
Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary

*Consolidated Financial Statements with Supplementary Information
and
Independent Auditor's Report
December 31, 2015 and 2014*



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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, 2015**

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

Board of Trustees

David Dallago, Chairman
David Bischoff, Treasurer
Mary Ann Armijo, Vice Chair/Secretary
Lydia Garcia-Usrey
Erwin Elber, MD
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Shannon Tanner
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Principal Employees

David Conejo, CEO
William Kiefer, COO
John McMullin, CFO

**Rehoboth McKinley Christian
Health Care Services Foundation**

Board of Trustees

Paul McCollum, Chairman
Thomas Carmany, Vice Chairman/Treasurer
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Mark Gartner
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Arlene High
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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, 2015 and 2014, 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, 2015 and 2014, and the change in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 9, 2016, on our consideration of RMCHCS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering RMCHCS's internal control over financial reporting and compliance.

REDW LLC

Albuquerque, New Mexico
May 9, 2016

Consolidated Financial Statements

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

	2015	2014
Assets		
Current assets		
Cash and cash equivalents	\$ 5,246,334	\$ 2,048,356
Patient accounts receivable, net of allowance for doubtful accounts of \$7,020,737 in 2015 and \$5,357,646 in 2014	4,147,320	5,787,517
Safety Net Care Pool receivable	1,453,903	-
Other receivables	1,478,703	928,577
Inventories	1,368,913	1,297,686
Prepaid expenses and deposits	285,916	383,438
Total current assets	13,981,089	10,445,574
Property, plant and equipment, net	11,649,504	12,342,353
Assets limited as to use		
Assets held by trustee	999,123	932,812
Assets held for 457(b) plan	411,414	381,355
Investment in risk retention group	2,670,060	2,684,819
Bond issuance costs, net	428,572	466,667
Total assets	<u>\$ 30,139,762</u>	<u>\$ 27,253,580</u>
Liabilities and Net Assets		
Current liabilities		
Accounts payable	\$ 3,865,957	\$ 4,199,071
Lease payable to McKinley county	1,500,000	2,000,000
Accrued salaries and related liabilities	3,251,842	2,938,952
Other accrued liabilities	998,111	977,237
Estimated third-party payor settlements	1,246,884	1,003,083
Current portion of long-term debt	2,064,917	7,691,267
Total current liabilities	12,927,711	18,809,610
Long-term debt, less current portion	5,308,631	202,865
Total liabilities	<u>18,236,342</u>	<u>19,012,475</u>
Net assets		
Unrestricted	11,180,366	7,972,720
Temporarily restricted	723,054	268,385
Total net assets	<u>11,903,420</u>	<u>8,241,105</u>
Total liabilities and net assets	<u>\$ 30,139,762</u>	<u>\$ 27,253,580</u>

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

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary**
Consolidated Statement of Activities
For the Year Ended December 31, 2015

	Unrestricted	Temporarily Restricted	Total
Operating Revenue			
Net patient service revenue	\$ 53,453,642	\$ -	\$ 53,453,642
Provision for uncollectible accounts	<u>5,553,521</u>	<u>-</u>	<u>5,553,521</u>
Net patient service revenue less provision for uncollectible accounts	47,900,121	-	47,900,121
Safety Net Care Pool revenue	5,284,219	-	5,284,219
Ad valorem tax revenue	2,477,393	-	2,477,393
Other operating revenue	2,202,521	720,954	2,923,475
Net assets released from restrictions	<u>266,285</u>	<u>(266,285)</u>	<u>-</u>
Total operating revenue	<u>58,130,539</u>	<u>454,669</u>	<u>58,585,208</u>
Operating Expenses			
Salaries, benefits, contract labor, and payroll taxes	29,372,644	-	29,372,644
Supplies	5,669,830	-	5,669,830
Professional fees	4,988,204	-	4,988,204
Purchased services	4,719,651	-	4,719,651
Rentals and leases	2,277,387	-	2,277,387
Depreciation and amortization	2,019,748	-	2,019,748
Other operating expenses	1,878,232	-	1,878,232
Utilities	1,322,622	-	1,322,622
Repairs and maintenance	1,094,987	-	1,094,987
Insurance	658,438	-	658,438
Licenses, permits, and fees	<u>432,097</u>	<u>-</u>	<u>432,097</u>
Total operating expenses	<u>54,433,840</u>	<u>-</u>	<u>54,433,840</u>
Operating income	<u>3,696,699</u>	<u>454,669</u>	<u>4,151,368</u>
Nonoperating income (expense)			
Investment income	6,024	-	6,024
Loss on disposal of property, plant and equipment	(81,606)	-	(81,606)
Interest expense	<u>(413,471)</u>	<u>-</u>	<u>(413,471)</u>
Total nonoperating income, net	<u>(489,053)</u>	<u>-</u>	<u>(489,053)</u>
Change in net assets/revenues and gains over expenses and losses	3,207,646	454,669	3,662,315
Net assets, beginning of year	<u>7,972,720</u>	<u>268,385</u>	<u>8,241,105</u>
Net assets, end of year	<u>\$ 11,180,366</u>	<u>\$ 723,054</u>	<u>\$ 11,903,420</u>

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

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

	Unrestricted	Temporarily Restricted	Total
Operating Revenue			
Net patient service revenue	\$ 43,495,368	\$ -	\$ 43,495,368
Provision for uncollectible accounts	4,071,117	-	4,071,117
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
Ad valorem tax revenue	2,502,031	-	2,502,031
Other operating revenue	380,235	261,638	641,873
Net assets released from restrictions	282,932	(282,932)	-
Total operating revenue	<u>48,196,743</u>	<u>(21,294)</u>	<u>48,175,449</u>
Operating Expenses			
Salaries, benefits, contract labor, and payroll taxes	28,209,022	-	28,209,022
Supplies	4,575,982	-	4,575,982
Professional fees	4,740,036	-	4,740,036
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
Utilities	1,304,323	-	1,304,323
Repairs and maintenance	1,236,900	-	1,236,900
Insurance	1,498,624	-	1,498,624
Licenses, permits, and fees	652,166	-	652,166
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 disposal of property, plant, and equipment	4,338	-	4,338
Interest expense	(547,693)	-	(547,693)
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	<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 consolidated financial statements.

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

	2015	2014
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 44,230,598	\$ 34,819,125
Cash received from Safety Net Care Pool and other operating receipts	7,681,058	10,059,090
Cash paid to employees and suppliers	(46,429,996)	(43,613,449)
Interest and dividends received	20,783	17,207
Interest paid	(413,471)	(547,693)
Net cash provided by operating activities	5,088,972	734,280
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,094,375)	(776,395)
Proceeds from sale of equipment	-	4,338
Net cash used in investing activities	(1,094,375)	(772,057)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	1,642,582	1,605,282
Payments on long-term debt	(2,439,201)	(2,066,284)
Net cash used in financing activities	(796,619)	(461,002)
Net increase (decrease) in cash and cash equivalents	3,197,978	(498,779)
Cash and cash equivalents, beginning of year	2,048,356	2,547,135
Cash and cash equivalents, end of year	\$ 5,246,334	\$ 2,048,356

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

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

	2015	2014
Reconciliation of change in net assets to net cash provided by operating activities		
Change in net assets	\$ 3,662,315	\$ (3,440,227)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	2,019,748	2,152,050
Provision for uncollectible accounts	5,553,521	4,071,117
Forgiveness of rent expense	(1,000,000)	-
Loss/(gain) on disposal of property, plant, and equipment	81,606	(4,338)
Unrealized loss (gain) on investments	14,759	(114,733)
Net changes in operating assets and liabilities		
Patient accounts receivable	(3,913,324)	(4,453,923)
Safety Net Care Pool receivable	(1,453,903)	1,194,627
Other receivables	(550,126)	113,265
Inventories	(71,227)	96,015
Prepaid expenses and deposits	97,522	(70,233)
Accounts payable	(333,114)	1,020,845
Lease payable to McKinley County	500,000	1,500,000
Accrued salaries and related liabilities	312,890	(344,155)
Other accrued liabilities	(75,496)	(834,827)
Estimated third-party payor settlements	243,801	(151,203)
Net cash provided by operating activities	\$ 5,088,972	\$ 734,280
Supplemental schedule of noncash investing and financing activities		
Equipment acquired through capital lease	\$ 276,035	\$ 233,999
Increase in 457(b) investments recorded to other accrued liabilities	\$ 96,370	\$ 3,829

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

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary**
Notes to the Consolidated Financial Statements
December 31, 2015 and 2014

1) Organization and Summary of Significant Accounting Policies

Organization

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

These financial statements include RMCHCS, as well as Rehoboth McKinley Christian Health Care Services Foundation (“RMCHCS Foundation” or the “Foundation”), a not-for-profit subsidiary (see Note 17). 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
Care Services, Inc. and Subsidiary**
Notes to the Consolidated Financial Statements
December 31, 2015 and 2014

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 2015 and 2014, RMCHCS wrote off approximately \$5.6 million and \$4.1 million, respectively, to the provision for uncollectible accounts. RMCHCS's allowance for doubtful accounts was approximately 63% and 48% of patient accounts receivable at December 31, 2015 and 2014, respectively. RMCHCS did not change its charity care or uninsured discount policies during fiscal years 2014 or 2015.

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
Care Services, Inc. and Subsidiary**
Notes to the Consolidated Financial Statements
December 31, 2015 and 2014

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>2015</u>	<u>2014</u>
Held by trustee under indenture agreement related to Series 2007 Revenue Bond - cash equivalents	<u>\$ 999,123</u>	<u>\$ 932,812</u>
Irrevocable trust – 457(b) plan		
Cash and cash equivalents	9,674	17,395
U.S. equity securities	244,285	263,714
Mutual funds	57,124	37,067
U.S. government securities	<u>100,331</u>	<u>63,179</u>
Total of irrevocable trust – 457(b) plan	<u>411,414</u>	<u>381,355</u>
	<u>\$ 1,410,537</u>	<u>\$ 1,314,167</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 the Consolidated Financial Statements
December 31, 2015 and 2014

Other Accrued Liabilities

Other accrued liabilities primarily consist of the estimated liability for malpractice and other claims outstanding. As of December 31, 2015 and 2014, the estimated liability for these claims was \$690,000 and \$465,000, respectively.

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, 2015 and 2014.

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 \$38,095 is included in the accompanying consolidated statements of activities for 2015 and 2014. Total bond issuance costs were \$761,905 and the accumulated amortized costs were \$333,333 and \$295,238 at December 31, 2015 and 2014, respectively, resulting in a balance of \$428,572 and \$466,667 at December 31, 2015 and 2014, 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

**Rehoboth McKinley Christian Health
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Notes to the Consolidated Financial Statements
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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 did not recognize any revenue related to EHR in 2015 or 2014. 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 and 2015.

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 organizations, exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. In addition, RMCHCS and the Foundation have been classified as entities that are not private foundations within the meaning of Section 509 (a) and qualify for deductible contributions as provided by Section 170(b)(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, 2015 and 2014. 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 2013 for its federal and state filings.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense totaled \$168,455 and \$84,715 for the years ended December 31, 2015 and 2014, respectively.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary**
Notes to the Consolidated Financial Statements
December 31, 2015 and 2014

Recent Accounting Pronouncements

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

Reclassifications

Certain reclassifications have been made to the 2014 financial information to conform to the 2015 financial statement presentation. Such reclassifications had no effect on 2014 net assets or change in net assets.

Subsequent Events

Subsequent events through May 9, 2016, the date which the financial statements were made available to be issued, were evaluated for recognition and disclosure in the December 31, 2015, 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

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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 2015 and 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. 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 67% and 63%, respectively, of RMCHCS's net patient revenue for the years ended December 31, 2015 and 2014.

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

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	Third-Party Payors	Self-Pay	Total All Payors
Year ended December 31, 2015	\$ 49,054,674	\$ 4,398,968	\$ 53,453,642
Year ended December 31, 2014	\$ 38,625,060	\$ 4,870,308	\$ 43,495,368

Estimated third-party payor settlement liabilities are as follows:

	December 31,		Current Status
	2015	2014	
Medicare			
2011	\$ -	\$ (64,576)	Settled
2012	(198,048)	-	Settled
2013	-	-	In progress
2014	-	-	In progress
2015	-	-	In progress
	<u>(198,048)</u>	<u>(64,576)</u>	
Medicaid			
2009	(737,693)	(737,693)	Tentative settlement
2010	-	-	Settled
2011	(174,277)	(80,228)	Tentative settlement
2012	(120,586)	(120,586)	Tentative settlement
2013	-	-	In progress
2014	(16,280)	-	In progress
2015	-	-	In progress
	<u>(1,048,836)</u>	<u>(938,507)</u>	
Total	<u>\$ (1,246,884)</u>	<u>\$ (1,003,083)</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.

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Other Third-Party Payors

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

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

	<u>2015</u>	<u>2014</u>
Gross charges – inpatient	\$ 42,269,490	\$ 30,463,417
Gross charges – outpatient	94,248,782	72,556,897
Third party contractual allowances	<u>(83,064,630)</u>	<u>(59,524,946)</u>
Net patient service revenue	<u>\$ 53,453,642</u>	<u>\$ 43,495,368</u>

3) Fair Value Measurements

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

- Level 1:* Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that RMCHCS has the ability to access.
- Level 2:* Quoted prices in markets that are not considered to be active or financial instruments without quoted market prices, but for which all significant inputs are observable, either directly or indirectly.
- Level 3:* Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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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, 2015 and 2014.

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2015 and 2014.

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

The following table provides information as of December 31, 2015, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

	Balance at		
	December 31,		
	2015	Level 1	Level 2
Assets limited as to use			
Cash and cash equivalents	\$ 1,008,797	\$ 1,008,797	\$ -
U.S. equity securities – various sectors	244,285	244,285	-
U.S. treasury notes	87,342	-	87,342
Mutual funds	57,124	57,124	-
FNMA mortgage backed securities	12,989	-	12,989
	<u>\$ 1,410,537</u>	<u>\$ 1,310,206</u>	<u>\$ 100,331</u>

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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 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>

4) Property, Plant and Equipment

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

	<u>2015</u>	<u>2014</u>
Equipment	\$ 29,955,873	\$ 29,206,862
Buildings and improvements	29,174,698	29,143,920
Land improvements	<u>1,851,994</u>	<u>1,804,423</u>
	60,982,565	60,155,205
Accumulated depreciation and amortization	<u>(50,339,771)</u>	<u>(48,547,821)</u>
	10,642,794	11,607,384
Land	734,969	734,969
Construction in progress	<u>271,741</u>	<u>-</u>
	<u>\$ 11,649,504</u>	<u>\$ 12,342,353</u>

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5) Long-Term Debt

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

	<u>2015</u>	<u>2014</u>
Series 2007A bonds	\$ 5,275,000	\$ 5,625,000
Notes payable and line of credit	1,649,914	1,912,332
Capital lease obligations	<u>448,634</u>	<u>356,800</u>
	7,373,548	7,894,132
Less current portion	<u>(2,064,917)</u>	<u>(7,691,267)</u>
	<u>\$ 5,308,631</u>	<u>\$ 202,865</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 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.

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, 2015, RMCHCS was in compliance with all compliance requirements. As of December 31, 2014, RMCHCS was not in compliance with the days cash on-hand requirement or the debt coverage service ratio, which represented an event of default under the Indenture. Due to these debt covenant violations, the total outstanding balance of the Series 2007A bonds was reported as a current liability in the accompanying consolidated statement of financial position at December 31, 2014.

Notes Payable and Line of Credit

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

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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. As of December 31, 2015, this loan was paid in full.

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

On December 31, 2015, RMCHCS entered into a loan agreement with a financial institution in the principal amount of \$1,200,000 to also provide financing for the electronic health record system implementation. The loan bears an interest rate of 4.5% and matures June 15, 2016. On February 15, 2016, the loan was paid in full.

Capital Lease Obligations

The cost of equipment under capital leases is included in property, plant and equipment in the consolidated statements of financial position and was \$1,857,179 and \$1,581,145 at December 31, 2015 and 2014, 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 June 2020, accrue interest at rates ranging from 3.31% to 10.25%, and are secured by the related equipment.

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

	Bonds Payable	Notes Payable and Line of Credit	Capital Lease Obligations
Year ending December 31,			
2016	\$ 370,000	\$ 1,500,000	\$ 194,917
2017	385,000	149,914	143,161
2018	405,000	-	75,935
2019	425,000	-	26,091
2020	460,000	-	8,530
Thereafter	3,230,000	-	-
	<u>\$ 5,275,000</u>	<u>\$ 1,649,914</u>	<u>\$ 448,634</u>

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6) 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. As of December 31, 2015 and 2014, RMCHCS had unpaid rent under this agreement of \$1,500,000 and \$2,000,000, respectively, reported as lease payable in the accompanying consolidated statements of financial position.

During 2015, McKinley County approved the forgiveness of \$1 million of rent under the facility lease agreement, which was forgiven for the period October 2014 through May 2015. In accordance with GAAP, RMCHCS has reported this as contribution revenue, which is included in other operating revenue in the consolidated statements of activities.

In addition to the facility lease agreement with McKinley County above, RMCHCS also has noncancelable operating leases for various equipment. The future minimum lease payments under the facility lease agreement and the equipment leases at December 31, 2015, are as follows:

	Operating Leases
Year ending December 31,	
2016	\$ 1,568,045
2017	1,526,026
2018	1,518,526
2019	1,501,544
2020	1,500,000
Thereafter	11,500,000
Total minimum lease payments	\$ 19,114,141

7) Employee Benefits

RMCHCS has established a Section 403(b) retirement plan (the “plan”). There is no minimum period of service or age in order to be eligible to participate; however, employees must make a minimum contribution to be eligible for a discretionary

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contribution. RMCHCS matches 30% of contributions up to 3% of the employee's salary. At December 31, 2015 and 2014, accrued employer contributions of \$102,933 and \$111,705 were included in accrued salaries and related liabilities in the accompanying consolidated statements of financial position.

Effective January 1, 2003, RMCHCS adopted a nonqualified deferred compensation plan under Section 457(b) of the Internal Revenue Code. The plan enables certain key employees to enhance their retirement security by deferring compensation in addition to 403(b) deferrals. An irrevocable trust was established to satisfy the financial obligations to provide benefits to participants under the plan. Participants do not have a secured interest in the assets held in the trust; as such, assets remain the property of RMCHCS and are subject to creditor claims. The amount funded to the trust as of December 31, 2015 and 2014, was \$411,414 and \$381,355, respectively. The funded amount is included in assets limited as to use in the consolidated statements of financial position. The related liabilities of \$411,414 and \$381,355 as of December 31, 2015 and 2014, respectively, are included in other accrued liabilities in the accompanying consolidated statements of financial position.

8) Employee Health Insurance Benefit Program

RMCHCS has retained liability for certain employee health claims up to \$100,000 per claim and has purchased insurance for claims in excess of these amounts. Management believes that adequate reserves have been established as of December 31, 2015 and 2014, to cover claims which have been incurred but not reported. Such reserves were \$463,183 and \$407,712 at December 31, 2015 and 2014, respectively, and are included in accrued salaries and related liabilities in the accompanying consolidated statements of financial position.

9) Safety Net Care Pool Revenue

RMCHCS participates 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, 2015 and 2014, totaled approximately \$5.3 million and \$5.6 million, respectively.

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10) Ad Valorem Tax Revenue

The Hospital Funding Act, a New Mexico state law, was adopted in 1980 and amended in 1981 and allowed for counties to provide tax support to qualifying hospitals. Through June 2012, McKinley County voters approved an ad valorem tax levy of two mills. Effective July 1, 2013, voters approved an ad valorem tax levy of four mills. The McKinley County Board of Commissioners ultimately approved an ad valorem tax levy of three mills effective for the tax year 2013. Revenue from the ad valorem tax levy was approximately \$2.5 million in both 2015 and 2014.

11) Other Operating Revenue

Other operating revenue 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 \$1,414,300 and \$2,247,596 during the years ended December 31, 2015 and 2014, 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

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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>2015</u>	<u>2014</u>
Medicare	32%	31%
Medicaid	33%	22%
Other third-party payors	23%	31%
Self-pay	12%	16%
	<u>100%</u>	<u>100%</u>

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

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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 allocation was a decrease of \$14,759, from a total pool of \$205,722, for 2015 and an increase of \$114,733, from a total pool of \$4,573,027, for 2014. 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, 2015 and 2014, 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.

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, 2015, 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, 2015 and 2014, 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.

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Management Services Agreement

On August 29, 2014, the RMCHCS Board of Trustees entered into a management services agreement with NewLight Healthcare LLC (NewLight). Under this two year agreement, NewLight provides management and administrative services for RMCHCS. The managements services agreement costs \$23,500 per month plus wages of administrative staff employed by NewLight. Currently, only the RMCHCS CEO is a NewLight employee. RMCHCS incurred expenses of \$624,972 and \$210,086 respectively in 2015 and 2014 under this agreement. These expenses are reported as a portion of purchased services in the accompanying consolidated statements of activities. At December 31, 2015 and 2014, RMCHCS owed NewLight Healthcare LLC \$53,434 and \$40,392, respectively, which is reported as a portion of accounts payable in the accompanying consolidated statements of financial position. 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, 2015, the future obligation associated with this agreement totaled \$141,000, which represents 75% of the remaining payments on the agreement.

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>2015</u>	<u>2014</u>
Health care services	\$ 33,788,530	\$ 28,311,112
Management and general	20,367,197	22,810,075
Fundraising	<u>278,113</u>	<u>83,074</u>
	<u>\$ 54,433,840</u>	<u>\$ 51,204,261</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 9) and from ad valorem tax levies (see Note 10). RMCHCS is economically dependent on the continuation of these revenues and significant reductions in either source of funds from current levels could negatively impact the ability of RMCHCS to continue its existing levels of service.

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17) RMCHCS Foundation Summarized Financial Statements

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

	2015	2014
Assets		
Current assets	<u>\$ 722,427</u>	<u>\$ 328,603</u>
Total assets	<u>\$ 722,427</u>	<u>\$ 328,603</u>
 Liabilities and Net Assets		
Current liabilities	<u>\$ 295,487</u>	<u>\$ 356,520</u>
Total liabilities	<u>295,487</u>	<u>356,520</u>
Net assets (deficit)		
Unrestricted	(296,114)	(296,302)
Temporarily restricted	<u>723,054</u>	<u>268,385</u>
Total net assets (deficit)	<u>426,940</u>	<u>(27,917)</u>
Total liabilities and net assets	<u>\$ 722,427</u>	<u>\$ 328,603</u>

	2015		
	Unrestricted	Temporarily Restricted	Total
Revenue	\$ 322	\$ 720,954	\$ 721,276
Net assets released from restrictions	<u>266,285</u>	<u>(266,285)</u>	<u>-</u>
Total revenue	266,607	454,669	721,276
Total expenses	<u>266,419</u>	<u>-</u>	<u>266,419</u>
Operating income	188	454,669	454,857
Net assets (deficit), beginning of year	<u>(296,302)</u>	<u>268,385</u>	<u>(27,917)</u>
Net assets (deficit), end of year	<u>\$ (296,114)</u>	<u>\$ 723,054</u>	<u>\$ 426,940</u>

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

18) 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 Gallup, New Mexico, which is owned by David Conejo. In conjunction with the Management Agreement 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; however, as of the date the consolidated financial statements were available to be issued, no final purchase agreement was in place.

New Mexico State Auditor's Supplementary Information

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Schedule of Pledged Collateral
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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	\$ 136,075	\$ 136,075	\$ -	\$ -	\$ -
Wells Fargo Bank – Bond Fund**	998,993	113,925	N/A	-	N/A
Zia Trust	9,674	9,674	-	-	-
U.S. Bank**	86,501	86,501	N/A	-	N/A
Bank of Colorado – Pinnacle Bank**	<u>2,130,103</u>	<u>250,000</u>	<u>N/A</u>	<u>-</u>	<u>N/A</u>
Total	<u>\$ 3,361,346</u>	<u>\$ 596,175</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>\$ 2,999,807</u>	<u>\$ -</u>	<u>\$ 3,059,803</u>	<u>\$ 3,059,803</u>	<u>\$ -</u>

Pledged Collateral

Type of security	Type of Security	CUSIP Number	Sequence Number	Maturity Date	Fair Value
FN-30 AB3575	Wells Fargo	3128MJV64	123115	4/1/2045	<u>\$ 3,059,803</u>

** RMCHCS is subject to collateralization requirements on the unexpended portion of its ad valorem tax 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 ad valorem tax levy monies at December 31, 2015, 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, 2015**

Account Title	Account Type	Bank Balance	Reconciling Items	Book Balance
<i>Cash and Cash Equivalents</i>				
Wells Fargo Bank				
Operational	Operating	\$ 102,164	\$ -	\$ 102,164
Operational	Depository	-	107,226	107,226
Operational	Accounts payable	-	(214,313)	(214,313)
Operational	Payroll	-	(1,921)	(1,921)
Operational	Pension	33,911	-	33,911
U.S. Bank				
Athena Account	Checking	86,501	-	86,501
Bank of Colorado – Pinnacle Bank				
Foundation Restricted Checking	Checking	3,492	(407)	3,085
Foundation Restricted	Money market account	641,360	-	641,360
Foundation Unrestricted Checking	Checking	1,595	(40)	1,555
Foundation Unrestricted Checking	Money market account	49,575	-	49,575
Mill Levy Proceeds	Checking	206,421	-	206,421
Mill Levy Loan	Checking	1,194,000	-	1,194,000
Grants Account	Checking	500	-	500
Auxiliary – Gift Shop	Checking	23,745	(127)	23,618
Auxiliary – General Account	Checking	9,415	-	9,415
Total deposits		<u>2,352,679</u>	<u>(109,582)</u>	<u>2,243,097</u>
Wells Fargo Bank				
Repurchase agreement	Sweep	2,999,807	-	2,999,807
Other				
Petty cash	Cash	3,673	-	3,673
Flex comprehensive cash	Cash	-	(243)	(243)
Total cash and cash equivalents		<u>\$ 5,356,159</u>	<u>\$ (109,825)</u>	<u>\$ 5,246,334</u>
<i>Bond Funds and Other Investments</i>				
Wells Fargo Bank				
Series 2007 Bond Improvement Fund	Money market account	\$ 84,843	\$ -	\$ 84,843
Series 2007 Bond Principal Fund	Money market account	268,828	130	268,958
Series 2007 Bond Reserve Fund	Money market account	645,322	-	645,322
Zia Trust				
Irrevocable trust – 457(b) plan	Cash equivalent	9,674	-	9,674
Irrevocable trust – 457(b) plan	Equity securities	244,285	-	244,285
Irrevocable trust – 457(b) plan	Fixed income securities and mutual funds	157,455	-	157,455
Total bond funds and other investments		<u>\$ 1,410,407</u>	<u>\$ 130</u>	<u>\$ 1,410,537</u>

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary
Schedule of Vendor Information
December 31, 2015**

RFB/ RFP#	Type of Procurement	Awarded Vendor	\$ Amount of Awarded Contract	\$ Amount of Amended Contract	Name and Physical Address per the procurement documentation, of <u>ALL</u> Vendor(s) that responded	In-State/Out-of- State Vendor (Y or N) (Based on Statutory Definition)	Was the vendor in-state and chose Veteran's preference (Y or N) For federal funds answer N/A	Brief Description of the Scope of Work
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Notes to 2015 Schedule of Vendor Information

RMCHCS is exempt from the State Procurement Code under the Hospital and Healthcare Exemption outlined in Section 13-1-98.2 of the Code. Therefore, no vendor contracts are reported for the year ended December 31, 2015.

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, 2015, 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 9, 2016.

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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified certain deficiencies in internal control, described as items 2015-001 and 2015-002 in the accompanying schedule of findings and responses, that we consider to be significant deficiencies.

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 2015-003, 2015-004 and 2015-005.

RMCHCS's Responses to Findings

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance, and the 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.

REDW LLC

Albuquerque, New Mexico
May 9, 2016

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary**
Schedule of Findings and Responses
For the Year Ended December 31, 2015

Section I — Financial Statement Findings

2015-001 – Patient Account Write-Off Access (Significant Deficiency)

Criteria or Specific Requirement: Adequate segregation of duties must exist between cash receipt collections and the ability to write-off receivable amounts.

Condition: Patient account representatives who have access to cash receipts can also post account write-offs in the billing system and a policy is in place that write offs should have appropriate approvals. Write-offs are reviewed in total on a monthly basis by the Board of Directors; however, individual write-offs are not scrutinized leaving the potential for fraud to occur.

Cause: The current control structure does not properly segregate the cash receipts and account write-off functions and there are not adequate additional monitoring controls in place to mitigate the processes.

Effect: Cash receipts could be stolen without being identified timely.

Auditor Recommendation: Management should either separate the cash receipts and write-off functions or add an additional review procedure to ensure all write-offs are reviewed and approved by someone other than the poster.

Management Response: Individuals accepting cash will no longer have access to post adjustments fully segregating the responsibilities.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary
Schedule of Findings and Responses — continued
For the Year Ended December 31, 2015**

Section I — Financial Statement Findings — continued

2015-002 – Analysis of Liability Account (Significant Deficiency)

Criteria or Specific Requirement: All general ledger accounts should be analyzed throughout the year and at year-end to ensure accurate financial reporting.

Condition: An analysis was not performed on the Recovery Audit Contractor (RAC) liability at year-end to ensure the estimated liability was appropriate.

Cause: Management has not developed a methodology for estimating the outstanding liability.

Effect: RMCHCS's estimated liability was overstated by approximately \$151,000.

Auditor Recommendation: Management should utilize the RAC tracking spreadsheet as a tool to help evaluate the appropriateness of the liability accrual at year-end.

Management Response: All accounts are reviewed monthly. The process will change so that accrual balances are adjusted to the RAC spreadsheet at year-end.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary
Schedule of Findings and Responses — continued
For the Year Ended December 31, 2015**

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

2015-003 – Inventory Count Discrepancies (Finding That Does Not Rise to the Level of a Significant Deficiency)

Criteria or Specific Requirement: Inventory counts are completed on an annual basis and the accounting records should be adjusted to reflect the amounts on hand to ensure accurate financial reporting.

Condition: During the year-end inventory count observation, we identified errors in the number of units reported for two of the 25 inventory items selected for testing. In total, this amount only represented a \$26.39 difference; however, this error rate could not be extrapolated to the total population.

Cause: Many of the inventory items are small, and the quantity of these items can be significant, resulting in large unit counts which create a greater potential for error. There was no mechanism in place to verify that the counts performed by Hospital personnel were accurate.

Effect: Errors in the year-end count can lead to inaccurate inventory balances if not identified and corrected.

Auditor Recommendation: RMCHCS should establish a quality control review process where spot checks are performed to recount selected inventory items. These spot checks should be performed by an employee other than the original counter. Variances should be investigated and corrected.

Management Response: Finance personnel will perform spot checks of inventory counts to ensure accurate counts.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary
Schedule of Findings and Responses — continued
For the Year Ended December 31, 2015**

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

2015-004 Disposition of Property (Other Noncompliance)

Criteria or Specific Requirement: According to section 2.2.2.10 (T) (1) of the New Mexico Administrative Code (NMAC), the Office of the State Auditor must be notified, at least thirty (30) days prior to any disposition of property that is included on the Hospital's inventory listing. Written notification of the proposed disposition, along with the Hospital's approval by an authoritative member, must be sent to the Office of the State Auditor.

Condition: RMCHCS did not notify the State Auditor of the disposition of property that occurred in 2015.

Cause: Inadequate controls in place by the Hospital over disposition of property to ensure compliance with the State Audit Rule 2.2.2.10 (T) (1).

Effect: The Hospital was not in compliance with the NMAC as required by the Office of the State Auditor.

Auditor Recommendation: RMCHCS should implement an effective system of controls over the disposition of property to ensure compliance requirements are being met. Consider adding a place for a sign off on the disposition form for verifying that the Office of the State Auditor was notified.

Management Response: RMCHCS was unaware of this requirement. We have since obtained a copy of the regulation and had discussion with the State Auditor. RMCHCS will notify the State Auditor of future asset dispositions as required.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary**
Schedule of Findings and Responses — continued
For the Year Ended December 31, 2015

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

2015-005 [2013-006] Personnel File Pay Rate Support (Finding That Does Not Rise to the Level of a Significant Deficiency)

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 Personnel Action Form (PAF), Letter of Intent (LOI), or an Offer Letter.

Condition: During our testing of a sample of five 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 \$43.71; however, they were being paid at a rate of \$44.21 resulting in a difference of \$.50 per hour. According to discussions with management this is a result of a shift differential for an advanced cardiac life support (ACLS) employee. Management has been in the process of reviewing the personnel files to ensure all documentation required is present.

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 has instructed the Human Resources department to review employee files and ensure all documentation is present. Management will continue to work with Human Resources to ensure all PAF's are complete, accurate and filed timely.

**Rehoboth McKinley Christian Health
Care Services, Inc. and Subsidiary
Current Status Schedule of 2016 Audit Findings
For the Year Ended December 31, 2015**

Prior-Year Number	Description	Current Status
2013-001	Analysis of Balance Sheet Accounts	Resolved
2014-001	Debt Covenant Noncompliance	Resolved
2013-006	Personnel File Pay Rate Support	Unresolved-See planned corrective action at 2015-005
2013-004	Segregation of Duties - Pharmacy	Resolved
2013-005	Cash Disbursements	Resolved

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

An exit conference was held on April 28, 2016, 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_{LLC}:

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

A presentation was made to a closed session of the Board of Trustees on April 28, 2016, with the following attendees:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (includes 2015 Board members and titles):

David Dallago, Chair
Mary Ann Armijo, Vice Chair
Irum Haq, MD, Chief of Staff
Lydia Garcia-Usrey, Board Member
Lorelei Kay, Board Member
John Luginbuhl, Board Member
Ken Zylstra, Board Member
David Conejo, Chief Executive Officer
Dr. William Keifer, Chief Operating Officer
John McMullin, CPA, MBA, FHFMA, Chief Financial Officer
Ina Burmeister, Director of Development
Denise Clark, Chief Nursing Officer
Ron Etcitty, Director of Human Resources
Sam MacBride, MD – Chief Medical Officer
Scott McIntyre, Director of Clinic Operations
Mike Nye, Chief Compliance Officer and Professional Services
Mary Lou Donkersloot, Executive Administrative Assistant (Recorder)

REDW_{LLC}:

Joshua Trujillo, Principal
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.