Sierra Vista Hospital

Basic Financial Statements and
Independent Auditors' Reports

June 30, 2008 and 2007

Sierra Vista Hospital
Table of Contents
June 30, 2008 and 2007

INTRODUCTORY SECTION

Sierra Vista Hospital
Governing Board and Principal Employees
June 30, 2008 and 2007

County of Sierra, New Mexico, Representative
Eunice Kent, Secretary
Nadyne Gardner Daves
Sandy Jones

City of Truth or Consequences, New Mexico, Representative
Jack Baker, Vice Chairperson
Bobby Allen
Ann Filosa

Village of Williamsburg, New Mexico, Representative
Greg D'Amour, Chairperson

Ex-officio Members
Domenica Rush, Sierra Vista Hospital Administrator
Janet Porter Carrejo, County of Sierra, New Mexico, County Manager
Jaime Aguilera, City of Truth or Consequences, New Mexico, City Manager
Renee Stamper, Village of Williamsburg, New Mexico, Village Clerk

Principal Employee
Domenica Rush, Administrator

FINANCIAL SECTION

Dingus, Zarecor & Associates PLLC
CERTIFIED PUBLIC ACCOUNTANTS
12015 East Main, Suite A • Spokane Valley, Washington 99206
(509) 242-0874 office • (509) 242-0877 fax • www.dzacpa.com

INDEPENDENT AUDITORS' REPORT

Joint Powers Commission, Governing Board
and Management of Sierra Vista Hospital,
and Mr. Hector H. Balderas
New Mexico State Auditor

We have audited the accompanying financial statements of the business-type activities of Sierra Vista Hospital (the Hospital) as of and for the years ended June 30, 2008 and 2007, which collectively comprise the Hospital's basic financial statements as listed in the table of contents. We also have audited the budgetary comparison of the Hospital for the year ended June 30, 2008, presented as supplemental information as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express opinions on these 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Hospital as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement referred to above presents fairly, in material respects, the budgetary comparison of the Hospital for the year ending June 30, 2008, and for the year ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2008, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 4 through 8 and 27, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Hospital's basic financial statements. The schedules of pledged collateral are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedules of pledged collateral have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
December 11, 2008

Sierra Vista Hospital
Management's Discussion and Analysis
Years Ended June 30, 2008 and 2007

Our discussion and analysis of Sierra Vista Hospital's (the Hospital) financial performance provides an overview of the Hospital's financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the Hospital's financial statements, which begin on page 9.

Financial Highlights

- The Hospital's net assets fluctuated in each of the past two years with a $328,160 or 27.2% decrease in 2008 and $139,488 or 13.1% increase in 2007.
- The Hospital reported operating losses in both 2008 ($1,299,489) and 2007 ($708,444). Losses in 2008 increased by $591,045 or 83.4% over the loss reported in 2007. Operating losses in 2007 increased by $169,076 or 31.3% over the loss reported in 2006.
- Nonoperating net revenues increased by $122,700 or 15.2% in 2008 compared to 2007. Nonoperating net revenues increased in 2007 by $196,660 or 32.3% in 2007 compared to 2006.

Using This Annual Report

The Hospital's financial statements consist of three statements – a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

Our analysis of the Hospital finances begins on page 5. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. You can think of the Hospital's net assets—the difference between assets and liabilities—as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from? What was cash used for? What was the change in cash balance during the reporting period?"

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 9. The Hospital's net assets decreased by $328,160 or 27.2% in 2008 and increased by $139,488 or 13.1% in 2007, as shown in Table 1.

Table 1. Assets, Liabilities, and Net Assets

	2008	2007	2006
Assets			
Current assets	**$ 2,714,115**	$ 2,520,271	$ 2,649,485
Capital assets, net	**1,691,772**	1,788,936	1,449,605
Total assets	**$ 4,405,887**	$ 4,309,207	$ 4,099,090
Liabilities and net assets			
Current liabilities	**$ 2,983,634**	$ 2,522,666	$ 2,843,704
Capital lease obligations	**545,575**	581,703	190,036
Total liabilities	**3,529,209**	3,104,369	3,033,740
Net assets			
Invested in capital assets, net of related debt	**924,922**	975,809	1,133,384
Unrestricted	**(48,244)**	229,029	(68,034)
Total net assets	**876,678**	1,204,838	1,065,350
Total liabilities and net assets	**$ 4,405,887**	$ 4,309,207	$ 4,099,090

A significant component of the change in the Hospital's assets is the increase in current assets. In 2008 current assets increased by $193,844. The most significant change in current assets is the increase in cash of $532,921. During 2008, net capital assets decreased by $97,164 because depreciation exceeded additions of new capital assets. Net patient service revenue, net of provision for bad debts, increased by $103,897 or 1.4% in 2008 compared to 2007 and patient accounts receivable, net of estimated uncollectible amounts, decreased by $19,550 or 1.2% in 2008 compared to 2007.

The composition of total assets has increased gradually over the last three years. Assets for 2008 are above both 2007 and 2006. Total assets consist primarily of accounts receivable and property and equipment. Total liabilities have continued to increase over the last three years due mainly to a Medicaid advance and an increase in third-party payor settlements payable.

Operating Results and Changes in the Hospital's Net Assets

In 2008, the Hospital's net assets decreased by $328,160 or 27.2%, as shown in Table 2. This decrease is the result of total operating revenues increasing $452,442, while total operating expenses increased by $1,043,487. Additionally, nonoperating revenues improved by $122,700 in 2008.

Table 2. Operating Results and Changes in Net Assets

	2008	2007	2006
Operating revenues			
Net patient service revenue	**$ 7,647,696**	$ 7,543,799	$ 7,061,350
Sole community provider	**1,685,726**	1,361,117	1,216,803
Grants and other operating revenue	**101,657**	77,721	99,222
Total operating revenues	**9,435,079**	8,982,637	8,377,375
Operating expenses			
Salaries, wages, and benefits	**6,776,538**	5,822,916	5,453,474
Supplies, insurance, and other	**3,541,635**	3,512,520	3,171,875
Depreciation and amortization	**416,395**	355,645	291,394
Total operating expenses	**10,734,568**	9,691,081	8,916,743
Operating loss	**(1,299,489)**	(708,444)	(539,368)
Nonoperating revenues (expenses)			
Gross receipts and mill levy tax revenue	**665,127**	633,598	742,358
Sierra County 412 Fund revenue	**220,000**	260,000	-
Grant revenue	**161,700**	-	-
Contributions	**-**	85,337	1,500
Interest expense	**(118,744)**	(167,011)	(134,716)
Other, net	**549**	(5,992)	130
Total nonoperating revenues (expenses), net	**928,632**	805,932	609,272
Excess of revenues over (under) expenses before capital contributions	**(370,857)**	97,488	69,904
Capital contributions	**42,697**	42,000	-
Change in net assets	**(328,160)**	139,488	69,904
Net assets, beginning of year	**1,204,838**	1,065,350	995,446
Net assets, end of year	**$ 876,678**	$ 1,204,838	$ 1,065,350

Analysis of Financial Position, Results of Operations, Nonoperating Activities, and Cash Flows

For the last three years, operating revenues and expenses have increased with patient volume. Operating revenues in 2008 have increased from 2007 by $452,442 or 5.0% and 2007 increased from 2006 by $605,262 or 7.2%. Operating expenses have increased from 2007 by $1,043,487 or 10.8% and 2007 increased from 2006 by $774,338 or 8.7%. Because expenses have been increasing more than revenues our operating loss has grown to $1,299,489 in 2008 over the operating losses of $708,444 in 2007 and $539,368 in 2006. The operating loss in 2008 is offset in large part by the nonoperating revenues of $928,632.

Changes in volumes over the last three years have led to increases in total operating revenues. During 2008 the Hospital initiated a hospitalist program that led to a significant increase in inpatient care. A hospitalist is a physician dedicated to providing inpatient care on a 24-hour basis. Additionally, the Hospital benefited from increases in sole community provider revenues and grant revenues.

Consistent with the healthcare industry nationally, as well as in New Mexico, wages, payroll taxes, and employee benefits have seen the highest increases of individual expense line items. The healthcare labor market is very competitive and healthcare providers must continually increase their salary and wage scales in order to attract, and then retain, caregivers. This represents an ongoing pressure on the operating results of providers.

Table 3. Budget to Actual

Actual results compare unfavorably to budgeted amounts for the hospital due to actual revenues being $714,664 less than budgeted, however actual expenses were $87,505 less than budgeted. This results in a loss of $328,160 as compared to budgeted net income of $298,999, as shown in table 3.

	Actual	Original and Final Budget	Positive (Negative) Variance
Budgetary basis revenues	**$ 10,406,408**	$ 11,121,072	$ (714,664)
Budgetary basis expenses	**10,734,568**	10,822,073	87,505
Excess of revenues over (under) expenses	**$ (328,160)**	$ 298,999	$ (627,159)

Capital Asset and Debt Administration

Capital Assets

At the end of 2008, the Hospital had $1,691,772 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the basic financial statements. In 2008, the Hospital purchased new equipment costing $312,731. In 2007, $698,595 was spent to acquire new equipment

Capital Asset and Debt Administration (continued)

Debt

At year end, the Hospital had $766,850 in capital lease obligations outstanding as detailed in note 7 to the financial statements. Except for capital leases of $196,726 and $628,719, initiated in 2008 and 2007 respectively, the Hospital issued no new debt in 2008 or 2007. The Hospital cannot issue formal debt issuances of revenue notes without approval of the County of Sierra (the County) Board of Commissioners. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in the Hospital's debt ratings in the past two years.

Currently Known Facts, Decisions, and Conditions

The healthcare industry is subject to a tremendous amount of regulatory activity related to the provision of services as well as the billing for such services. Many different regulatory agencies establish standards that must be met by the Hospital in order for it to continue its operations. The costs involved with meeting constantly changing regulations can create a costly burden for the Hospital. The costs of not meeting such regulations, however, are potentially far greater. Significant penalties are assessed, for example, when fraud and/or abuse, either intentional or unintentional, is noted in billings submitted to Medicare or Medicaid. There has been no such activity detected at the Hospital.

There will continue to be significant pressure on net patient service revenues in the future. Changes in the Medicare and Medicaid programs and the possible reduction of funding could have an adverse impact on the Hospital. Negotiations with other third-party payors regarding payment for services provided to these payors' insured members are critical to maintaining the Hospital's financial position. These third-party payors are facing increasing pressures on their own operating results. In addition, the costs of providing care to uninsured patients are very significant due to the high percentage of such patients within New Mexico. Economic conditions in Truth or Consequences and the surrounding area can have a direct impact on the Hospital's operating results.

Healthcare expenditures are expected to continue representing a greater and greater percentage of the Gross National Product. The costs related to salaries, wages, payroll taxes, and employee benefits will continue to increase due to what is expected to be continued intense competition for caregivers and qualified administrative personnel. Pharmaceutical and medical supply costs are also expected to continue to increase.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the finance department at 800 East 9th Street, Truth or Consequences, New Mexico 87901.

Sierra Vista Hospital
Balance Sheets
June 30, 2008 and 2007

ASSETS		**2008**		**2007**
Current assets				
Cash and cash equivalents	**$**	**532,921**	$	-
Patient accounts receivable, net of estimated uncollectible accounts of $1,849,342 and $1,301,563, respectively		**1,593,183**		1,612,733
Sole community provider receivable		**-**		370,148
Taxes receivable		**48,140**		51,481
Estimated third-party payor settlements receivable		**-**		327,826
Grant receivable		**261,700**		-
Inventories		**226,122**		143,613
Prepaid expenses		**52,049**		14,470
Total current assets		**2,714,115**		2,520,271
Capital assets, net		**1,691,772**		1,788,936
Total assets	**$**	**4,405,887**	$	4,309,207
LIABILITIES AND NET ASSETS				
Current liabilities				
Cash overdraft	**$**	**-**	$	113,257
Current maturities of capital lease obligations		**221,275**		231,424
Medicaid advance		**500,000**		-
Accounts payable		**899,317**		1,304,651
Accrued compensation and related liabilities		**519,486**		493,922
Estimated third-party payor settlements payable		**470,576**		-
Due to Joint Powers Commission entities		**194,632**		202,942
Deferred grant revenue		**100,000**		-
Accrued lawsuit settlement		**78,348**		98,122
Total current liabilities		**2,983,634**		2,444,318
Accrued lawsuit settlement, net of current portion		**-**		78,348
Capital lease obligations, net of current maturities		**545,575**		581,703
Total liabilities		**3,529,209**		3,104,369
Net assets (deficit)				
Investment in capital assets, net of related debt		**924,922**		975,809
Unrestricted		**(48,244)**		229,029
Total net assets		**876,678**		1,204,838
Total liabilities and net assets	**$**	**4,405,887**	$	4,309,207

The accompanying notes are an integral part of the basic financial statements.

Sierra Vista Hospital
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2008 and 2007

	2008	2007
Operating revenues		
Net patient service revenue, net of provision for bad debts of $2,837,827 and $2,078,669, respectively	**$ 7,647,696**	$ 7,543,799
Sole community provider	**1,685,726**	1,361,117
Grants	**58,988**	32,900
Other	**42,669**	44,821
Total operating revenues	**9,435,079**	8,982,637
Operating expenses		
Salaries and wages	**5,842,810**	4,974,209
Employee benefits	**933,728**	848,707
Professional fees	**1,568,260**	1,593,314
Supplies	**804,533**	949,354
Utilities	**265,239**	196,938
Repairs and maintenance	**154,047**	91,332
Leases and rentals	**58,965**	76,592
Depreciation and amortization	**416,395**	355,645
Insurance	**346,131**	328,791
Other	**344,460**	276,199
Total operating expenses	**10,734,568**	9,691,081
Operating loss	**(1,299,489)**	(708,444)
Nonoperating revenues (expenses)		
Gross receipts tax revenue	**231,708**	218,656
Mill levy revenue	**433,419**	414,942
Sierra County 412 Fund revenue	**220,000**	260,000
Grant revenue	**161,700**	-
Contributions	**-**	85,337
Interest income	**549**	1,424
Interest expense	**(118,744)**	(167,011)
Loss on sale of assets	**-**	(7,416)
Total nonoperating revenues (expenses), net	**928,632**	805,932
Excess of revenues over (under) expenses before capital contributions	**(370,857)**	97,488
Capital contributions	**42,697**	42,000
Change in net assets	**(328,160)**	139,488
Net assets, beginning of year	**1,204,838**	1,065,350
Net assets, end of year	**$ 876,678**	$ 1,204,838

The accompanying notes are an integral part of the basic financial statements.

Sierra Vista Hospital
Statements of Cash Flows
Years Ended June 30, 2008 and 2007

	2008	2007
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities		
Receipts from and on behalf of patients	**$ 11,021,522**	$ 8,640,230
Receipts from grants	**58,988**	32,900
Receipts from other revenue	**42,669**	44,821
Payments to employees	**(6,750,974)**	(5,870,906)
Payments to suppliers and contractors	**(4,165,179)**	(3,341,801)
Net cash provided by (used in) operating activities	**207,026**	(494,756)
Cash flows from noncapital financing activities		
Checks outstanding in excess of deposits	**(113,257)**	(11,134)
Payments to the Joint Powers Commission entities	**(303,102)**	(426,792)
Advances from the Joint Powers Commission entities	**294,792**	275,610
Noncapital contributions	**-**	85,337
Receipts from gross receipts tax	**233,960**	224,025
Receipts from mill levies	**434,508**	416,783
Receipts from Sierra County 412 fund	**220,000**	260,000
Net cash provided by noncapital financing activities	**766,901**	823,829
Cash flows from capital and related financing activities		
Payment of capital lease obligations	**(243,003)**	(131,813)
Interest paid	**(118,744)**	(167,011)
Capital contributions	**42,697**	42,000
Purchase of capital assets	**(122,505)**	(78,486)
Proceeds from sale of capital assets	**-**	4,813
Net cash used in capital and related financing activities	**(441,555)**	(330,497)
Cash flows from investing activities		
Interest received	**549**	1,424
Net increase in cash and cash equivalents	**532,921**	-
Cash and cash equivalents, beginning of year	**-**	-
Cash and cash equivalents, end of year	**$ 532,921**	$ -

The accompanying notes are an integral part of the basic financial statements.

Sierra Vista Hospital
Statements of Cash Flows (Continued)
Years Ended June 30, 2008 and 2007

	2008	2007
Reconciliation of Operating Loss to Net Cash Provided by (Used In) Operating Activities		
Operating loss	**$ (1,299,489)**	$ (708,444)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation and amortization	**416,395**	355,645
Provision for bad debts	**2,837,827**	2,078,669
Changes in assets and liabilities:		
Patient accounts receivable	**(2,818,277)**	(1,991,913)
Sole community provider receivable	**370,148**	(47,528)
Estimated third-party payor settlements receivable	**327,826**	(303,914)
Inventories	**(82,509)**	97,644
Prepaid expenses	**(37,579)**	289,046
Medicaid advance	**500,000**	-
Accounts payable	**(405,334)**	(167,441)
Accrued compensation and related liabilities	**25,564**	(47,990)
Estimated third-party payor settlements payable	**470,576**	-
Accrued lawsuit settlement	**(98,122)**	(48,530)
Net cash provided by (used in) operating activities	**$ 207,026**	$ (494,756)

Noncash Capital and Related Financing Activities

The Hospital entered into capital lease obligations of $196,726 and $628,719 during fiscal years 2008 and 2007, respectively.

The accompanying notes are an integral part of the basic financial statements.

1. Description of Reporting Entity, Component Unit, and Summary of Significant Accounting Policies:

a. Reporting Entity

Sierra Vista Hospital (the Hospital) operates a 25-bed critical access hospital, rural health clinic, and behavioral health services in Truth or Consequences, New Mexico. The Hospital provides inpatient, outpatient, physician, and counseling services for the residents of the County of Sierra, New Mexico.

Pursuant to the authority provided by the Joint Powers Agreement Act (11-1-1 et. seq. NMSA 1978) and the Hospital Funding Act (Section 4-48B-9 NMSA), the County of Sierra, New Mexico (the County), the City of Truth or Consequences, New Mexico (the City), and the Village of Williamsburg, New Mexico (the Village) entered into a joint powers agreement (JPA) to operate Sierra Vista Hospital for the benefit of their citizens.

A Joint Powers Commission (JPC) was created which has general fiscal oversight authority and responsibility for the Hospital. The JPC consists of the three County Commissioners, three City Commissioners and three Village Trustees. Each participating governing body appoints their respective members to serve on the JPC.

The JPC established a governing board to exercise all powers and carry out all duties that the JPC may be authorized to exercise by law, including but not limited to the Hospital Funding Act, with respect to the operation and control of the Hospital, except for the power to issue bonds, call an election for the purpose of authorizing the issuance of bonds, imposition of a mill levy or other tax or to levy annual assessments for a mill levy or other tax. A total of seven Sierra County full-time residents are appointed by the JPC to the governing board for terms not to exceed three years. The County and City each appoint three members and the Village appoints one member.

All real property purchased or acquired under the terms of the JPA are owned by the participating parties as follows: County – 47.5%, City – 47.5%, and Village – 5.0%.

b. Component Unit

As required by accounting principles generally accepted in the United States of America, the financial statements present the Hospital—the primary government—and its component unit. The component unit discussed below is included in the Hospital reporting entity because of the significance of its operations or financial relationships with the Hospital.

Sierra Vista Hospital Development Organization – The Sierra Vista Hospital Development Organization, Inc. (the Organization) is a separate nonprofit corporation with a fiscal year end of December 31. The Organization was organized to solicit and accept charitable contributions in order to provide support to the Hospital. The Organization did not contribute to the Hospital during the year ended June 30, 2008. The Hospital provided support to the Organization of $120,334 during the year ended June 30, 2008. This support included the Organization's director and assistant salaries as well as office space costs.

1. Description of Reporting Entity, Component Unit, and Summary of Significant Accounting Policies (continued):

b. Component Unit (continued)

The Organization's condensed balance sheet at December 31, 2007, is summarized as follows:

		2007
Assets		
Cash	$	24,913
Total assets	$	24,913
Liabilities		
Note payable	$	15,000
Net assets		9,913
Total liabilties and net assets	$	24,913

The Organization's condensed statement of revenues, expenses, and changes in net assets for the year ended December 31, 2007, is summarized as follows:

		2007
Revenues		
Contributions	$	54,247
Expenses		
Management and general		807
Fund raising		43,527
Total expenses		44,334
Change in net assets		9,913
Net assets, beginning of year		-
Net assets, end of year	$	9,913

In July 2008, the Organization received $711,047 in appropriations from the Department of Health and Human Services on behalf of the Hospital to be used for construction, renovation, and equipment. In December 2008, the Organization received $160,000 from the Wolslager Foundation on behalf of the Hospital for mammography equipment.

Community Health Foundation – The Community Health Foundation (the Foundation) is a related party of the Hospital since the Hospital is its sole stated beneficiary. The Foundation is authorized by the Hospital to solicit contributions on its behalf. The Foundation's financial position is not material to the Hospital and has not been consolidated in these financial statements. The Foundation contributed $0 and $3,000 to the Hospital during fiscal years 2008 and 2007, respectively.

1. Description of Reporting Entity, Component Unit, and Summary of Significant Accounting Policies (continued):

c. Summary of Significant Accounting Policies

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual events and results could differ from those estimates.

Enterprise fund accounting – The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board, including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and cash equivalents – Cash and cash equivalents include business checking accounts maintained with local financial institutions, cash on hand, and investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by the Board's designation or other arrangements under bond indenture agreements.

Patient accounts receivable – Receivables arising from patient service revenues are reduced by an allowance for uncollectible accounts and contractual adjustments based on experience, third-party contractual arrangements, and any unusual circumstances which may affect the ability of patients to meet their obligations. Accounts deemed uncollectible are charged against this allowance.

Inventories – Inventories consist of medical, pharmaceutical, and dietary supplies and are stated at the lower of cost (using the first-in, first-out method) or market value.

Compensated absences – The Hospital's employees earn paid days off at varying rates depending on years of service. Paid days off earned, but not used, are paid upon termination.

Income taxes – The Hospital is exempt from federal and state income tax as it is jointly owned by the County, City, and Village.

Restricted resources – When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Net assets – Net assets of the Hospital are classified in four components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted*. The Hospital did not have any restricted net assets at June 30, 2008 and 2007.

1. Description of Reporting Entity, Component Unit, and Summary of Significant Accounting Policies (continued):

c. Summary of Significant Accounting Policies (continued)

Operating revenues and expenses – The Hospital's statements of revenues, expenses, and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions, including grants for specific operating activities associated with providing healthcare services—the Hospital's principal activity. Nonexchange revenues, including taxes and contributions received for purposes other than capital assets acquisitions, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services other than financing costs.

Grants and contributions – From time to time, the Hospital receives grants from the County, City, and State as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Grants that are unrestricted or that are restricted to a specific operating purpose are reported as operating revenues. Grants that are used to subsidize operating deficits are reported as nonoperating revenues. Contributions, except for capital contributions, are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported as nonoperating revenues and expenses.

Net patient service revenue – Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Net patient service revenue also includes estimated retroactive adjustments under reimbursement agreements with third-party payors.

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Provisions for estimated third-party payor settlements are provided in the period the related services are rendered. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the year of settlement.

Charity care – The Hospital provides care to patients who lack financial resources and are deemed to be medically indigent based on criteria established under the Hospital's charity care policy. This care is provided without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care provided. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The charges related to this care approximated $156,000 and $200,000 in 2008 and 2007, respectively. In addition, the Hospital provides services to other medically indigent patients under various state and local governmental programs. Such programs pay amounts that are less than the cost of the services provided to the recipients.

1. Description of Reporting Entity, Component Unit, and Summary of Significant Accounting Policies (continued):

c. Summary of Significant Accounting Policies (continued)

Budgets and budgetary accounting – Prior to the beginning of each fiscal year, an accrual basis budget for the Hospital is prepared by the Hospital's management and is presented to the governing board and then the JPC for approval. Upon approval, the budget is sent to the State of New Mexico Department of Finance and Administration (DFA) for tentative approval. Final approval is granted after the beginning of the fiscal year when the fund balances for the prior year are known. Expenditures cannot legally exceed the total fund budget. Any budget amendments are approved by the Board and the JPC and sent to the DFA for approval. Budgeted amounts may be transferred between departments within a fund; however, any revisions that alter the total expenditures of a fund must be approved by the DFA.

Reclassifications – Certain reclassifications of the 2007 amounts have been made in the financial statements in order to conform to the 2008 presentation. These reclassifications had no effect on the previously reported change in net assets.

2. Compliance and Accountability:

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of various statutes and regulations by healthcare providers. 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. Management believes that the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations. If the Hospital is found in violation of these laws, the Hospital could be subject to substantial monetary fines, civil and criminal penalties, and exclusion from participation in the Medicare and Medicaid programs.

3. Deposits and Investments:

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a custodial risk policy.

The Hospital's deposits are covered by the Federal Deposit Insurance Corporation (FDIC) up to $100,000 at each financial institution. In accordance with Section 6-10-17, NMSA, 1978 Compilation, the Hospital is required to collateralize an amount equal to one-half of the public money in excess of $100,000 at each financial institution.

Of the Hospital's total deposits of $736,268 and $66,624 at June 30, 2008 and 2007, respectively, none was exposed to custodial credit risk because the collateral was held in the name of the financial institution and are fully insured by the FDIC.

Statutes authorize the Hospital to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, commercial paper, and bankers' acceptances.

4. Net Patient Service Revenue:

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

- *Medicare* – The Hospital has been designated a critical access hospital and the clinic a rural health clinic by Medicare. Hospital inpatient and outpatient services and the rural health clinic are reimbursed by Medicare on a cost basis as defined and limited by the Medicare program. The Hospital and rural health clinic are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. Final settlements are estimated and recorded in the financial statements in the year in which they occur.
- *Medicaid/SALUD!* – The Hospital participates in the New Mexico Medicaid managed care program. Inpatient acute care services are primarily paid at per diem rates varying according to the level of inpatient services provided. Outpatient services are paid as a percentage of charges. Rural health clinic services are paid on a prospective rate per visit.
- *Other programs* – The Hospital has patient service agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Revenue from the Medicare and Medicaid programs accounted for approximately 55% and 21% of the Hospital's net patient revenue for the year ended June 30, 2008. Revenue from the Medicare and Medicaid programs accounted for approximately 46% and 9% of the Hospital's net patient revenue for the year ended June 30, 2007. 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. The net patient service revenue decreased approximately $120,000 in 2008 and increased approximately $60,000 in 2007, due to differences between original estimates and final settlements or revised estimates.

Gross revenue, contractual adjustments, provision for bad debts, and charity care for the years ended June 30, 2008 and 2007, were as follows:

	2008	**2007**
Gross revenue		
Inpatient	**$ 4,231,163**	$ 3,318,301
Outpatient	**14,377,724**	12,846,195
	18,608,887	16,164,496
Less		
Third-party contactual adjustments based on charges	**7,967,763**	6,342,267
Provision for bad debts	**2,837,827**	2,078,669
Unsponsored charges, including charity care and governmental indigent care programs	**155,601**	199,761
Net patient service revenue	**$ 7,647,696**	$ 7,543,799

5. Patient Accounts Receivable:

Patient accounts receivable reported as current assets by the Hospital at June 30, 2008 and 2007, consisted of these amounts:

	2008	2007
Receivable from patients and their insurance carriers	**$ 2,219,020**	$ 2,053,503
Receivable from Medicare	**933,498**	689,996
Receivable from Medicaid	**290,007**	170,797
Total patient accounts receivable	**3,442,525**	2,914,296
Less allowance for uncollectible accounts	**1,849,342**	1,301,563
Net patient accounts receivable	**$ 1,593,183**	$ 1,612,733

6. Capital Assets:

The Hospital capitalizes assets whose costs exceed $5,000 and with an estimated useful life of at least two years. Capital assets acquisitions are recorded at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated or amortized (in the case of capital leases) by the straight-line method of depreciation using these asset lives:

Buildings and leasehold improvements	20 to 40 years
Equipment, software, and furniture	3 to 10 years

6. Capital Assets (continued):

Capital asset additions, retirements, transfers, and balances for the year ended June 30, 2008, were as follows:

	2008				
	Beginning Balance	**Additions**	**Retirements**	**Transfers**	**Ending Balance**
Capital assets not being depreciated					
Construction in progress	$ 8,610	$ 6,500	$ -	$ (8,610)	**$ 6,500**
Land	75,000	-	-	-	**75,000**
Total capital assets not being depreciated	83,610	6,500	-	(8,610)	**81,500**
Capital assets being depreciated					
Buildings and improvements	1,091,164	40,792	-	8,610	**1,140,566**
Equipment	2,791,801	271,939	-	-	**3,063,740**
Total capital assets being depreciated	3,882,965	312,731	-	8,610	**4,204,306**
Less accumulated depreciation for					
Buildings and improvements	(439,783)	(70,052)	-	-	**(509,835)**
Equipment	(1,737,856)	(346,343)	-	-	**(2,084,199)**
Total accumulated depreciation	(2,177,639)	(416,395)	-	-	**(2,594,034)**
Total capital assets being depreciated, net	1,705,326	(103,664)	-	8,610	**1,610,272**
Capital assets, net of accumulated depreciation	**$ 1,788,936**	**$ (97,164)**	**$ -**	**$ -**	**$ 1,691,772**

6. Capital Assets (continued):

Capital asset additions, retirements, transfers, and balances for the year ended June 30, 2007, were as follows:

	2007				
	Beginning Balance	**Additions**	**Retirements**	**Transfers**	**Ending Balance**
Capital assets not being depreciated					
Construction in progress	$ -	$ 8,610	$ -	$ -	**$ 8,610**
Land	79,901	-	(4,901)	-	**75,000**
Total capital assets being depreciated	79,901	8,610	(4,901)	-	**83,610**
Capital assets being depreciated					
Buildings and improvements	1,086,164	5,000	-	-	**1,091,164**
Equipment	2,435,791	693,595	(337,585)	-	**2,791,801**
Total capital assets being depreciated	3,521,955	698,595	(337,585)	-	**3,882,965**
Less accumulated depreciation for					
Buildings and improvements	(373,274)	(66,509)	-		**(439,783)**
Equipment	(1,778,977)	(289,136)	330,257	-	**(1,737,856)**
Total accumulated depreciation	(2,152,251)	(355,645)	330,257	-	**(2,177,639)**
Total capital assets being depreciated, net	1,369,704	342,950	(7,328)	-	**1,705,326**
Capital assets, net of accumulated depreciation	**$ 1,449,605**	**$ 351,560**	**$ (12,229)**	**$ -**	**$ 1,788,936**

7. Noncurrent Liabilities:

A schedule of changes in the Hospital's noncurrent liabilities for 2008 and 2007 follows:

	2008				
	Beginning Balance	**Additions**	**Decreases**	**Ending Balance**	**Amounts Due Within One Year**
Capital lease obligations	$ 813,127	$ 196,726	$ (243,003)	$ 766,850	$ 221,275
Accrued lawsuit settlement	176,470	-	(98,122)	78,348	78,348
Compensated absences	194,536	450,134	(423,176)	221,494	221,494
Total noncurrent liabilities	**$ 1,184,133**	**$ 646,860**	**$ (764,301)**	**$ 1,066,692**	**$ 521,117**

	2007				
	Beginning Balance	**Additions**	**Decreases**	**Ending Balance**	**Amounts Due Within One Year**
Capital lease obligations	$ 316,221	$ 628,719	$ (131,813)	$ 813,127	$ 231,424
Accrued lawsuit settlement	-	225,000	(48,530)	176,470	98,122
Compensated absences	170,757	202,308	(178,529)	194,536	194,536
Total noncurrent liabilities	**$ 486,978**	**$ 1,056,027**	**$ (358,872)**	**$ 1,184,133**	**$ 524,082**

Capital lease obligations at varying rates of imputed interest from 4.24% to 22.78%, collateralized by leased building and equipment. At June 30, 2008, the capitalized costs and net book value of the capital lease obligations were $1,539,105 and $741,402, respectively.

Scheduled future annual payments on capital lease obligations payable are as follows:

Years Ending June 30,	**Principal**	**Interest**	**Total**
2009	$ 221,275	$ 50,709	**$ 271,984**
2010	172,364	34,853	**207,217**
2011	177,780	20,496	**198,276**
2012	173,851	7,725	**181,576**
2013	21,580	121	**21,701**
	$ 766,850	$ **113,904**	**$ 880,754**

8. Mill Levy Tax and Gross Receipts Tax Revenue:

A New Mexico law adopted in 1980, and amended in 1981, allows counties to provide expanded tax support to qualified hospitals. The Hospital received mill levy proceeds from the County approximating $433,000 and $415,000 in 2008 and 2007, respectively. Mill levies were used in accordance with the provisions of the 1980 Hospital Funding Act, as amended.

The Hospital also received a share of gross receipts taxes collected by the City and the Village approximating $232,000 and $219,000 in 2008 and 2007, respectively.

9. Risk Management, Medical Malpractice Claims, and Contingencies:

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters.

The Hospital is insured with a commercial insurance company for medical malpractice under a policy written on a self-insured retention of $25,000 per occurrence. Coverage is limited to $1,000,000 per occurrence and a $3,000,000 annual aggregate. Should the claims-made policy not be renewed or be replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured. Management intends to continue claims-made coverage.

During fiscal year 2007, a settlement was entered into for a total of $225,000 to be awarded to a former employee for wrongful termination. Equal monthly payments are being made by the Hospital and have proceeded on schedule. The Hospital accrued a liability for this amount and has an unpaid balance of $78,348 and $176,470 as of June 30, 2008 and 2007, respectively.

The Hospital is involved in litigation and regulatory investigations arising in the ordinary course of business. While the ultimate outcome of these matters is not presently determinable, it is the opinion of management that the resolution of outstanding claims will not have a material adverse effect on the financial position or results of operations of the Hospital.

10. Retirement Plan:

Effective January 1, 2007, the Hospital amended the retirement plan previously established April 1, 2001, which had been discontinued January 16, 2006. The Plan is a defined contribution plan and is authorized under Internal Revenue Code 403(b). The Plan is administered by the Hospital. Substantially all employees are eligible. Employee contributions are limited to $15,500 and $5,000 of catch-up contributions per year for employees over 50. Employee contributions were approximately $109,000 and $49,000 during the years ended June 30, 2008 and 2007, respectively. The Hospital will match up to 3% of each employee’s contribution. The Hospital contributions to this plan were $40,352 and $36,250, for the years ended June 30, 2008 and 2007, respectively.

11. Concentration of Risk:

Receivables—The Hospital receives payment for services rendered from federal and state agencies, private insurance carriers, employers, managed care programs, and patients. The majority of these patients are geographically concentrated in and around Sierra County. The mix of receivables from patients and third-party payors at June 30, 2008 and 2007, were as follows:

	2008	**2007**
Medicare	**33** %	26 %
Medicaid	**12**	9
Private pay	**31**	37
Commercial and other	**24**	28
	100 %	100 %

Physicians—The Hospital is dependent on local physicians in its service area to provide admissions and utilize hospital services on an outpatient basis. A decrease in the number of physicians providing these services or change in their utilization patterns may have an adverse effect on the Hospital's operations.

12. Sierra County Bonds Payable:

On September 9, 1997, a purchase agreement was approved providing for the purchase of the Hospital facilities, associated equipment, and real estate by the County from the former operators of the Hospital for $1,500,000. The purchase was funded through bond proceeds received from the New Mexico Financing Authority (NMFA). A promissory note was executed between the County and NMFA for the purchase price of the facilities plus an additional $500,000 to fund future capital expenditures for the Hospital.

The promissory note is an obligation of the County and not the Hospital. The transfer of the cash and Hospital facilities was accounted for as an increase in the net assets of the Hospital. The carrying value of the facilities received in the transfer was allocated to land, buildings and improvements, and equipment based on their respective estimated fair values on the date of transfer based on an appraisal.

The note will be paid by the County from revenue earned through a 1/4% County gross receipts tax. Gross receipts tax revenue in excess of scheduled promissory note payments, if any, will be remitted to the County's 412 Fund to the Hospital to fund operations. Such remittances approximated $220,000 and $260,000, respectively, for the years ended June 30, 2008 and 2007.

13. Related-party Transactions:

The Hospital purchased dispatch services from the County of approximately $21,000 in the fiscal years ended June 30, 2008 and 2007.

The Hospital purchased electricity from the City of approximately $125,000 and $95,000 during the fiscal years ended June 30, 2008 and 2007, respectively.

The Hospital contributed $31,000 for the purchase of an ambulance to the County during the fiscal year ended June 30, 2007.

14. State of New Mexico Capital Appropriation:

The State of New Mexico (the State) has appropriated $1,024,000 and $2,102,785 during 2008, and 2007, respectively. The purpose of the appropriations is to acquire land for, design, construct, furnish, and equip a new hospital in Sierra County. The State is holding the appropriation. Sierra County, acting as the Hospital's fiscal agent, has access to the appropriations. The expiration dates for the 2008 and 2007 appropriations are June 30, 2012 and 2011, respectively. No amounts of the appropriations have been accessed by the County or Hospital as of June 30, 2008.

15. Subsequent Events:

In September 2008, the Hospital received a second sole community supplemental payment in the amount of $294,308 from New Mexico Human Services. This payment was in addition to the Hospital's regular sole community supplemental payment.

On June 26, 2008 the State of New Mexico Board of Finance granted the Hospital a $100,000 loan to be converted to a grant if the Hospital were to match the loan by October 15, 2008. The Hospital requested the JPC to match these funds. In September 2008, the Hospital received the $100,000 match from the JPC.

SUPPLEMENTARY INFORMATION

Sierra Vista Hospital
Schedules of Pledged Collateral
Years Ended June 30, 2008 and 2007

	2008	2007
Bank of the Southwest – Joint Powers Group checking account	**$ 13,346**	$ 2
Bank of the Southwest – development office account	**500,987**	1,474
Bank of the Southwest – operating checking account	**147,596**	49,165
Bank of the Southwest – payroll checking account	**74,339**	15,983
Total amount of deposits per bank	**736,268**	66,624
Less FDIC insurance	**100,000**	100,000
Total uninsured public funds	**$ 636,268**	$ -
50% collateral requirement	**$ 318,134**	$ -
Less market value of pledged securities held by		
Bank of the Southwest in Roswell, New Mexico		
FNMA Arm Pool #89416, matures April 1, 2029	**12,353**	17,419
FHLB letter of credit, matured August 25, 2007	**-**	100,000
FHLB letter of credit, matures June 3, 2009	**175,000**	-
FHLB letter of credit, matures May 26, 2009	**325,000**	-
FHLB letter of credit, matures August 25, 2008	**50,000**	-
Total pledged securities	**562,353**	117,419
Excess of pledged securities over collateral requirement	**$ 244,219**	$ 117,419
Total amount of deposits per bank	**$ 736,268**	$ 66,624
Less reconciling items	**203,347**	179,881
Total surplus (deficit)	**$ 532,921**	$ (113,257)

Sierra Vista Hospital
Schedule of Revenues and Expenses – Budget to Actual
Year Ended June 30, 2008

	Actual	Original and Final Approved Budget	Over (Under) Budget
Revenues			
Net patient service revenue	**$ 7,647,696**	$ 8,332,156	$ (684,460)
Other	**1,787,383**	17,796	1,769,587
Nonoperating revenues (expenses), net	**971,329**	2,771,120	(1,799,791)
Total revenues	**10,406,408**	11,121,072	(714,664)
Expenses			
Salaries and wages	**6,776,538**	6,666,985	109,553
Other	**3,958,030**	4,155,088	(197,058)
Total expenses	**10,734,568**	10,822,073	(87,505)
Change in net assets	**$ (328,160)**	$ 298,999	$ (627,159)

Dingus, Zarecor & Associates PLLC
CERTIFIED PUBLIC ACCOUNTANTS

12015 East Main, Suite A • Spokane Valley, Washington 99206
(509) 242-0874 office • (509) 242-0877 fax • www.dzacpa.com

INDEPENDENT AUDITORS' 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*

Joint Powers Commission, Governing Board
and Management of Sierra Vista Hospital,
and Mr. Hector H. Balderas
New Mexico State Auditor

We have audited the financial statements of the business-type activities of Sierra Vista Hospital (the Hospital) as of and for the year ended June 30, 2008, which collectively comprise the Hospital's basic financial statements and have issued our report thereon dated December 11, 2008. We also have audited the budgetary comparison of the Hospital for the year ended June 30, 2008, presented as supplemental information as listed in the table of contents. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hospital's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the Hospital's financial statements that is more than inconsequential will not be prevented or detected by the Hospital's internal control. We consider the deficiencies described in the accompanying schedule of findings and response to be significant deficiencies in internal control over financial reporting as items 01-06, 04-03, 06-04, 07-02, 08-01, and 08-02.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Hospital's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 07-02, 08-01, and 08-02 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital'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*, which are described in the accompanying schedule of findings and response as item 01-06.

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

This report is intended solely for the information and use of the Joint Powers Commission, Governing Board, management, New Mexico State Auditor, New Mexico Legislature, and the New Mexico Department of Finance and Administration and is not intended to be and should not be used by anyone other than these specified parties.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
December 11, 2008

01-06 Late Submission of Audit Report

Condition	The financial statements as of and for the year ended June 30, 2008, were delivered to the New Mexico State Auditor on December 19, 2008. The statements were due, however, on October 15, 2008.
Criteria	[X] Compliance Finding [X] Significant Deficiency [ ] Material Weakness New Mexico State Auditor Rule 2.2.2.9 (A) requires delivery of the financial statements of hospitals to the New Mexico State Auditor on or before October 15 of the fiscal year under audit.
Cause	The Hospital is a critical access hospital. Critical access hospitals receive or pay material Medicare cost report settlements five months after year end. The information necessary and the time required to prepare the Medicare cost report precluded meeting the October 15th delivery deadline.
Effect	The financial statements were not delivered in accordance with New Mexico State Auditor Rule 2.2.2.9 (A).
Recommendation	The accounting books and records should be maintained completely, accurately, and in a timely manner.
Management's Response	Management agrees with the conclusion. The audit was intentionally delayed to include accurate Medicare settlement numbers. The Medicare settlement is very material to the bottom line, so premature completion of the audit should be avoided. The Medicare cost report cannot be completed until sometime in November.

04-03 Controls Over Information Systems Function and Data Security

Condition

During our review of the Hospital's internal control structure for information systems, we noted the following:

- There is only one employee in this department and proper segregation of duties is not achieved.
- Access to the key areas of the system is available to the accountant in the event of an emergency; however the accountant has access to the general ledger and proper segregation of duties is not achieved.

Criteria

[ ] Compliance Finding [X] Significant Deficiency [ ] Material Weakness

In order to ensure security over system data, there should be proper segregation of duties between system maintenance, system operations, and the system security functions as well as segregation of those functions from the accounting and finance functions.

Cause

Due to the size of the Hospital, management does not believe an additional Information System Department employee is cost effective.

Effect

There is an increased risk that data can be lost or misappropriated. Also, there is an increased risk that HIPAA requirements could be violated.

Recommendation

The Hospital should consider splitting up the tasks of the system maintenance function and the system security function between the IT Administrator and the CFO or other designated employee who does not have access to the general ledger.

Management's Response

Management agrees with the conclusion. Due to the Hospital's small size it is economically unfeasible to hire a second IT person to accomplish segregation of system maintenance, system operations, and system security functions. These functions are not easily accomplished by someone without IT skills. The accounting person serves as a back-up person in case the IT employee is absent or unavailable. However, this does not offer segregation of duties.

06-04 IRS Penalties

Condition	The Hospital was assessed penalties by the Internal Revenue Service due to late depositing of employee and employer payroll taxes. IRS penalties of $10,281; $11,229; $19,648; and $3,925 were noted and were an ongoing problem during fiscal years 2006, 2007, and 2008.
Criteria	[ ] Compliance Finding [X] Significant Deficiency [ ] Material Weakness Payroll tax deposits are required to be made timely.
Cause	The Hospital was experiencing cash flow difficulties and did not have the cash available to make the payroll tax deposits.
Effect	The Hospital incurred significant penalties.
Recommendation	The Hospital should make the payroll tax deposits by their respective due dates.
Management's Response	Management agrees with the conclusion. In the past the cash flow problems at the Hospital caused late payment of employee and employer deductions to the IRS. This was a serious problem and has been discontinued as of March 2008 due to improved cash flow and improved management.

07-02 Controls Over Access to the Hospital's General Ledger

Condition

During our review of manual journal entries we noted the following:

- The Chief Financial Officer (CFO) had the ability to generate and post adjustments to the general ledger.
- Support for 30 journal entries selected for testing was not available. We selected 33 journal entries for testing from a total of approximately 396 journal entries posted by the Hospital. The journal entries tested were primarily for recording transfers between cash accounts and correcting expense classifications.

Criteria

[ ] Compliance Finding [ ] Significant Deficiency [X] Material Weakness

To help minimize the risk of fraud to the Hospital the CFO should not have general ledger access to post adjustments; rather the CFO should review journal entries posted by the accountant. In addition, all journal entries should be supported by detailed documentation that is retained.

Cause

The Hospital did not have a qualified person to segregate the journal entry preparation, posting, and approval. The Hospital did not have procedures developed to retain journal entry support.

Effect

There is an increased risk of fraud to the Hospital.

Recommendation

Policies and procedures should be created that define personnel responsible for generating, posting, and approving journal entries in the Hospital's general ledger and retention of supporting documentation.

Management's Response

Management agrees with the conclusion. This problem has been resolved as of March 2008 and is no longer a condition in the Hospital. The CFO reviews and approves all journal entries and requires appropriate supporting documentation to be kept with each entry. The CFO does not enter journal entries into the general ledger.

08-01 Accounts Receivable Credit Balances

Condition	During our review of accounts receivable and testing of patient accounts at year end, we noted that the Hospital, Rural Health Clinic, and Behavioral Health Clinic, have approximately $460,000, $30,000, and $12,000, respectively, in patient accounts receivable credit balances.
Criteria	[ ] Compliance Finding [ ] Significant Deficiency [X] Material Weakness Accounts receivable should accurately reflect the outstanding balances owed to the Hospital by patients and third-party payors.
Cause	Accounts receivable records are not being researched and updated in a timely manor.
Effect	Accounts receivable reported on internal financial statements may be improperly stated. The large dollar value of credit balances makes the estimation of actual receivables due to the Hospital difficult, increases the difficulty in collecting accounts receivable, and increases the possibility of unpaid refunds that could become a significant liability for the Hospital.
Recommendation	The Hospital should review and resolve credit balances. Policy and procedures should be put into place to mitigate unapplied and incorrectly applied patient payments along with timely reconciliations and review of patient accounts.
Management's Response	Management agrees with the conclusion. Near the end of fiscal year 2008 management took the initiative to measure credit balances and a substantial amount was discovered. Measures have been implemented to monitor credit balances as of each month end and processes are in place in the business office to resolve credit balances in a timely fashion. The majority of the credit balances are due to posting errors rather than refunds due to patients or insurance companies.

08-02 Revenue Cycle

Condition

The Hospital is experiencing significant difficulties in billing and collecting patient accounts receivable in a timely manner. The untimely billing and collections create cash flow problems for the Hospital and increase the likelihood that all cash that could be collected by the Hospital is not being collected. The total net days in patient accounts receivable at June 30, 2008, was 92.

Criteria

[ ] Compliance Finding [ ] Significant Deficiency [X] Material Weakness

Good business practices and good internal control procedures require patient billing and collecting to be timely. Also, the public expects public-owned hospitals to collect the amount due to them by patients and third-party payors. Industry standards for total net days in patient accounts receivable is in the range of 50 to 60 days.

Cause

The Hospital, like many rural hospitals, has had difficulty recruiting and retaining employees to work in their business office with the necessary skills. The Hospital's financial condition has also made it difficult to commit additional financial resources for training.

Effect

There is an increased risk that not all amounts due to the Hospital will be collected.

Recommendation

The Hospital should consider some combination of the following recommendations:

- Continue to receive additional training and support from their software vendor.
- Continue to provide external education opportunities to their business office employees.
- Outsourcing business office functions to a centralized billing office.

Management's Response

Management agrees with the conclusion. A new Business Office Manager was hired near fiscal year end and improved practices are being implemented. Training from the patient management system software vendor has been accomplished as well as a consultation from another Critical Access Hospital using the same software system. Senior leadership and governance have a keen awareness of the importance of the revenue cycle and it is being closely monitored for improvements.

Sierra Vista Hospital
Summary Status of Prior Year Findings
Year Ended June 30, 2008

01-06 Late Submission of Audit Report – Repeated

04-03 Controls Over Information Systems Function and Data Security – Repeated

05-03 Completeness of Billings – Resolved

06-01 Payments Applied to the Incorrect Accounts – Resolved

06-02 No Invoice or Receipt for Cash Payments – Resolved

06-04 IRS Penalties – Repeated

06-05 Accounts Reconciliation - Material Weakness – Resolved

07-01 Auditor Preparation of the Hospital's Audited Financial Statements – Resolved

07-02 Controls Over Access to the Hospital's G/L – Repeated

07-03 Late Submission of Interim Budget - Resolved

Sierra Vista Hospital
Exit Conference
Year Ended June 30, 2008

An exit conference was held on December 10, 2008, with the Finance Committee to discuss the basic financial statements and the findings contained in this report. The personnel attending this meeting were:

Greg D’Amour	Governing Board
Anne Filosa	Governing Board
Eunice Kent	Governing Board
Domenica Rush	Administrator
Bret Goebel	Interim Chief Financial Officer
Belinda Cloud	Accountant
Melanie Shade	Executive Assistant
Tom Dingus	Dingus, Zarecor & Associates PLLC
Tristi Cohelan	Dingus, Zarecor & Associates PLLC

These financial statements were prepared by Dingus, Zarecor & Associates PLLC from records of the Hospital.