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

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

*December 31, 2016 and 2015*

CPAs | Business & Financial Advisors

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

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# Health Care Services, Inc. and Subsidiary
## Board of Trustees and Principal Employees
## December 31, 2016

# 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, 2016 and 2015, 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



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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, 2016 and 2015, and the change in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### *Other Matters*

*Other Information*

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

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated May 24, 2017, 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 24, 2017

Consolidated Financial Statements

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

## Consolidated Statements of Financial Position

## December 31,

| | 2016 | 2015 (as restated) |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | **$ 5,749,445** | $ 5,246,334 |
| Patient accounts receivable, net of allowance for doubtful accounts of $11,365,796 in 2016 and $7,020,737 in 2015 | **8,120,938** | 4,147,320 |
| Safety Net Care Pool receivable | **1,185,110** | 1,453,903 |
| Other receivables | **1,191,110** | 1,478,703 |
| Inventories | **1,082,047** | 1,368,913 |
| Prepaid expenses and deposits | **227,528** | 285,916 |
| Total current assets | **17,556,178** | 13,981,089 |
| Property, plant and equipment, net | **11,505,280** | 11,649,504 |
| Assets limited as to use | | |
| Assets held by trustee | **953,989** | 999,123 |
| Assets held for 457(b) plan | **444,795** | 411,414 |
| Investment in risk retention group | **2,158,682** | 2,670,060 |
| Total assets | **$ 32,618,924** | $ 29,711,190 |
| **Liabilities and Net Assets** | | |
| Current liabilities | | |
| Accounts payable | **$ 7,538,924** | $ 3,865,957 |
| Lease payable to McKinley County | **-** | 1,500,000 |
| Accrued salaries and related liabilities | **4,534,430** | 3,251,842 |
| Other accrued liabilities | **5,283,078** | 4,898,111 |
| Estimated third-party payor settlements | **1,370,924** | 1,246,884 |
| Current portion of long-term debt | **2,303,709** | 2,064,917 |
| Total current liabilities | **21,031,065** | 16,827,711 |
| Long-term debt, less current portion, net of unamortized debt issuance costs | **4,629,420** | 4,880,059 |
| Total liabilities | **25,660,485** | 21,707,770 |
| Net assets | | |
| Unrestricted | **5,703,912** | 7,280,366 |
| Temporarily restricted | **1,254,527** | 723,054 |
| Total net assets | **6,958,439** | 8,003,420 |
| Total liabilities and net assets | **$ 32,618,924** | $ 29,711,190 |

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

# Rehoboth McKinley Christian Health
# Care Services, Inc. and Subsidiary
## Consolidated Statement of Activities
## For the Year Ended December 31, 2016

| | Unrestricted | Temporarily Restricted | Total |
|---|---|---|---|
| **Operating Revenue** | | | |
| Net patient service revenue | $ 63,374,679 | $ - | $ 63,374,679 |
| Provision for uncollectible accounts | 5,913,656 | - | 5,913,656 |
| Net patient service revenue less provision for uncollectible accounts | 57,461,023 | - | 57,461,023 |
| Safety Net Care Pool revenue | 1,936,178 | - | 1,936,178 |
| Ad valorem tax revenue | 2,558,764 | - | 2,558,764 |
| Other operating revenue | 3,889,650 | 1,061,826 | 4,951,476 |
| Net assets released from restrictions | 530,353 | (530,353) | - |
| Total operating revenue | 66,375,968 | 531,473 | 66,907,441 |
| **Operating Expenses** | | | |
| Salaries, benefits, contract labor, and payroll taxes | 36,866,611 | - | 36,866,611 |
| Supplies | 7,184,221 | - | 7,184,221 |
| Professional fees | 6,053,175 | - | 6,053,175 |
| Purchased services | 6,865,373 | - | 6,865,373 |
| Rentals and leases | 2,240,496 | - | 2,240,496 |
| Depreciation and amortization | 1,913,759 | - | 1,913,759 |
| Other operating expenses | 2,325,636 | - | 2,325,636 |
| Utilities | 1,313,919 | - | 1,313,919 |
| Repairs and maintenance | 1,121,104 | - | 1,121,104 |
| Insurance | 765,034 | - | 765,034 |
| Licenses, permits, and fees | 345,851 | - | 345,851 |
| Total operating expenses | 66,995,179 | - | 66,995,179 |
| Operating income (loss) | (619,211) | 531,473 | (87,738) |
| Nonoperating income (expense) | | | |
| Investment loss | (521,116) | - | (521,116) |
| Interest expense | (436,127) | - | (436,127) |
| Total nonoperating expense, net | (957,243) | - | (957,243) |
| Change in net assets/revenues and gains over expenses and losses | (1,576,454) | 531,473 | (1,044,981) |
| Net assets, beginning of year | 7,280,366 | 723,054 | 8,003,420 |
| **Net assets**, end of year | $ 5,703,912 | $ 1,254,527 | $ 6,958,439 |

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

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

## Consolidated 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 | 5,553,521 | - | 5,553,521 |
| 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 | 266,285 | (266,285) | - |
| Total operating revenue | 58,130,539 | 454,669 | 58,585,208 |
| **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 | 1,981,653 | - | 1,981,653 |
| 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 | 432,097 | - | 432,097 |
| Total operating expenses | 54,395,745 | - | 54,395,745 |
| Operating income | 3,734,794 | 454,669 | 4,189,463 |
| Nonoperating income (expense) | | | |
| Investment income | 6,024 | - | 6,024 |
| Gain on disposal of property, plant, and equipment | (81,606) | - | (81,606) |
| Interest expense | (451,566) | - | (451,566) |
| Total nonoperating income (expense), net | (527,148) | - | (527,148) |
| Change in net assets/revenues and gains over expenses and losses | 3,207,646 | 454,669 | 3,662,315 |
| Net assets, beginning of year, as previously reported | 7,972,720 | 268,385 | 8,241,105 |
| Restatement (Note 10) | (3,900,000) | - | (3,900,000) |
| Net assets, beginning of year, as restated | 4,072,720 | 268,385 | 4,341,105 |
| **Net assets,** end of year (restated) | $ 7,280,366 | $ 723,054 | $ 8,003,420 |

**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,

| | 2016 | 2015 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash received from patients and third-party payors | **$ 53,611,445** | $ 44,230,598 |
| Cash received from Safety Net Care Pool and other operating receipts | **10,002,804** | 7,681,058 |
| Cash paid to employees and suppliers | **(60,864,830)** | (46,391,901) |
| Interest and dividends (paid) received | **(9,738)** | 20,783 |
| Interest paid | **(436,127)** | (451,566) |
| Net cash provided by operating activities | **2,303,554** | 5,088,972 |
| **Cash flows from investing activities** | | |
| Purchase of property, plant and equipment | **(1,552,141)** | (1,094,375) |
| Net cash used in investing activities | **(1,552,141)** | (1,094,375) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of long-term debt | **1,830,087** | 1,642,582 |
| Payments on long-term debt | **(2,078,389)** | (2,439,201) |
| Net cash used in financing activities | **(248,302)** | (796,619) |
| Net increase in cash and cash equivalents | **503,111** | 3,197,978 |
| Cash and cash equivalents, beginning of year | **5,246,334** | 2,048,356 |
| **Cash and cash equivalents,** end of year | **$ 5,749,445** | $ 5,246,334 |

**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,

| | **2016** | 2015 |
|---|---|---|
| **Reconciliation of change in net assets to net cash provided by operating activities** | | |
| Change in net assets | **$ (1,044,981)** | $ 3,662,315 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities | | |
| Depreciation | **1,913,759** | 1,981,653 |
| Amortization of debt issuance costs | **19,061** | 38,095 |
| Provision for uncollectible accounts | **5,913,656** | 5,553,521 |
| Forgiveness of rent expense | **-** | (1,000,000) |
| Loss on disposal of property, plant, and equipment | **-** | 81,606 |
| Unrealized loss on investments | **511,378** | 14,759 |
| Net changes in operating assets and liabilities | | |
| Patient accounts receivable | **(9,887,274)** | (3,913,324) |
| Safety Net Care Pool receivable | **268,793** | (1,453,903) |
| Other receivables | **287,593** | (550,126) |
| Inventories | **286,866** | (71,227) |
| Prepaid expenses and deposits | **58,388** | 97,522 |
| Accounts payable | **3,672,967** | (333,114) |
| Lease payable to McKinley County | **(1,500,000)** | 500,000 |
| Accrued salaries and related liabilities | **1,282,588** | 312,890 |
| Other accrued liabilities | **396,720** | (75,496) |
| Estimated third-party payor settlements | **124,040** | 243,801 |
| Net cash provided by operating activities | **$ 2,303,554** | $ 5,088,972 |
| **Supplemental schedule of noncash investing and financing activities** | | |
| Equipment acquired through capital lease | **$ 217,394** | $ 276,035 |
| Increase (decrease) in 457(b) investments recorded to other accrued liabilities | **$ (11,753)** | $ 96,370 |

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

## 1) Organization and Summary of Significant Accounting Policies

Organization

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

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

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

Basis of Presentation

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

Use of Estimates

Financial statement preparation in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the financial statement date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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.

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

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

On a monthly basis, RMCHCS evaluates patient accounts receivable balances older than six months to determine collectability. Accounts are considered uncollectible when there has been no recent payment activity and no other indication that payment will be received. Those balances that are considered uncollectible are written off upon approval from the Director of Patient Financial Services, Chief Financial Officer and Chief Executive Officer depending on the balance of the account. During 2016 and 2015, RMCHCS wrote off approximately $5.9 million and $5.6 million, respectively, to the provision for uncollectible accounts. RMCHCS's allowance for doubtful accounts was approximately 76% and 83% of patient accounts receivable at December 31, 2016 and 2015, respectively. RMCHCS did not change its charity care or uninsured discount policies during fiscal years 2016 or 2015.

<u>Other Receivables</u>
Other receivables consist of mill levy amounts due to RMCHCS, Safety Net Care Pool receivables and other receivables related to deposits etc.

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

Property, Plant and Equipment
Property, plant and equipment are recorded at cost. Property and equipment donated for RMCHCS 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:

| | 2016 | 2015 |
|---|---|---|
| Held by trustee under indenture agreement related to Series 2007 Revenue Bond - cash equivalents | **$ 953,989** | $ 999,123 |
| Irrevocable trust – 457(b) plan | | |
| Cash and cash equivalents | **31,982** | 9,674 |
| U.S. equity securities | **262,768** | 244,285 |
| Mutual funds | **60,770** | 57,124 |
| U.S. government securities | **89,275** | 100,331 |
| Total of irrevocable trust – 457(b) plan | **444,795** | 411,414 |
| | **$ 1,398,784** | $ 1,410,537 |

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.

Other Accrued Liabilities

Other accrued liabilities primarily consist of the Safety Net Care Pool payable and the estimated liability for malpractice and other claims outstanding.

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Other accrued liabilities | | | | |
| Safety net care pool | **$** | **4,530,503** | $ | 3,900,000 |
| Malpractice claims estimated liability | | **465,000** | | 690,000 |
| Other liabilities | | **287,575** | | 308,111 |
| Total other accrued liabilities | **$** | **5,283,078** | $ | 4,898,111 |

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, 2016 and 2015.

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 ASC 450-30, RMCHCS recognizes EHR incentive payments when all contingencies relating to the incentive payment have been satisfied with no subsequent payment adjustment. Certain contingencies require the demonstration of meaningful use which is based on meeting a series of objectives. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services (CMS). The amounts recorded are subject to audit by CMS. RMCHCS did not recognize any revenue related to EHR in 2016 or 2015. On March 21, 2017, RMCHCS filed its updated software with CMS demonstrating the use of certified EHR technology for 2016. RMCHCS had previously filed its software for the program in 2013; however, due to system constraints additional updates were needed to be compliant with the program. As such, RMCHCS does not believe they will be subject to any payment adjustments for 2016. In 2015, a hardship exemption letter was obtained from CMS that exempted RMCHCS from any fines or penalties for the lack of implementation in 2015.

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 $1,412,862 and $1,414,300 during the years ended December 31, 2016 and 2015, respectively.

Other Operating Revenue
Other operating revenue includes cafeteria, gift shop, donation, rent and grant revenues.

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

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

Advertising Costs
Advertising costs are expensed as incurred. Advertising expense totaled $180,128 and $168,455 for the years ended December 31, 2016 and 2015, respectively.

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.

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

Reclassifications
Certain reclassifications have been made to the 2015 financial information to conform to the 2016 financial statement presentation. Such reclassifications had no effect on 2015 net assets or change in net assets.

Subsequent Events
Subsequent events through May 24, 2017, the date which the financial statements were made available to be issued, were evaluated for recognition and disclosure in the December 31, 2016, 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 non-acute 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 2016 and 2015, 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 68% and 67%, respectively, of RMCHCS's net patient service revenue for the years ended December 31, 2016 and 2015.

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

| | Third-Party Payors | Self-Pay | Total All Payors |
|---|---|---|---|
| Year ended December 31, 2016 | $ 59,318,319 | $ 4,056,360 | $ 63,374,679 |
| Year ended December 31, 2015 | $ 49,054,674 | $ 4,398,968 | $ 53,453,642 |

Estimated third-party payor settlement liabilities are as follows:

| | December 31, 2016 | December 31, 2015 | Current Status |
|---|---|---|---|
| Medicare | | | |
| 2012 | **$ -** | $ (198,048) | Settled |
| 2013 | **(616,913)** | - | In progress |
| 2015 | **(737,731)** | - | In progress |
| 2016 | **-** | - | In progress |
| | **(1,354,644)** | (198,048) | |
| Medicaid | | | |
| 2009 | **-** | (737,693) | Settled |
| 2011 | **-** | (174,277) | Settled |
| 2012 | **-** | (120,586) | Settled |
| 2014 | **(16,280)** | (16,280) | In progress |
| 2015 | **-** | - | In progress |
| 2016 | **-** | - | In progress |
| | **(16,280)** | (1,048,836) | |
| Total | **$ (1,370,924)** | $ (1,246,884) | |

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

Other Third-Party Payors

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

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

| | **2016** | 2015 |
|---|---|---|
| Gross charges – inpatient | **$ 50,968,336** | $ 42,298,420 |
| Gross charges – outpatient | **127,138,292** | 94,155,276 |
| Charity care | **(2,268,936)** | (780,329) |
| Third party contractual allowances | **(112,463,013)** | (82,219,725) |
| Net patient service revenue | **$ 63,374,679** | $ 53,453,642 |

## 3) Fair Value Measurements

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

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

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

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

The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. RMCHCS has no Level 3 fair value measurements. In addition, RMCHCS had no transfers between levels during the years ended December 31, 2016 and 2015.

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, 2016 and 2015.

- 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, 2016, about RMCHCS's financial assets and liabilities measured at fair value on a recurring basis.

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

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 | $ 1,008,797 | $ 1,008,797 | $ - |
| Cash and cash equivalents | 244,285 | 244,285 | - |
| U.S. equity securities – various sectors | 87,342 | - | 87,342 |
| U.S. treasury notes | 57,124 | 57,124 | - |
| Mutual funds | 12,989 | - | 12,989 |
| FNMA mortgage backed securities | $ 1,410,537 | $ 1,310,206 | $ 100,331 |

## 4) Property, Plant and Equipment

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

| | **2016** | 2015 |
|---|---|---|
| Equipment | **$ 31,059,216** | $ 29,955,873 |
| Buildings and improvements | **29,464,288** | 29,174,698 |
| Land improvements | **1,868,790** | 1,851,994 |
| | **62,392,294** | 60,982,565 |
| Accumulated depreciation and amortization | **(52,253,530)** | (50,339,771) |
| | **10,138,764** | 10,642,794 |
| Land | **788,219** | 734,969 |
| Construction in progress | **578,297** | 271,741 |
| | **$ 11,505,280** | $ 11,649,504 |

## 5) Long-Term Debt

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

| | **2016** | 2015 |
|---|---|---|
| Series 2007A bonds, net of unamortized debt | **$ 4,479,612** | $ 4,846,428 |
| Notes payable and line of credit | **1,965,639** | 1,649,914 |
| Capital lease obligations | **487,878** | 448,634 |
| | **6,933,129** | 6,944,976 |
| Less current portion | **(2,303,709)** | (2,064,917) |
| | **$ 4,629,420** | $ 4,880,059 |

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.

In prior years, RMCHCS had reported debt issuance costs as a deferred charge in the statements of financial position and amortization of such costs in the income statement as amortization. To comply with the new presentation requirements under GAAP, in 2016 RMCHCS began reporting such costs as a direct deduction from the face amount of the related debt and reclassified prior year amounts, resulting in a reduction of total 2015 assets by $380,477. The change did not affect net assets.

Similarly, RMCHCS now reports 2016 amortization of debt issuance costs of $38,095 as interest expense and reclassified 2015 amounts accordingly. As a result, reported interest expense in 2015 was increased (and depreciation and amortization decreased) by $38,095, with no effect on net income.

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, 2016 and 2015, RMCHCS was in compliance with all compliance requirements.

Notes Payable and Line of Credit

On May 11, 2015, RMCHCS entered into a line of credit loan agreement with a financial institution totaling $750,000 to provide financing for the electronic health record system implementation. Under this agreement, the principal balance must be reduced by $150,000 every six months starting on June 15, 2015, and paid in full by December 15, 2017. The line of credit bears an interest rate of 4.25%. As of December 31, 2016, 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 was set to mature on June 15, 2016. On February 15, 2016, the loan was paid in full and an additional borrowing of $1,200,000 was made with all the same interest rate and payment terms. The maturity date on the new loan is June 15, 2017.

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 $505,489 and $448,634 at December 31, 2016 and 2015, 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 2019, accrue interest at rates ranging from 3.31% to 10.95%, and are secured by the related equipment.

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

| | Series 2007A Bonds | Notes Payable and Line of Credit | Capital Lease Obligations |
|---|---|---|---|
| Year ending December 31, | | | |
| 2017 | $ 352,917 | $ 1,707,886 | $ 242,906 |
| 2018 | 405,000 | 65,252 | 144,092 |
| 2019 | 425,000 | 68,765 | 100,880 |
| 2020 | 450,000 | 55,471 | - |
| Thereafter | 2,846,695 | 68,265 | - |
| | $ 4,479,612 | $ 1,965,639 | $ 487,878 |

## 6) Operating Leases

RMCHCS has a facility lease agreement with McKinley County, New Mexico extending through August 31, 2028, for use of the hospital building and dialysis building. The annual rent paid to the County for the use of the Hospital facility is $1,500,000 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, 2016 and 2015, RMCHCS had unpaid rent under this agreement of $0 and $1,500,000, 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 statement of activities for 2015.

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, 2016, are as follows:

| | Operating Leases |
|---|---|
| Year ending December 31, | |
| 2017 | $ 2,008,159 |
| 2018 | 1,875,245 |
| 2019 | 1,876,995 |
| 2020 | 1,876,995 |
| 2021 | 1,803,201 |
| Thereafter | 10,031,226 |
| Total minimum lease payments | $ 19,471,821 |

## 7) Employee Benefits

RMCHCS has established a Section 403(b) retirement plan (the "plan"). There is no minimum period of service or age in order to be eligible to participate; however, employees must make a minimum contribution to be eligible for a discretionary contribution. RMCHCS matches 30% of contributions up to 3% of the employee's salary. At December 31, 2016 and 2015, accrued employer contributions of $99,868 and $100,000 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, 2016 and 2015, was $444,795 and $411,414, respectively. The funded amount is included in assets limited as to use in the consolidated statements of financial position. The related liabilities of $444,795 and $411,414 as of December 31, 2016 and 2015, 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, 2016 and 2015, to cover claims which have been incurred but not reported. Such reserves were $420,000 and $463,183 at December 31, 2016 and 2015, respectively, and are included in accrued salaries and related liabilities in the accompanying consolidated statements of financial position.

## 9) Safety Net Care Pool Revenue

RMCHCS participates the Safety Net Care Pool (SNCP) program, previously known as the sole community provider indigent care program, administered by the State of New Mexico. Revenue from this program for the years ended December 31, 2016 and 2015, totaled approximately $4.9 million and $5.3 million, respectively. Of this balance approximately $1.2 and $1.5 million was a receivable as of December 31, 2016 and 2015, respectively.

## 10) Restatement of Previously Reported Amounts

RMCHCS has restated its previously issued 2015 consolidated financial statements for amounts payable back to the State of New Mexico under the SNCP program based on actual uncompensated care (UC) data from previous years. Consistent with state regulations, in December 2016 RMCHCS reconciled the 2015 actual SNCP payments to UC costs from the 2015 cost report. This reconciliation determined that RMCHCS was overpaid for 2015 UC. The accompanying financial statements for 2015 have been restated to reflect the correction. Net assets and accrued liabilities were increased in the consolidated statement of financial position by $3,900,000 at December 31, 2015.

## 11) 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 $2.6 and $2.5 million in 2016 and 2015, respectively.

## 12) Concentrations of Risk

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

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

| | **2016** | 2015 |
|---|---|---|
| Medicare | **28%** | 32% |
| Medicaid | **40%** | 33% |
| Other third-party payors | **23%** | 23% |
| Self-pay | **9%** | 12% |
| | **100%** | 100% |

## 13) Commitments and Contingencies

Healthcare Regulatory Environment

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

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

The Health Insurance Portability and Accountability Act (HIPAA) was enacted to assure health insurance portability, guarantee security and privacy of health information, and enforce standards for health information. Under the Health Information Technology for Economic and Clinical Health (HITECH) Act, several of the HIPAA security and privacy requirements 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. The purpose of this group is to provide malpractice and general liability coverage. RMCHCS recognizes annual changes in valuation through allocations. RMCHCS's allocation was a decrease of $511,378, from a total pool of $2,670,060, for 2016 and an increase of $14,759, from a total pool of $2,684,819, for 2015. 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, 2016 and 2015, 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

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

Workers' Compensation Insurance

Pursuant to the New Mexico Self Insurance Act, RMCHCS is insured under the New Mexico Hospital Workers Compensation Group for the purpose of providing insurance for workers' compensation coverage. The policy is retrospectively rated; premiums accrue based on the ultimate cost of the experience of a group of health care entities. At December 31, 2016 and 2015, 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.

## 14) 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:

| | **2016** | 2015 |
|---|---|---|
| Health care services | **$ 44,344,263** | $ 33,788,530 |
| Management and general | **22,440,951** | 20,329,102 |
| Fundraising | **209,965** | 278,113 |
| | **$ 66,995,179** | $ 54,395,745 |

## 15) 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.

## 16) Management Service Agreement and Anticipated Sale

In April 2014, the RMCHCS Board of Trustees made a decision to enter into an agreement to sell the assets of RMCHCS to Healthcare Integrity, LLC (HCI, LLC) wholly owned by David Conejo of Gallup, New Mexico. On August 29, 2014, the RMCHCS Board of Trustees entered into a management services agreement with NewLight Healthcare LLC to employ David Conejo as Chief Executive Officer of RMCHCS. On September 1, 2016, the RMCHCS Board of Trustees entered into a management agreement directly with HCI, LLC. Under this agreement, HCI, LLC provides management and administrative services for RMCHCS. The management services agreement costs $23,500 per month plus wages of the administrative staff employed by HCI, LLC. Currently, only the RMCHCS Chief Executive Officer is a HCI, LLC employees. RMCHCS incurred expenses of $914,764 and $624,972 respectively in 2016 and 2015 under these management agreements. These expenses are reported as portion of purchased services in the accompanying consolidated statements of activities. At December 31, 2016 and 2015, RMCHCS owed $0 and $53,434, respectively for management services which is reported as a portion of accounts payable in the accompanying consolidated statements of financial position. In conjunction with the Management Agreement RMCHCS gave HCI, LCC an option to purchase RMCHCS and the right of first refusal. The right of first refusal continues but due processing required because of RMCHCS tax exempt bonds no acquisition has transpired. In September 2016, RMCHCS entered a five-year management agreement with HCI while evaluation available options to HCI.

## 17) Future Operations

RMCHCS has experienced operating losses in recent years. In addition, other uncertainties exist with future legislation. Specifically, the State of New Mexico is evaluating implementation of a gross receipts tax on non-profit hospitals, which could be very costly to RMCHCS. If approved the tax would be effective January 1, 2018. In addition, the Affordable Care Act (ACA) was repealed in the House of Representatives. The ACA converted uncompensated care to Medicaid as a primary payer improving RMCHCS cash flow, so the repeal could have a significant effect on RMCHCS. Given these uncertainties, management is still confident that RMCHCS will continue as a going concern through 2017 and beyond because of the following:

- RMCHCS has structured a repayment plan for the SNCP liability. After meeting with the State of New Mexico, RMCHCS will satisfy this obligation through the State's recoupment of the next three quarterly SNCP installments and a monthly remittance of approximately $184,000.
- RMCHCS is implementing significant cost saving measures in 2017 to reduce expenses including implementing a plan to reduce total expenses by 10%. The various methods of achieving this will be through hours reductions for employees, eliminating positions, and other non-payroll cost saving initiatives.
- RMCHCS plans to treat more patients in-house versus having to refer them out to another facility. To do this, management plans to engage contract pulmonologists that will be available via telemedicine and activating the helipad.

New Mexico State Auditor's Supplementary Information

# Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
## Schedule of Pledged Collateral
## December 31, 2016

### 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 | $ 155,593 | $ 141,200 | $ 7,197 | $ - | $ (7,197) |
| Wells Fargo Bank – Bond Fund | 953,989 | 108,800 | 422,595 | - | (422,595) |
| Zia Trust | 28,994 | 28,994 | - | - | - |
| U.S. Bank | 180,397 | 180,397 | - | - | - |
| Bank of Colorado – Pinnacle Bank | 3,113,019 | 250,000 | 1,556,260 | - | (1,431,510) |
| Total | $ 4,431,992 | $ 709,391 | $ 1,986,052 | $ - | $ (1,861,302) |

### 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 | $ 2,728,889 | $ - | $ 2,783,467 | $ 2,783,467 | $ - |

### Pledged Collateral

| Type of security | Type of Security | CUSIP Number | Sequence Number | Maturity Date | Fair Value |
|---|---|---|---|---|---|
| FN-30 AB3575 | Wells Fargo | 3128MJV64 | 123016 | 5/1/2045 | $ 2,783,467 |

# Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
## Schedule of Deposits and Investments
## December 31, 2016

| Account Title | Account Type | Bank Balance | Reconciling Items | Book Balance |
|---|---|---|---|---|
| *Cash and Cash Equivalents* | | | | |
| **Wells Fargo Bank** | | | | |
| Operational | Operating | $ 107,289 | $ (3,640) | $ 103,649 |
| Operational | Depository | 11,815 | (122,366) | (110,551) |
| Operational | Accounts payable | - | (303,185) | (303,185) |
| Operational | Payroll | 2,578 | (1,171) | 1,407 |
| Operational | Pension | 33,911 | - | 33,911 |
| **U.S. Bank** | | | | |
| Athena Account | Checking | 180,397 | - | 180,397 |
| **Bank of Colorado – Pinnacle Bank** | | | | |
| Foundation Restricted Checking | Checking | 5,786 | (165) | 5,621 |
| Foundation Restricted | Money market account | 774,610 | - | 774,610 |
| Foundation Unrestricted Checking | Checking | 1,407 | - | 1,407 |
| Foundation Unrestricted Checking | Money market account | 46,550 | - | 46,550 |
| Grants | Checking | 500 | - | 500 |
| Mill Levy Proceeds | Checking | 2,262,345 | - | 2,262,345 |
| Auxiliary – Gift Shop | Checking | 12,986 | (498) | 12,488 |
| Auxiliary – General Account | Checking | 8,835 | (40) | 8,795 |
| Total deposits | | 3,449,009 | (431,065) | 3,017,944 |
| **Wells Fargo Bank** | | | | |
| Repurchase agreement | Sweep | 2,728,889 | - | 2,728,889 |
| **Other** | | | | |
| Petty cash | Cash | 3,495 | - | 3,495 |
| Flex comprehensive cash | Cash | - | (883) | (883) |
| Total cash and cash equivalents | | $ 6,181,393 | $ (431,948) | $ 5,749,445 |
| *Bond Funds and Other Investments* | | | | |
| **Wells Fargo Bank** | | | | |
| Series 2007 Bond Improvement Fund | Money market account | $ 94,934 | $ - | $ 94,934 |
| Series 2007 Bond Principal Fund | Money market account | 213,739 | - | 213,739 |
| Series 2007 Bond Reserve Fund | Money market account | 645,316 | - | 645,316 |
| **Zia Trust** | | | | |
| Irrevocable trust – 457(b) plan | Cash equivalent | 28,994 | - | 28,994 |
| Irrevocable trust – 457(b) plan | U.S. Treasury Securities | 2,987 | - | 2,987 |
| Irrevocable trust – 457(b) plan | Equity securities | 262,768 | - | 262,768 |
| Irrevocable trust – 457(b) plan | Fixed income securities and mutual funds | 150,046 | - | 150,046 |
| Total bond funds and other investments | | $ 1,398,784 | $ - | $ 1,398,784 |

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

## Schedule of Vendor Information

## For the Year Ended December 31, 2016

| RFB/ RFP# | Type of Procurement | Awarded Vendor | $ Amount of Awarded Contract | $ Amount of Amended Contract | Name and Physical Address per the procurement documentation, of ALL 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 |
|---|---|---|---|---|---|---|---|---|

**Notes to 2016 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, 2016.

# 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. ( RMCHCS), a New Mexico nonprofit organization, which comprise the consolidated statement of financial position as of December 31, 2016, 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 24, 2017.

**Internal Control Over Financial Reporting**

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

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



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Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses as 2016-001, that we consider to be a material weakness.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether RMCHCS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2016-002 through 2016-006.

**RMCHCS's Responses to Findings**

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

**Purpose of this Report**

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

REDW LLC

Albuquerque, New Mexico
May 24, 2017

# Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary
**Schedule of Findings and Responses**
**For the Year Ended December 31, 2016**

## Section I — Financial Statement Findings

### 2016–001 – Allowance Methodology for Accounts Receivable (Material Weakness)

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*Criteria:* Accounts receivable (AR) allowances should be based on actual historical collection data, composition of receivables, and management's general knowledge of industry and hospital collection expectations.

*Condition:* In 2016, management utilized a new methodology to estimate AR allowances. This new methodology used a six-month lookback comparing total collections to total adjustment. The new methodology did not account for certain factors resulting in an overstatement of net AR as of December 31, 2016.

*Cause:* The new model did not completely account for the increases to gross AR caused by a 20% charge master increase that occurred in 2016. Additionally, the new methodology only assessed accounts that had collections versus all outstanding accounts.

*Effect:* An audit adjustment of $2.9 million was required to increase the allowances as of December 31, 2016.

*Auditor's Recommendation:* Management should continue to refine the new allowance model for estimating allowances on a monthly basis. Consideration should be given to accounts where payments have not been made and the overall collection of aged AR. If changes to the charge master or other unusual circumstances arise in future years, management should adjust their model to accommodate these fluctuations. Adjustments should be recorded on a monthly basis to ensure that the financial statements presented to the Board are accurate.

*Management Response:* RMCHCS management has changed its look back approach to include all A/R and not just collected A/R. The CFO is responsible for this change. The change was made and applied to the April 30, 2017, internal financial statements.

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

### 2016-002 – Segregation of Duties (Finding That Does Not Rise to the Level of a Significant Deficiency)

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

*Condition:* Six of the 26 travel and expense reimbursements tested, totaling approximately $2,200, were approved by the same individual who submitted the reimbursement request. In addition, the same employee signed the reimbursement check.

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

*Effect*: Due to the lack of controls in place there was approximately $2,200 in travel reimbursements that were submitted and approved by the same individual.

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

*Management Response:* Management did a self-audit after receiving news of this situation. The documents in question were approved post audit noting their appropriateness. The process that failed had been corrected earlier. A new employee did not realize that certain documents require a secondary approving signature. This employee was trained on approval processes. The six examples in question occurred prior to this training. Subsequent payments appear to be compliant with the process. The CFO is responsible for this change and effectively implemented it in July 2016 with ongoing daily monitoring.

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

**2016-003 [2015-003] – Inventory Count Discrepancies (Finding That Does Not Rise to the Level of a Significant Deficiency)**

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*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 one of the 25 inventory items selected for testing. In total, this amount only represented a $4.16 difference; however, this error rate could not be extrapolated to the total population. Management did complete its response plan from 2015 and conducted quarterly spot checks throughout the year of various inventory balances; however, 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.

*Cause:* There was not adequate controls in place to verify that the counts performed by RMCHCS personnel were accurate.

*Effect:* Errors in the year-end inventory count 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:* RMCHCS will review inventory count process with the appropriate staff to improve accuracy.

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

**2016-004 – Untimely Cash Deposits (Other Noncompliance)**

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

*Condition:* Six of the 31 deposits tested were not deposited within the required timeframe. Exceptions were noted at the College Clinic, Red Rock Clinic, Cardiology Clinic, the Customer Service department, and Hospital admissions.

*Cause:* In the College Clinic, the automatic deposit machine for checks was not in service for a portion of the year, so deposits were picked up three times a week, as opposed to being electronically deposited daily. The remaining clinics did not have adequate controls in place to ensure that deposits of cash received were made within the required timeframe.

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

*Auditor Recommendation:* RMCHCS should establish controls to ensure that deposits are made within 24 hours of receipt. Additionally, the College Clinic Desktop Deposit scanning machine should be repaired to allow for real time deposits without the use of a courier.

*Management Response:* RMCHCS has replaced hardware in all locations to ensure timely deposits of checks and negotiable instruments. Additionally, management will evaluate and implement (where cost effective) a process of depositing cash daily.

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

**2016-005 – Capital Asset Physical Inventory Count Not Performed (Other Noncompliance)**

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*Criteria or Specific Requirement:* Subsection A of Section 12-6-10 NMSA 1978 requires each agency to conduct an annual physical inventory of movable chattels and equipment on the inventory list at the end of each fiscal year. The agency shall certify the correctness of the inventory after the physical inventory is performed. This certification should be provided to the agency's auditors.

*Condition:* A physical inventory count of capital assets was not performed during 2016.

*Cause:* A physical inventory count of capital assets was not performed due to other priorities at year-end.

*Effect:* RMCHCS's capital assets listing may be incorrect.

*Auditor Recommendation:* RMCHCS should assign the responsibility to perform the capital asset inventory count each year to a member of management to ensure that RMCHCS remains in compliance.

*Management Response:* RMCHCS will follow process to ensure the capital assets inventory is completed each year. The CFO, or his appointee, will perform a capital asset inventory commencing in November 2017.

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

**2016-006 – Collateralization of Public Funds (Other Noncompliance)**

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*Criteria or Specific Requirement:* According to the Audit Rule 2016 (Subsection M 2.2.2.10 NMAC "Public Monies,") Public Monies is defined as all monies coming into all agencies (i.e. vending machines, fees for photocopies, telephone charges etc.). Any funds considered public monies must be collateralized at 50% of the deposit amount. Since RMCHCS is considered an agency of the State, all money held by RMCHCS must be collateralized at 50%.

*Condition:* At December 31, 2016, RMCHCS had uninsured bank deposits of $3,776,972. State law requires that $2,013,237 of these bank deposits be collateralized.

*Cause:* RMCHCS did not have 50% collateralization coverage on all public monies that are held in a financial institution exceeding the FDIC coverage of $250,000.

*Effect:* RMCHCS deposits were not collateralized appropriately, and RMCHCS was not in compliance with the public money requirements.

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

*Management Response:* RMCHCS has been in contact with the financial institution on this topic. The financial institution and RMCHCS have executed agreements for funds to be collateralized pursuant to public money regulations effective June 1, 2017.

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

## Current Status Schedule of 2017 Audit Findings

## For the Year Ended December 31, 2016

| Prior-Year Number | Description | Current Status |
|---|---|---|
| 2015-001 | Patient Account Write-Off Access | Resolved |
| 2015-002 | Analysis of Liability Account | Resolved |
| 2015-003 | Inventory Count Discrepancies | Unresolved-See planned corrective action at 2016-003 |
| 2015-004 | Disposition of Property | Resolved |
| 2013-006 | Personnel File Pay Rate Support | Resolved |

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

### Exit Conference and Board of Trustees Presentation

An exit conference was held on May 18, 2017, with the following attending:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary:
David Conejo, CEO
John McMullin, CPA, MBA, FHFMA, CFO

REDWLLC:
Halie Garcia, Principal
Claire Hilleary, Manager

A presentation was made to a closed session of the Board of Trustees on May 18, 2017, with the following attendees:

Rehoboth McKinley Christian Health Care Services, Inc. and Subsidiary (includes 2016 Board members and titles):
David Dallago, Chair
Lorelei Kay, Board Member
John Luginbuhl, Board Member
Ken Zylstra, Board Member
David Conejo, Chief Executive Officer
John McMullin, CPA, MBA, FHFMA, Chief Financial Officer
Mary Lou Donkersloot, Executive Administrative Assistant (Recorder)

REDWLLC:
Halie Garcia, 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.