance adjustments were made in March 2012.

Assets are being entered into FA system and reconciled to the roll forward schedule on a monthly basis.

Finding 10-02: Verification that Payments Received are in Accordance with Terms of Insurance Contracts (Repeat and Modified)

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 accordance 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
There is currently no regular process in place to ascertain if third party payments have been made in accordance with terms. Some contracts have been reviewed when specifically requested. The result of these reviews has been satisfactory.

Finding 10-03: Reconciliation of Cash and Net Asset Accounts (Repeat and Modified)

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. The outstanding receipts went as far back as 2008 for patient refunds.

- We noted an account with a credit balance of $163,764. Per inquiry, the credit balance was a direct cause of unidentified patient accounts for which the Hospital received payment for but could not apply payment directly to the patient account. A reconciling entry was necessary to properly classify the noted credit.

- 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
It was unknown if the Hospital had rights to the receipt or whether it needed to be returned. It was unknown as to what account the receipt needed to be posted to. 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 and net assets and implement needed improvements. Further, such completed reconciliations should be subject to appropriate management review.

Management Response
The reconciliation process is in place, but has been limited due to staffing changes. Staffing issues are being addressed and reconciliations are being review by management.

Finding 10-04: Review and Analysis of Professional Liability Claims (Repeat and Modified)

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. An entity that is indemnified for these liabilities shall recognize an insurance receivable at the same time that it recognizes the liability measure on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts.

Effect
The consolidated 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.

Management Response
Professional liability claims are evaluated to determine the likelihood of future liability. Management will implement steps to identify and quantify probable claims liability in the future.

REHOBOTH MCKINLEY CHRISTIAN HEALTH CARE SERVICES, INC.
CURRENT STATUS OF PRIOR YEAR FINDINGS
DECEMBER 31, 2011

Prior Year Number	Description	Current Status
10-01	Physical Inventory and Reconciliation of Fixed Assets	Repeated and Updated
10-02	Verification that Payments Received are in Accordance with Terms of Insurance Contracts	Repeated and Updated
10-03	Reconciliation of Cash and Net Assets	Repeated and Updated
10-04	Review and Analysis of Professional Liability Claims	Repeated and Updated
10-05	Review of Journal Entries	Cleared

A closed meeting exit conference was held on June 26, 2012, with the following attending:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary:

Board Members
David Bischoff
Jennifer Dowling
Eric Begay
Erwin Elber, MD
Tony Gonzales, C.P.A.
Yogash Kumar
John Mezoff, MD

Staff
Roger Gleisner, Acting CEO
Steven Groenewold, Acting CFO
Bart Hansen, Controller
Mary Poel, MD, CMO
Mary Lou Donkersloot, Recorder

Moss Adams LLP:
Brandon Fryar, Partner
Purvi Mody, Senior Manager

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.