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# **Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary**

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*Consolidated Financial Statements with Supplementary Information  
and  
Independent Auditor's Report  
December 31, 2014 and 2013*



CPAs | Business & Financial Advisors

# **Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary**

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**Rehoboth McKinley Christian  
Health Care Services, Inc. and Subsidiary  
Board of Trustees and Principal Employees  
December 31, 2014**

**Rehoboth McKinley Christian  
Health Care Services, Inc.**

**Board of Trustees**

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David Bischoff, Treasurer  
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**Principal Employees**

David Conejo, CEO  
Dr. Philip Kamps, CMO  
William Kiefer, COO

**Rehoboth McKinley Christian  
Health Care Services Foundation**

**Board of Trustees**

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**Principal Employees**

Ina Burmeister, Executive Director  
David Conejo, CEO

## Independent Auditor's Report

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

### **Report on Financial Statements**

We have audited the accompanying consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (RMCHCS), a New Mexico not-for-profit corporation, which comprise the consolidated statements of financial position as of December 31, 2014 and 2013, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk

assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RMCHCS as of December 31, 2014 and 2013, and the change in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis-of-Matter***

#### ***Going Concern***

The accompanying consolidated financial statements have been prepared assuming that RMCHCS will continue as a going concern. RMCHCS has suffered recurring significant reductions in the Safety Net Care Pool revenues, decreasing Hospital census, and a decrease in net assets for the last several years that raise substantial doubt about its ability to continue as a going concern. Additionally, as discussed in Note 6, RMCHCS is out of compliance with its debt covenant requirements, which represents an event of default in its bond indenture. Management's plans regarding those matters are described in Note 19. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

### ***Other Matters***

#### ***Other Information***

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

### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated May 11, 2015, on our consideration of RMCHCS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering RMCHCS's internal control over financial reporting and compliance.

REDWllc

Albuquerque, New Mexico  
May 11, 2015

## Consolidated Financial Statements

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Consolidated Statements of Financial Position  
December 31,

	2014	2013 (as restated)
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 2,048,356	\$ 2,547,135
Patient accounts receivable, net of allowance for doubtful accounts of \$5,357,646 in 2014 and \$5,488,968 in 2013	5,787,517	5,404,711
Estimated third party payor settlement	-	100,000
Safety Net Care Pool receivable	-	1,194,627
Other receivables	928,577	1,041,842
Inventories	1,297,686	1,393,701
Prepaid expenses and deposits	383,438	313,205
Total current assets	10,445,574	11,995,221
Property, plant and equipment, net	12,342,353	13,445,913
Assets limited as to use		
Assets held by trustee	932,812	977,897
Assets held for 457(b) plan	381,355	332,441
Investment in risk retention group	2,684,819	2,570,086
Bond issuance costs, net	466,667	504,763
Total assets	\$ 27,253,580	\$ 29,826,321
<b>Liabilities and Net Assets</b>		
Current liabilities		
Accounts payable	\$ 6,199,071	\$ 3,678,226
Accrued salaries and related liabilities	2,557,597	2,901,752
Other accrued liabilities	1,358,592	2,189,590
Estimated third-party payor settlements	1,003,083	1,254,286
Current portion of long-term debt	7,691,267	1,552,616
Total current liabilities	18,809,610	11,576,470
Long-term debt, less current portion	202,865	6,568,519
Total liabilities	19,012,475	18,144,989
Net assets		
Unrestricted	7,972,720	11,391,653
Temporarily restricted	268,385	289,679
Total net assets	8,241,105	11,681,332
Total liabilities and net assets	\$ 27,253,580	\$ 29,826,321

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



**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Consolidated Statements of Activities  
For the Year Ended December 31, 2014

	Unrestricted	Temporarily Restricted	Total
<b>Operating Revenue</b>			
Net patient service revenue	\$ 43,495,368	\$ -	\$ 43,495,368
Provision for uncollectible accounts	<u>4,071,117</u>	<u>-</u>	<u>4,071,117</u>
Net patient service revenue less provision for uncollectible accounts	39,424,251	-	39,424,251
Safety Net Care Pool revenue	5,607,294	-	5,607,294
Other operating revenue	2,882,266	261,638	3,143,904
Net assets released from restrictions	<u>282,932</u>	<u>(282,932)</u>	<u>-</u>
Total operating revenue	<u>48,196,743</u>	<u>(21,294)</u>	<u>48,175,449</u>
<b>Operating Expenses</b>			
Salaries, benefits, contract labor, and payroll taxes	28,209,022	-	28,209,022
Professional fees	4,740,036	-	4,740,036
Supplies and other	4,575,982	-	4,575,982
Purchased services	2,989,431	-	2,989,431
Rentals and leases	2,292,093	-	2,292,093
Depreciation and amortization	2,152,050	-	2,152,050
Other operating expenses	1,553,634	-	1,553,634
Insurance	1,498,624	-	1,498,624
Utilities	1,304,323	-	1,304,323
Repairs and maintenance	1,236,900	-	1,236,900
Licenses, permits, and fees	<u>652,166</u>	<u>-</u>	<u>652,166</u>
Total operating expenses	<u>51,204,261</u>	<u>-</u>	<u>51,204,261</u>
Operating loss	<u>(3,007,518)</u>	<u>(21,294)</u>	<u>(3,028,812)</u>
Nonoperating income (expense)			
Investment income	131,940	-	131,940
Gain on sale of property, plant and equipment	4,338	-	4,338
Interest expense	<u>(547,693)</u>	<u>-</u>	<u>(547,693)</u>
Total nonoperating expense, net	<u>(411,415)</u>	<u>-</u>	<u>(411,415)</u>
Change in net assets/revenues and gains under expenses and losses	(3,418,933)	(21,294)	(3,440,227)
Net assets, beginning of year (as restated, Note 17)	<u>11,391,653</u>	<u>289,679</u>	<u>11,681,332</u>
Net assets, end of year	<u>\$ 7,972,720</u>	<u>\$ 268,385</u>	<u>\$ 8,241,105</u>

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

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Consolidated Statements of Activities  
For the Year Ended December 31, 2013 (as restated)

	Unrestricted	Temporarily Restricted	Total
<b>Operating Revenue</b>			
Net patient service revenue	\$ 49,156,384	\$ -	\$ 49,156,384
Provision for uncollectible accounts	<u>6,783,620</u>	<u>-</u>	<u>6,783,620</u>
Net patient service revenue less provision for uncollectible accounts	42,372,764	-	42,372,764
Sole community provider revenue	6,042,497	-	6,042,497
Other operating revenue	3,683,063	94,015	3,777,078
Net assets released from restrictions	<u>267,449</u>	<u>(267,449)</u>	<u>-</u>
Total operating revenue	<u>52,365,773</u>	<u>(173,434)</u>	<u>52,192,339</u>
<b>Operating Expenses</b>			
Salaries, benefits, contract labor, and payroll taxes	29,918,108	-	29,918,108
Professional fees	3,441,814	-	3,441,814
Supplies and other	5,101,636	-	5,101,636
Purchased services	3,293,049	-	3,293,049
Rentals and leases	2,355,548	-	2,355,548
Depreciation and amortization	2,222,420	-	2,222,420
Other operating expenses	1,461,965	-	1,461,965
Insurance	1,102,098	-	1,102,098
Utilities	1,387,045	-	1,387,045
Repairs and maintenance	1,003,938	-	1,003,938
Licenses, permits, and fees	<u>774,718</u>	<u>-</u>	<u>774,718</u>
Total operating expenses	<u>52,062,339</u>	<u>-</u>	<u>52,062,339</u>
Operating income (loss)	<u>303,434</u>	<u>(173,434)</u>	<u>130,000</u>
Nonoperating income (expense)			
Investment income	85,338	-	85,338
Gain on sale of dialysis operation	6,356	-	6,356
Interest expense	<u>(517,242)</u>	<u>-</u>	<u>(517,242)</u>
Total nonoperating expense, net	<u>(425,548)</u>	<u>-</u>	<u>(425,548)</u>
Change in net assets/revenues and gains under expenses and losses, as restated	(122,114)	(173,434)	(295,548)
Net assets, beginning of year (as restated, Note 17)	<u>11,513,767</u>	<u>463,113</u>	<u>11,976,880</u>
<b>Net assets, end of year</b>	<u>\$ 11,391,653</u>	<u>\$ 289,679</u>	<u>\$ 11,681,332</u>

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

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Consolidated Statements of Cash Flows  
December 31,

	<u>2014</u>	<u>2013</u> (as restated)
<b>Cash flows from operating activities</b>		
Cash received from patients and third-party payors	\$ 34,819,125	\$ 35,910,844
Cash received from safety net care pool and other operating receipts	10,059,090	9,422,212
Cash paid to employees and suppliers	(43,613,449)	(44,726,480)
Interest and dividends received	17,207	3,476
Interest paid	<u>(547,693)</u>	<u>(517,242)</u>
Net cash provided by operating activities	<u>734,280</u>	<u>92,810</u>
<b>Cash flows from investing activities</b>		
Purchase of property, plant and equipment	(776,395)	(735,462)
Proceeds from sale of equipment	<u>4,338</u>	<u>10,004</u>
Net cash used in investing activities	<u>(772,057)</u>	<u>(725,458)</u>
<b>Cash flows from financing activities</b>		
Proceeds from long-term debt	1,605,282	2,500,000
Payments on long-term debt	<u>(2,066,284)</u>	<u>(1,025,728)</u>
Net cash provided by (used in) financing activities	<u>(461,002)</u>	<u>1,474,272</u>
Net increase (decrease) in cash and cash equivalents	(498,779)	841,624
Cash and cash equivalents, beginning of year	<u>2,547,135</u>	<u>1,705,511</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 2,048,356</u>	<u>\$ 2,547,135</u>

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

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Consolidated Statements of Cash Flows — continued  
December 31,

<b>Reconciliation of change in net assets to net cash provided by operating activities</b>	<b>2014</b>	2013 (as restated)
Change in net assets	\$ (3,440,227)	\$ (295,548)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	2,152,050	2,222,420
Provision for uncollectible accounts	4,071,117	6,783,620
Gain on disposal of assets	(4,338)	(6,356)
Unrealized gains on investments	(114,733)	(81,862)
Net changes in operating assets and liabilities		
Patient accounts receivable	(4,453,923)	(5,612,532)
Safety net care pool receivable	1,194,627	(23,512)
Other receivables	113,265	(373,851)
Inventories	96,015	(33,441)
Prepaid expenses and deposits	(70,233)	22,628
Accounts payable	2,520,845	(1,529,267)
Accrued salaries and related liabilities	(344,155)	(1,012,470)
Other accrued liabilities	(834,827)	964,231
Estimated third-party payor settlements	(151,203)	(931,250)
Net cash provided by operating activities	<u>\$ 734,280</u>	<u>\$ 92,810</u>
 <b>Supplemental schedule of noncash investing and financing activities</b>		
Equipment acquired through capital lease	<u>\$ 233,999</u>	<u>\$ 127,208</u>
Increase in 457(b) investments recorded to other accrued liabilities	<u>\$ 3,829</u>	<u>\$ 91,733</u>

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

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Notes to Consolidated Financial Statements  
December 31, 2014 and 2013

**1) Organization and Summary of Significant Accounting Policies**

Organization

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

These financial statements include RMCHCS as well as Rehoboth McKinley Christian Health Care Services Foundation (“RMCHCS Foundation” or the “Foundation”), a not-for-profit subsidiary (see Note 18). RMCHCS is the sole stated beneficiary of the Foundation, and the Foundation is authorized by RMCHCS to solicit contributions on its behalf. The financial statements have been consolidated given that RMCHCS meets the criteria of having an economic interest in the Foundation. Intercompany balances and transactions have been eliminated in consolidation.

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

Basis of Presentation

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

Use of Estimates

Financial statement preparation in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the financial statement date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates contained in RMCHCS’s financial statements include the allowance for doubtful accounts, contractual allowances, estimated third-party payor settlements, depreciation and amortization, Recovery Audit Contractor (RAC) audit liability, health insurance incurred but not reported claims, Safety Net Care Pool receivables, and legal liability claims.

**Rehoboth McKinley Christian Health  
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Notes to Consolidated Financial Statements  
December 31, 2014 and 2013

Cash and Cash Equivalents

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

Accounts Receivable Allowances

Contractual allowances represent the amounts which reduce patient accounts receivable to amounts that are considered to be due from third-party payors based on existing contracts RMCHCS has with these payors. The contractual allowance percentages are updated periodically by payor class and line of business. 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. RMCHCS 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, RMCHCS evaluates patient accounts receivable balances older than six months to determine collectability. Accounts are considered uncollectible when there has been no recent payment activity and no other indication that payment will be received. Those balances that are considered uncollectible are written off upon approval from the Director of Patient Financial Services, Chief Financial Officer and Chief Executive Officer depending on the balance of the account. During 2014 and 2013, RMCHCS wrote off approximately \$4.1 million and \$6.8 million, respectively, to the provision for uncollectible accounts. RMCHCS's allowance for doubtful accounts was approximately 48% and 50% of accounts receivable at December 31, 2014 and 2013, respectively. RMCHCS did not change its charity care or uninsured discount policies during fiscal years 2013 or 2014.

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.

**Rehoboth McKinley Christian Health  
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Notes to Consolidated Financial Statements  
December 31, 2014 and 2013

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 repairs and maintenance are expensed as incurred.

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

Assets Limited as To Use

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

	<u>2014</u>	<u>2013</u>
Held by trustee under indenture agreement related to Series 2007 Revenue Bond - cash equivalents	<u>\$ 932,812</u>	<u>\$ 977,897</u>
Irrevocable trust – 457(b) plan		
Cash and cash equivalents	17,395	10,847
U.S. equity securities	263,714	233,858
Mutual funds	37,067	54,561
U.S. government securities	<u>63,179</u>	<u>33,175</u>
Total of irrevocable trust – 457(b) plan	<u>381,355</u>	<u>332,441</u>
	<u>\$ 1,314,167</u>	<u>\$ 1,310,338</u>

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

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Notes to Consolidated Financial Statements  
December 31, 2014 and 2013

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 RMCHCS and changes therein are classified and reported as follows:

- *Unrestricted*—Unrestricted net assets represent those resources that are not restricted by donors, or for which donor-imposed restrictions have expired.
- *Temporarily Restricted*—Temporarily restricted net assets reflect donor-imposed restrictions that require RMCHCS to use or expend the related assets as specified. The restrictions are satisfied either by the passage of time or by the satisfaction of donor specified use. RMCHCS records contributions as temporarily restricted if they are received with donor stipulations that limit their use through either purpose or time restrictions. When donor restrictions expire, that is, when a time restriction ends or a purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets. Temporarily restricted contributions received and expended in the same accounting period are recorded in the unrestricted net asset category.
- *Permanently Restricted*—Permanently restricted net assets reflect donor-imposed restrictions which stipulate that the related resources be maintained in perpetuity, but which permit RMCHCS to expend part or all of the income and capital appreciation derived from the donated assets for either specified or unspecified purposes. RMCHCS had no permanently restricted net assets at December 31, 2014 and 2013.

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 of \$38,096 is included in the accompanying consolidated statements of activities for 2014 and 2013. Total bond issuance costs were \$761,905 and the accumulated amortized costs were \$295,238 and \$257,142 at December 31, 2014 and 2013, respectively, resulting in a balance of \$466,667 and \$504,763 at December 31, 2014 and 2013, respectively, which is included in the accompanying consolidated statements of financial position.

New Mexico Electronic Health Record Incentive Program Revenue

In 2011, RMCHCS joined the New Mexico Electronic Health Record (EHR) Incentive Program whose purpose is to encourage eligible Medicaid providers to adopt and meaningfully use certified EHR technology by offering payments to offset some of the costs incurred by the providers. RMCHCS accounts for EHR incentive payments in accordance with FASB ASC 450-30, *Gain Contingencies*. In accordance with FASB



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ASC 450-30, RMCHCS recognizes EHR incentive payments when all contingencies relating to the incentive payment have been satisfied with no subsequent payment adjustment. Certain contingencies require the demonstration of meaningful use which is based on meeting a series of objectives. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services. The amounts recorded are subject to audit by the Centers for Medicare and Medicaid Services. RMCHCS recognized \$0 and \$830,603 related to EHR during 2014 and 2013, respectively. A hardship exemption letter was obtained from the Centers for Medicare and Medicaid Services that exempted RMCHCS from any fines or penalties for the lack of implementation in 2014.

Charity Care

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

Income Taxes

RMCHCS 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, RMCHCS and the Foundation have been classified as entities that are not private foundations within the meaning of Section 509 (a) and qualify for deductible contributions as provided by Section 170(b)(1)(A)(vi). Accordingly, no provision has been made for income taxes in the financial statements.

RMCHCS recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. RMCHCS had no unrecognized tax benefits at December 31, 2014 and 2013. RMCHCS and the Foundation file an exempt organization return and, if applicable, unrelated business income tax or other returns with the U.S. Internal Revenue Service, New Mexico Attorney General and New Mexico Department of Taxation and Revenue. RMCHCS and the Foundation are no longer subject to income tax examinations by taxing authorities for years before fiscal year 2012 for its federal and state filings.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense totaled \$84,715 and \$76,310 for the years ended December 31, 2014 and 2013, respectively.

**Rehoboth McKinley Christian Health  
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Notes to Consolidated Financial Statements  
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Reclassifications

Certain reclassifications have been made to the 2013 financial information to conform to the 2014 financial statement presentation. Such reclassifications had no effect on 2013 net assets or change in net assets.

Subsequent Events

Subsequent events through May 11, 2015, the date which the financial statements were made available to be issued, were evaluated for recognition and disclosure in the December 31, 2014, financial statements.

**2) Net Patient Service Revenue**

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

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

Medicare

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

Medicaid

Effective January 1, 2014, New Mexico Medicaid went to a new reimbursement system, Centennial Care, a managed care system. Throughout 2014, there were four managed care organizations (MCOs), Blue Cross Blue Shield of New Mexico (BCBS), Molina Health Care of New Mexico (Molina), Presbyterian Health Plan (Presbyterian) and United Healthcare (United), who are responsible for approving and processing payments.

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Each MCO negotiates a rate with RMCHCS and pays using a prospective payment system, often referred to as the PPS rate, similar to the traditional Medicaid program described below.

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

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

Revenue from the Medicare and Medicaid programs accounted for approximately 52% and 49%, respectively, of RMCHCS's net patient revenue for the years ended December 31, 2014 and 2013.

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

	Third-Party Payors	Self-Pay	Total All Payors
Year ended December 31, 2014	\$ 37,204,513	\$ 6,290,855	\$ 43,495,368
Year ended December 31, 2013	\$ 39,648,885	\$ 9,507,499	\$ 49,156,384

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Estimated third-party payor settlement receivables (liabilities) are as follows:

	December 31,		Current Status
	2014	2013	
Medicare			
2011	\$ (64,576)	\$ -	Tentative settlement
2012	-	-	Settled
2013	-	100,000	Settled
2014	-	-	In progress
	<u>(64,576)</u>	<u>100,000</u>	
Medicaid			
2009	(737,693)	(737,692)	Tentative settlement
2010	-	(300,000)	Settled
2011	(80,228)	(80,228)	Tentative settlement
2012	(120,586)	(136,366)	Tentative settlement
2013	-	-	Tentative settlement
2014	-	-	In progress
	<u>(938,507)</u>	<u>(1,254,286)</u>	
Total	<u>\$ (1,003,083)</u>	<u>\$ (1,154,286)</u>	

Management believes that these estimates are adequate. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimates are continually monitored and reviewed and as settlements are made or more information is available to improve estimates, changes are reflected in current operations.

Other Third-Party Payors

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

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

	<u>2014</u>	<u>2013</u>
Gross charges – inpatient	\$ 30,463,417	\$ 38,067,783
Gross charges – outpatient	72,556,897	72,706,718
Third party contractual allowances	<u>(59,524,946)</u>	<u>(61,618,117)</u>
Net patient service revenue	<u>\$ 43,495,368</u>	<u>\$ 49,156,384</u>

**3) Investment Income**

Investment income from cash, cash equivalents, and investments consists of the following for the years ended December 31:

	<u>2014</u>	<u>2013</u>
Interest and dividends	\$ 17,207	\$ 3,476
Net unrealized gains	<u>114,733</u>	<u>81,862</u>
	<u>\$ 131,940</u>	<u>\$ 85,338</u>

**4) Fair Value Measurements**

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

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

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

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

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. RMCHCS has no Level 3 fair value measurements. In addition, RMCHCS had no transfers between levels during the years ended December 31, 2014 and 2013.

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, 2014 and 2013.

- 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.

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The following table provides information as of December 31, 2014, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at December 31,		
	2014	Level 1	Level 2
Assets included in			
Assets limited as to use			
Cash and cash equivalents	\$ 950,207	\$ 950,207	\$ -
U.S. equity securities – various sectors	263,714	263,714	-
U.S. treasury notes	55,797	-	55,797
Mutual funds	36,067	36,067	-
FNMA mortgage backed securities	8,382	-	8,382
	<u>\$ 1,314,167</u>	<u>\$ 1,249,988</u>	<u>\$ 64,179</u>

The following table provides information as of December 31, 2013, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at December 31,		
	2013	Level 1	Level 2
Assets included in			
Assets limited as to use			
Cash and cash equivalents	\$ 988,880	\$ 988,880	\$ -
U.S. equity securities – various sectors	233,858	233,858	-
U.S. treasury notes	46,043	-	46,043
Mutual funds	33,175	33,175	-
FNMA mortgage backed securities	8,382	-	8,382
	<u>\$ 1,310,338</u>	<u>\$ 1,255,913</u>	<u>\$ 54,425</u>

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**5) Property, Plant and Equipment**

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

	<u>2014</u>	<u>2013</u>
Equipment	\$ 29,206,862	\$ 28,563,008
Buildings and improvements	29,143,920	28,774,344
Land improvements	<u>1,804,423</u>	<u>1,804,423</u>
	60,155,205	59,141,775
Accumulated depreciation and amortization	<u>(48,547,821)</u>	<u>(46,559,237)</u>
	11,607,384	12,582,538
Land	734,969	734,969
Construction in progress	<u>-</u>	<u>128,406</u>
	<u>\$ 12,342,353</u>	<u>\$ 13,445,913</u>

**6) Long-Term Debt**

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

	<u>2014</u>	<u>2013</u>
Series 2007A bonds	\$ 5,625,000	\$ 5,960,000
Note payable	1,912,332	1,875,000
Capital lease obligations	<u>356,800</u>	<u>286,135</u>
	7,894,132	8,121,135
Less current portion	<u>(7,691,267)</u>	<u>(1,552,616)</u>
	<u>\$ 202,865</u>	<u>\$ 6,568,519</u>

Series 2007A Bonds

In March 2007, RMCHCS issued the Series 2007A New Mexico Hospital Equipment Loan Council Hospital Facility Refunding and Improvement Bonds to refund the outstanding Series 1996 and Series 2000 bonds, to finance the costs of the acquisition of certain equipment, to fund a project fund, and to pay certain costs of issuance for the



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Series 2007A bonds. The Refunding and Improvement Bond Master Trust Indenture (the “Indenture”) requires RMCHCS to make monthly deposits with a trustee for payment on the bonds. See Note 1 for the amounts held by the trustee under the Indenture agreement related to the 2007A bonds.

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

Debt Covenants

RMCHCS is subject to certain bond covenant requirements specified in the Series 2007A bond agreements, including limits on the incurrence of additional debt and certain measures of financial performance. As of December 31, 2014, RMCHCS was not in compliance with the days cash on-hand requirement or the debt coverage service ratio, which represents an event of default under the Indenture. Due to these debt covenant violations, the total outstanding balance of the Series 2007A bonds is reported as a current liability in the accompanying consolidated statements of financial position. RMCHCS management does not expect the bonds to be called.

Note Payable

On March 22, 2013, RMCHCS entered into a loan agreement with a financial institution in the principal amount of \$2,500,000 to provide financing for maintenance and operating expenditures. On April 15, 2014, the loan agreement was amended and an additional \$1,600,000 was borrowed. Under this revised agreement, the principal balance must be reduced to \$1,300,000 by January 15, 2015, to \$450,000 by June 15, 2015, and paid in full by December 15, 2015. The loan is secured by mill levy funds collected by McKinley County and derived from property taxes imposed under the Hospital Funding Act, specifically by the three mills as described in Note 11. Under the terms of the loan and related agreements, McKinley County has been instructed to transfer the proceeds of the mill property tax payments directly to the financial institution where 2/3 is used to pay down the loan until it reaches the specified principal balances above and any amounts remaining are returned directly to RMCHCS. The loan is subordinate to the 2007A bonds, bears an interest rate of 4.5% and matures December 15, 2015. The balance on this loan at December 31, 2014, was \$1,912,332 and was reduced to \$1,300,000 on January 15, 2015.

While management expects the mill levy funds to be sufficient to reduce the outstanding loan amount to the above principal balances, in the event such funds are insufficient, RMCHCS would be required to pay such deficiency from other operating funds.

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Capital Leases

The cost of equipment under capital leases is included in property, plant and equipment in the consolidated statements of financial position and was \$1,581,145 and \$1,317,070 at December 31, 2014 and 2013, 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 March 2019, accrue interest at rates ranging from 3.31% to 7.98%, and are secured by the related equipment.

Required principal payments on long-term debt are as follows, assuming no demand is made on the Series 2007A bonds described above:

	Bonds Payable	Note Payable	Capital Leases
Year ending December 31,			
2015	\$ 350,000	\$ 1,912,332	\$ 142,004
2016	370,000	-	88,917
2017	385,000	-	93,820
2018	405,000	-	25,813
2019	425,000	-	6,246
Thereafter	3,690,000	-	-
	<u>\$ 5,625,000</u>	<u>\$ 1,912,332</u>	<u>\$ 356,800</u>

**7) Operating Leases**

RMCHCS has a facility lease agreement with McKinley County, New Mexico extending through for August 31, 2028 for use of the hospital building and dialysis building. The annual rent paid to the County for the use of the Hospital facility is \$1,500,000 per year and requires monthly payments of \$125,000. Prior to July 1, 2015, and every five years thereafter, the base rent will be reevaluated based on updated appraisals reviewed and concurred by the Property Tax Division of the New Mexico Taxation and Revenue Department.

RMCHCS has noncancelable operating leases consisting of the lease of the hospital building and various equipment. As of December 31, 2014 and 2013, RMCHCS had unpaid rent and leases of \$2,000,000 and \$500,000 included in accounts payable in the accompanying consolidated statements of financial position. Total rent, lease and related

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expenses were \$2,292,093 and \$2,355,548 for the years ended December 31, 2014 and 2013, respectively.

The future minimum lease payments under the leases at December 31, 2014, are as follows:

	Operating Leases
Year ending December 31,	
2015	\$ 1,770,083
2016	1,518,526
2017	1,518,526
2018	1,518,526
2019	1,518,526
Thereafter	13,001,544
Total minimum lease payments	\$ 20,845,731

**8) Employee Benefits**

RMCHCS has established a Section 403(b) retirement plan (the “plan”). There is no minimum period of service or age in order to be eligible to participate; however, employees must make a minimum contribution to be eligible for a discretionary contribution. Prior to 2013, RMCHCS made 100% employer match contributions up to 3% of the employee’s salary. Additionally, RMCHCS previously matched 50% of additional contributions up to 5% of the employee’s salary. Beginning in 2013, RMCHCS matches 30% of contributions up to 3% of the employee’s salary. At December 31, 2014 and 2013, accrued employer contributions of \$111,705 and \$130,000, were included in accrued salaries and benefits in the accompanying consolidated statements of financial position.

Effective January 1, 2003, RMCHCS adopted a nonqualified deferred compensation plan under Section 457(b) of the Internal Revenue Code. The plan enables certain key employees to enhance their retirement security by deferring compensation in addition to 403(b) deferrals. An irrevocable trust was established to satisfy the financial obligations to provide benefits to participants under the plan. Participants do not have a secured interest in the assets held in the trust; as such, assets remain the property of RMCHCS

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and are subject to creditor claims. The amount funded to the trust as of December 31, 2014 and 2013, was \$381,355 and \$332,441, respectively. The funded amount is included in assets limited as to use in the consolidated statements of financial position. The related liabilities of \$381,355 and \$332,441 as of December 31, 2014 and 2013, respectively, are included in other accrued liabilities in the accompanying consolidated statements of financial position.

**9) Employee Health Insurance Benefit Program**

RMCHCS has retained liability for certain employee health claims up to \$100,000 per claim and has purchased insurance for claims in excess of these amounts. Management believes that adequate reserves have been established as of December 31, 2014 and 2013, to cover claims which have been incurred but not reported. Such reserves were \$418,886 and \$407,712 at December 31, 2014 and 2013, respectively, and are included in accrued salaries and benefits in the accompanying consolidated statements of financial position.

**10) Safety Net Care Pool Revenue**

RMCHCS participates in a Safety Net Care Pool (SNCP) program, previously known as the sole community provider indigent care program, administered by the State of New Mexico. Revenue from this program for the years ended December 31, 2014, 2013, and 2012, totaled approximately \$5.6 million, \$6.0 million, and \$8.4 million, respectively.

**11) Other Operating Revenue**

Other operating revenue includes the following:

Ad Valorem Tax Levy

A New Mexico state law, the Hospital Funding Act, was adopted in 1980 and amended in 1981 and allowed for counties to provide tax support to qualifying hospitals. Through June 2012, McKinley County voters had approved a property tax levy of two mills. Effective July 1, 2013, voters approved a property tax levy of four mills. The County Commission has approved three mills effective for the property tax year 2013. Revenue from the mill levies was approximately \$2.5 million and \$2.1 million, for 2014 and 2013, respectively.

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Other

Other operating revenue also includes cafeteria, gift shop, donation, rent, grant and New Mexico EHR Incentive Program revenues.

**12) Charity Care**

RMCHCS provides charity care to patients who are financially unable to pay for health care services they receive. RMCHCS's policy is not to pursue collection of amounts determined to qualify as charity care. RMCHCS maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Direct and indirect costs for providing charity care are estimated by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. The estimated total direct and indirect costs of charity care services and unpaid cost of services were \$2,247,596 and \$2,578,062 during the years ended December 31, 2014 and 2013, respectively.

**13) Concentrations of Risk**

RMCHCS provides credit, in the normal course of business, primarily to residents of the city of Gallup, McKinley County and the surrounding areas. RMCHCS does not require collateral with the extension of credit. RMCHCS maintains an allowance for doubtful accounts based on management's assessment of collectability, current economic conditions, and prior experience. Because of the uncertainty regarding the ultimate collectability 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:

	<u>2014</u>	<u>2013</u>
Medicare	31%	24%
Medicaid	22%	15%
Other third-party payors	31%	38%
Self-pay	16%	23%
	<u>100%</u>	<u>100%</u>

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**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. The government continues to conduct reviews and investigations of allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that RMCHCS is in compliance with fraud and abuse as well as other applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act (HIPAA) was enacted August 21, 1996, to assure health insurance portability, guarantee security and privacy of health information, and enforce standards for health information. Under the Health Information Technology for Economic and Clinical Health (HITECH) Act, several of the HIPAA security and privacy requirements have been expanded, including business associates being subject to civil and criminal penalties and enforcement proceedings for violations of HIPAA. Management believes that RMCHCS is in compliance with all applicable provisions of HIPAA and HITECH.

Malpractice Insurance

Effective March 1, 2003, pursuant to the Federal Risk Retention Act and under the captive insurance Hospital provisions of Vermont law, RMCHCS is insured under and is a founding subscriber in the VHA Mountain States Reciprocal Risk Retention Group for the purpose of providing insurance for malpractice and general liability coverage. RMCHCS's ownership percentage was 2.5% and 4.5% at December 31, 2014 and 2013, respectively. 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, 2014 and 2013, RMCHCS 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.

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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

RMCHCS is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against RMCHCS 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 RMCHCS. Estimated deductibles for pending claims are accrued at December 31, 2014, and included with other accrued liabilities on the accompanying statements of financial position.

Workers' Compensation Insurance

Pursuant to the New Mexico Self Insurance Act, RMCHCS is insured under the New Mexico Hospital Workers Compensation Group for the purpose of providing insurance for workers' compensation coverage. The policy is retrospectively rated; premiums accrue based on the ultimate cost of the experience of a group of health care entities. At December 31, 2014 and 2013, RMCHCS cannot estimate the additional premiums or refunds, if any, which may accrue as a result of the Group's experience to date. Additional premiums, if any, are not expected to be significant.

Management Services Agreement

On August 29, 2014, the RMCHCS Board of Trustees entered into a management services agreement with NewLight Healthcare LLC. This agreement provides management and administrative services for RMCHCS, and certain key positions of RMCHCS were held by employees of NewLight Healthcare LLC during 2014. RMCHCS incurred expenses of \$210,086 during 2014 under this agreement, which are reported as a portion of purchased services in the accompanying consolidated statements of activities. At December 31, 2014, RMCHCS owed NewLight Healthcare LLC \$40,392, which is reported as a portion of accounts payable in the accompanying consolidated statements of financial position.

The management services agreement is for a term of two years for a management fee of \$23,500 per month, plus gross receipts tax and reimbursable travel expenses. During 2014, NewLight Healthcare LLC filled key positions at RMCHCS on an interim basis and provided consulting services. If RMCHCS terminates this agreement, other than through material breach by NewLight Healthcare LLC, 75% of all remaining payments on the then-current term of the agreement become due and payable. As of December 31, 2014, the future obligation associated with this agreement totaled \$352,500, which represents 75% of the remaining payments on the agreement.

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**15) Functional Expense Classification**

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

	<u>2014</u>	<u>2013</u>
Health care services	\$ 27,430,585	\$ 29,590,623
Management and general	23,255,381	22,369,840
Fundraising	<u>518,295</u>	<u>101,876</u>
	<u>\$ 51,204,261</u>	<u>\$ 52,062,339</u>

**16) Economic Dependency**

As previously described, RMCHCS receives a significant amount of revenue from the State's Safety Net Care Pool program (see Note 10) and from ad valorem tax levies (see Note 11). RMCHCS is economically dependent on the continuation of these revenues and significant reductions in either source of funds from current levels could negatively impact the ability of RMCHCS to continue its existing levels of service.

**17) Correction of an Error**

RMCHCS has restated its previously issued 2013 consolidated financial statements for the mill levy receivable and the related effects on net assets. RMCHCS also reclassified net assets due to contributions that were previously incorrectly recorded as permanently restricted to temporarily restricted net assets as of January 1, 2013. The accompanying financial statements for 2013 have been restated to reflect the corrections. Net assets and other receivables were increased in the consolidated statement of financial position by \$560,563 at December 31, 2013. Temporarily restricted net assets were increased by \$96,588 at January 1, 2013, with a corresponding decrease to permanently restricted net assets.



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**18) RMCHCS Foundation Summarized Financial Statements**

Summarized financial statements for RMCHCS Foundation as of and for the years ended December 31, are as follows:

	<u>2014</u>	<u>2013</u> (as restated)
<b>Assets</b>		
Current assets	\$ <u>328,603</u>	\$ 533,645
Total assets	\$ <u>328,603</u>	\$ <u>533,645</u>
<b>Liabilities and Net Assets</b>		
Current liabilities	\$ <u>356,520</u>	\$ 318,940
Total liabilities	<u>356,520</u>	<u>318,940</u>
Net assets (deficit)		
Unrestricted	(296,302)	(74,974)
Temporarily restricted	<u>268,385</u>	<u>289,679</u>
Total net assets (deficit)	<u>(27,917)</u>	<u>214,705</u>
Total liabilities and net assets	\$ <u>328,603</u>	\$ <u>533,645</u>

	<u>2014</u>		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Revenue	\$ 14,035	\$ 261,638	\$ 275,673
Net assets released from restrictions	<u>282,932</u>	<u>(282,932)</u>	<u>-</u>
Total revenue	296,967	(21,294)	275,673
Total expenses	<u>518,295</u>	<u>-</u>	<u>518,295</u>
Operating loss	(221,328)	(21,294)	(242,622)
Net assets (deficit), beginning of year	<u>(74,974)</u>	<u>289,679</u>	<u>214,705</u>
<b>Net assets (deficit), end of year</b>	<u>\$ (296,302)</u>	<u>\$ 268,385</u>	<u>\$ (27,917)</u>

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	2013 (as restated)		
	Unrestricted	Temporarily Restricted	Total
Revenue	\$ 12,574	\$ 94,015	\$ 106,589
Net assets released from restrictions	267,449	(267,449)	-
Total revenue	280,023	(173,434)	106,589
Total expenses	136,510	-	136,510
Operating income (loss)	143,513	(173,434)	(29,921)
Net assets, beginning of year	(218,487)	463,113	244,626
<b>Net assets (deficit), end of year</b>	<b>\$ (74,974)</b>	<b>\$ 289,679</b>	<b>\$ 214,705</b>

**19) Management's Plans and Anticipated Sale**

In April 2014, RMCHCS Board of Trustees made a decision to enter into an agreement to sell the assets of RMCHCS to Healthcare Integrity, LLC of Bonham, Texas, which is owned and co-founded by David Conejo and Pablo Chapa. Mr. Conejo brought in NewLight Healthcare LLC from Austin, Texas to assist in evaluating and managing RMCHCS. NewLight Healthcare LLC currently manages a number of hospitals. The Management Agreement was signed on August 29, 2014, and RMCHCS gave Healthcare Integrity, LLC an option to purchase RMCHCS and the right of first refusal. RMCHCS expects the purchase to occur sometime during 2015; however, as of the date the financial statements were available to be issued, no agreement was in place.

In addition to the pending sale, management also has plans to improve cash flows and profitability and to stabilize operations. Management has identified debt financing of \$750,000 to pursue mandated EHR meaningful use incentive payments. Management is also hopeful the outsourcing of the coding and billing cycles, which occurred in 2014, will help improve the revenue cycle by establishing consistent and accurate billing. There are no plans to terminate any business segments.

New Mexico State Auditor's Supplementary Information

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Schedule of Pledged Collateral  
December 31, 2014**

**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	\$ 135,748	\$ 135,748	\$ -	\$ -	\$ -
Wells Fargo Bank – Bond Fund**	932,812	114,252	N/A	-	N/A
Zia Trust	17,395	17,395	-	-	-
Bank of Colorado – Pinnacle Bank**	337,157	250,000	N/A	-	N/A
Total	<u>\$ 1,423,112</u>	<u>\$ 517,395</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

**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	<u>\$ 1,772,825</u>	<u>\$ -</u>	<u>\$ 1,808,282</u>	<u>\$ 1,808,282</u>	<u>\$ -</u>

**Pledged Collateral**

Type of security	Type of Security	CUSIP Number	Sequence Number	Maturity Date	Fair Value
FN-30 AB3575	Wells Fargo	31416Y6M5	123114	9/1/2041	<u>\$ 1,808,282</u>

\*\* RMCHCS is subject to collateralization requirements on the unexpended portion of its mill levy monies, which are considered “Public Monies” according to the New Mexico State Audit Rule section 2.2.2.10 N. There were no unexpended mill levy monies at December 31, 2014, in the Bond Fund or Pinnacle Bank accounts; accordingly, there is no requirement for collateralization on the Wells Fargo Bank – Bond Fund or the Bank of Colorado – Pinnacle Bank.

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Schedule of Deposits and Investments  
December 31, 2014**

Account Title	Account Type	Bank Balance	Reconciling Items	Book Balance
<i>Cash and Cash Equivalents</i>				
<b>Wells Fargo Bank</b>				
Operational	Operating	\$ 101,837	\$ -	\$ 101,837
Operational	Depository	-	26,763	26,763
Operational	Accounts payable	-	(218,965)	(218,965)
Operational	Payroll	-	(9,245)	(9,245)
Operational	Pension	33,911	-	33,911
<b>Bank of Colorado – Pinnacle Bank</b>				
Foundation Restricted Checking	Checking	7,405	(7)	7,398
Foundation Restricted	Money market account	259,250	-	259,250
Foundation Unrestricted Checking	Checking	1,173	-	1,173
Foundation Unrestricted Checking	Money market account	50,616	-	50,616
Auxiliary – Gift Shop	Checking	14,024	-	14,024
Auxiliary – General Account	Checking	4,689	(7)	4,682
Total deposits		472,905	(201,461)	271,444
<b>Wells Fargo Bank</b>				
Repurchase agreement	Sweep	1,772,825	-	1,772,825
<b>Other</b>				
Petty cash	Cash	-	4,069	4,069
Flex comprehensive cash	Cash	-	18	18
Total cash and cash equivalents		<u>\$ 2,245,730</u>	<u>\$ (197,374)</u>	<u>\$ 2,048,356</u>
<i>Bond Funds and Other Investments</i>				
<b>Wells Fargo Bank</b>				
Series 2007 Bond Improvement Fund	Money market account	\$ 73,188	\$ -	\$ 73,188
Series 2007 Bond Principal Fund	Money market account	214,540	(238)	214,302
Series 2007 Bond Reserve Fund	Money market account	645,322	-	645,322
<b>Zia Trust</b>				
Irrevocable trust – 457(b) plan	Cash equivalent	17,395	-	17,395
Irrevocable trust – 457(b) plan	Equity securities	263,714	-	263,714
Irrevocable trust – 457(b) plan	Fixed income securities and mutual funds	100,246	-	100,246
Total bond funds and other investments		<u>\$ 1,314,405</u>	<u>\$ (238)</u>	<u>\$ 1,314,167</u>

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary, (RMCHCS), a New Mexico not-for-profit corporation, which comprise the consolidated statement of financial position as of December 31, 2014, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated May 11, 2015.

**Internal Control Over Financial Reporting**

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

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

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 *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. 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. We consider the deficiency described in the accompanying schedule of findings and responses as item 2013-001 to be a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether RMCHCS's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2013-004, 2013-005, 2013-006, and 2014-001.

### **RMCHCS's Responses to Findings**

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

### **Purpose of this Report**

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

REDWllc

Albuquerque, New Mexico  
May 11, 2015

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
Schedule of Findings and Responses  
For the Year Ended December 31, 2014

**Section I — Financial Statement Finding**

**2013-001 – Analysis of Balance Sheet Accounts – Material Weakness**

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*Criteria or Specific Requirement:* Timely and accurate information should be available to management and those charged with governance to make decisions. To promote this, general ledger accounts should be analyzed throughout the year and at year-end for accurate financial presentation.

*Condition:* Significant adjusting journal entries were required after the accounting records were closed at year-end in the following areas:

- Mill levy receivable balances were understated as of December 31, 2013 and 2014. The net effect of these adjustments on 2014 revenue totaled \$190,386.
- Legal liability claims expenses were understated by \$330,000 at December 31, 2014, due to a mis-posting of this amount to an asset account.
- Accounts payable balances were understated by \$25,000 at December 31, 2014, due to an unrecorded liability that was identified by management after the accounting records were closed.
- RMCHCS's investment in its Risk Retention Group was understated by \$168,846.
- Capital lease balances did not agree to future payment schedules and thus were understated by \$18,096.

*Cause:* There was turnover in certain accounting positions during the year, and a current and thorough analysis of various balance sheet accounts was not able to be performed in a timely manner.

*Effect:* There were significant errors in the financial statements, which were corrected through adjustments after the accounting records were closed.

*Auditor Recommendation:* RMCHCS should establish and monitor a schedule for monthly and annual account reconciliations. RMCHCS should analyze all balance sheet accounts on a regular basis to ensure that balances are accurately presented.

*Management Response:* Management will develop a process for routine reconciliations of balance sheet accounts. This will be under the direction of the CFO with assistance from the Senior Accountants. The reconciliations shall include, when possible, validation to independent sources or approved amortization schedules.



**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary**  
**Schedule of Findings and Responses — continued**  
**For the Year Ended December 31, 2014**

The following findings are reported in accordance with the New Mexico State Audit Rule NMAC 2.2.2, *Requirements for Contracting and Conducting Audits of Agencies*.

**2014-001 – Debt Covenant Noncompliance – Material Noncompliance**

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*Criteria or Specific Requirement:* According to the Refunding and Improvement Bond Master Trust Indenture (the “Indenture”), RMCHCS must maintain a minimum debt service coverage ratio of 1.5 and maintain a minimum of 30 days cash on-hand at December 31, 2014. The Indenture allows RMCHCS to cure noncompliance with the debt service coverage ratio if the ratio is between 1.0 and 1.5. A debt service coverage ratio under 1.0 is considered an event of default under the Indenture.

*Condition:* RMCHCS was not in compliance with the debt coverage service and the days cash on-hand ratios as of December 31, 2014. The debt service coverage ratio fell below 1.0.

*Cause:* RMCHCS encountered decreased census, which caused a significant decrease in net patient service revenue. RMCHCS also encountered decreased funding from the Safety Net Care Pool program.

*Effect:* RMCHCS did not maintain its debt covenant requirements, which represents an event of default under the Indenture. This could cause RMCHCS to have to repay its outstanding bond obligation before maturity.

*Auditor Recommendation:* RMCHCS should work to improve its census and increase net patient service revenue and related collections. RMCHCS should also consider implementing additional cost cutting measures to address expected revenue shortfalls, or seek out additional funding sources so that RMCHCS can cure the debt covenant violations.

*Management Response:* Management has taken steps to reduce expenses. These steps include eliminating 18 positions and a 10% salary reduction for remaining employees. Further, management is anxiously pursuing renewing lines of practice to expand revenue. Examples include podiatry and pain management.

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Schedule of Findings and Responses — continued  
For the Year Ended December 31, 2014**

**2013-006 Personnel File Pay Rate Support – Finding That Does Not Rise to the Level of a Significant Deficiency**

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*Criteria or Specific Requirement:* Payroll disbursements should be supported by approved pay rates. Documentation supporting approved pay rates should be maintained through use of a Personal Action Form (PAF), Letter of Intent (LOI), or an Offer Letter.

*Condition:* During our testing of a sample of 25 payroll disbursements, we identified one instance in which an employee was paid at a rate higher than documented in their PAF on file. The employee's approved rate was \$26.75; however, they were being paid at a rate of \$27.39 resulting in a difference of \$.64 per hour.

*Cause:* The PAF supporting the current pay rate may have been misfiled or not completed.

*Effect:* RMCHCS could be paying employees at other than approved pay rates.

*Auditor Recommendation:* The Human Resources department should ensure that adequate supporting documentation is maintained for all changes in employee pay rates.

*Management Response:* Management will work with Human Resources to ensure all PAF's are complete, accurate and filed timely.

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Schedule of Findings and Responses — continued  
For the Year Ended December 31, 2014**

**2013-004 Segregation of Duties – Pharmacy – Finding That Does Not Rise to the Level of a Significant Deficiency**

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*Criteria or Specific Requirement:* Ordering and receiving functions should be segregated in any purchasing workflow to reduce the opportunity for theft to occur and to provide sound internal control.

*Condition:* There were times, depending on the availability of employees, where pharmacy employees may have been responsible for completing both the ordering and receiving functions for drugs inventory.

*Cause:* The Pharmacy Department is very small and, at times, duties were shared due to staffing levels or unforeseen events.

*Effect:* The lack of segregation between the ordering and receiving functions creates opportunities for theft to occur.

*Auditor Recommendation:* RMCHCS should implement controls to ensure that the ordering and receiving functions are not performed by the same employee. If this is impractical, consider implementing an additional layer of review of the items received and having the first and second reviewer sign off on the invoice as evidence that the reviews occurred.

*Management Response:* Management acknowledges the lack of segregation of duties. With a small pharmacy department, management has concluded it is best to overlay an external review process to validate receipts. A Senior Accountant from Finance will be present upon receipt drugs inventory to validate quantities received compared to quantities ordered.

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Schedule of Findings and Responses — continued  
For the Year Ended December 31, 2014**

**2013-005 Cash Disbursements – Finding That Does Not Rise to the Level of a Significant Deficiency**

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*Criteria or Specific Requirement:* To help prevent error or fraud, supporting documentation and authorization should be maintained for all disbursements.

*Condition:* During our testing of a sample of 25 general disbursements, we identified one instance of a purchase for \$3,737.37 in which supporting documentation for the disbursement could not be located.

*Cause:* The supporting documentation may have been misfiled or inadvertently disposed of.

*Effect:* Unauthorized payments could be made to vendors if RMCHCS is disbursing funds without supporting documentation.

*Auditor Recommendation:* RMCHCS should implement a process to ensure that all supporting documentation is available and reviewed prior to processing cash disbursements. This supporting documentation should be properly filed after disbursements are made.

*Management Response:* Management will analyze and improve the accounts payable process to ensure that all disbursements are adequately documented and authorized prior to disbursing funds.

**Rehoboth McKinley Christian Health  
Care Services, Inc. and Subsidiary  
Current Status Schedule of 2013 Audit Findings  
For the Year Ended December 31, 2014**

<b>Prior-Year Number</b>	<b>Description</b>	<b>Current Status</b>
2013-001	Analysis of Balance Sheet Accounts	Unresolved
2013-002	Security and Access Controls	Resolved
2013-003	Fixed Asset Count	Resolved
2013-004	Segregation of Duties - Pharmacy	Unresolved
2013-005	Cash Disbursements	Unresolved
2013-006	Personnel File Pay Rate Support and New Hire Review	Unresolved

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

An exit conference was held on April 21, 2015, with the following attending:

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

David, Conejo, CEO  
John McMullin, CPA, MBA, FHFMA, CFO  
Dr. William Keifer, COO

REDW<sub>LLC</sub>:

Joshua Trujillo, Principal  
Claire Hilleary, Manager

A presentation was made to a closed session of the Board of Trustees on April 23, 2015, with the following attendees:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (includes 2014 Board members and titles):

Priscilla Smith, Chair  
David Dallago, Vice Chairman  
David Bischoff, Treasurer  
Pastor John Luginbihl, Board Member  
Dr. Ayodele Erinle, Board Member  
Lydia Garcia-Usrey, Board Member  
Dr. Rakesh Patel, Board Member  
Dr. Erwin Elber, Board Member  
Shannon Tanner, Board Member  
David Conejo, CEO  
Dr. William Keifer, COO  
John McMullin, CPA, MBA, FHFMA, CFO  
Dr. Phil Kamps, CMO  
Nancy Santiesteban, CNO  
Mary Lou Donkersloot, Executive Administrative Assistant

REDW<sub>LLC</sub>:

Johsua Trujillo, Principal  
Halie Garcia, Senior Manager  
Claire Hilleary, Manager

Financial Statement Preparation

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