



**UNM SANDOVAL REGIONAL
MEDICAL CENTER, INC.
(A Component Unit of the
University of New Mexico)**

Financial Statements

June 30, 2012 and 2011

MOSS-ADAMS_{LLP}

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A Component Unit of the University of New Mexico)
Official Roster
June 30, 2012

BOARD OF DIRECTORS

Dr. Paul Roth, Chairman of the Board
Michael Olguin
Dr. Jeffery Griffith
Dick Mason
Dr. Martha McGrew
Steve McKernan
Dr. Carolyn Voss
Charlotte Garcia
David A. Gonzales

OFFICERS

Kevin Rogols
Troy Clark
Erica Hamilton
David V. Gonzales

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A Component Unit of the University of New Mexico)**

TABLE OF CONTENTS

| | Page |
|--|-------------|
| Report of Independent Auditors | 1 - 2 |
| Management's Discussion and Analysis | 3 - 7 |
| Financial Statements: | |
| Balance Sheets | 8 |
| Statements of Revenues, Expenses, and Changes in Net Assets | 9 |
| Statements of Cash Flows | 10 |
| Notes to Financial Statements | 11-19 |
| Supplementary Information: | |
| Pledged Collateral by Banks | 20 |
| Deposit and Investment Account Balances | 21 |
| Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> | 22-23 |
| Schedule of Findings and Responses | 24 |
| Exit Conference | 26 |

Report of Independent Auditors

The Board of Directors
UNM Sandoval Regional Medical Center, Inc.
and
Mr. Hector Balderas, State Auditor

We have audited the accompanying financial statements of UNM Sandoval Regional Medical Center, Inc. (SRMC), a component unit of the University of New Mexico, as of and for the year ended June 30, 2012. These financial statements are the responsibility of SRMC's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of SRMC as of June 30, 2011, were audited by other auditors whose report dated October 28, 2011, expressed an unqualified opinion on those statements.

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. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SRMC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SRMC as of June 30, 2012, and the changes in financial position and cash flows for the year then 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 November 2, 2012 on our consideration of SRMC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Board of Directors
UNM Sandoval Regional Medical Center, Inc.
and
Mr. Hector Balderas, State Auditor

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise SRMC's financial statements. The accompanying schedules of pledged collateral by banks and deposit and investment account balances (schedules 1 and 2, respectively) are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules of pledged collateral by banks and deposit and investment account balances are fairly stated in all material respects in relation to the financial statements as a whole.

Mess Adams LLP

Albuquerque, New Mexico
November 2, 2012

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011**

The following discussion and analysis provides an overview of the financial position and activities of UNM Sandoval Regional Medical Center (SRMC) as of and for the fiscal year ended June 30, 2012 and 2011. This discussion should be read in conjunction with the accompanying financial statements and notes. Management has prepared the basic financial statements and the related note disclosures along with this discussion and analysis. As such, the financial statements, notes, and this discussion are the responsibility of SRMC's management.

Using This Annual Report

This annual report consists of a series of financial statements.

The balance sheets provide information about SRMC's overall financial status. The statements of revenues, expenses, and changes in net assets provide information about the revenues and expenses of SRMC. The statements of cash flows provide information related to the cash inflows and outflows of SRMC.

Overview of Entity

In August 2009, Regents of the University of New Mexico (UNM) approved the formation of SRMC, a New Mexico nonprofit corporation organization under and pursuant to the New Mexico University Research Park and Economic Development Act. SRMC was organized for the development, construction and operation of a licensed general, community teaching hospital in Sandoval County and to facilitate and develop the clinical and medical practices of the faculty of the University of New Mexico School of Medicine (UNMSOM).

SRMC believes that construction of the hospital will provide much needed access to health care for the residents of Sandoval County and surrounding areas.

The following summarizes the healthcare services that will be offered by the Hospital:

Inpatient Care - Acute care provided by practitioners in 48 acute medical-surgical beds, 12 intensive care unit beds and 12 dedicated behavioral health beds. The hospital will be equipped with an emergency department with 11 exam rooms, 2 trauma rooms and 2 triage rooms. Additionally, the hospital will be equipped with 6 operating rooms and 3 endoscopy rooms.

Outpatient Care - Comprehensive offering of laboratory, radiology, and diagnostic services.

Surgical Services - Anesthesia, General Surgery, Gynecologic, Orthopedic (including hand), Ophthalmology, Otolaryngology, Urologic, and outpatient laparoscopic surgery.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011**

Physician Services - The hospital will provide physicians on the active medical staff Boarded as family practice and internal medicine to provide hospitalist services; 24/7 Emergency services. In addition, unlike the UNM Hospitals, SRMC will have an "open" medical staff, allowing community physicians to be members of the active medical staff and to admit and follow their patients at the SRMC.

In January 2010, SRMC submitted a mortgage insurance application to the U.S. Department of Housing and Urban Development (HUD) for an insured mortgage loan to be funded with the proceeds of bonds, to finance the construction of a 200,000 square foot hospital and 40,000 square foot connected medical office building. In September 2010, HUD issued its commitment to insure, under the provisions of Section 242 of the National Housing Act, a mortgage note in the amount of \$143,425,000.

In November 2010, SRMC issued bonds totaling \$143,425,000, including \$133,425,000 in aggregate principal amount of its Taxable Revenue Build America Bonds (Direct Pay) (GNMA Collateralized - UNM Sandoval Regional Medical Center Project) Series 2010A with a maturity date of July 20, 2036 and \$10,000,000 in aggregate principal amount of its Taxable Revenue Recovery Zone Economic Development Bonds (Direct Pay) (GNMA Collateralized - UNM Sandoval Regional Medical Center Project) Series 2010B with a maturity date of July 20, 2037. The Bonds were issued pursuant to a Trust Indenture, dated October 1, 2010, by and between SRMC and Wells Fargo Bank, National Association, as trustee for the purpose of financing SRMC's hospital facility and to pay certain costs associated with the issuance of the bonds. Additionally, UNM made an equity contribution of \$46 million to SRMC. These funds are to sustain the pre-opening operational costs, and working capital needs of SRMC.

During the fiscal years of 2011 and 2012, the SRMC executive team was assembled, bonds were issued to provide financing, and construction of the facility began. As an entity in the pre-opening phase of the business cycle, SRMC operations and financial results primarily involve the \$143.4 million bond issuance transaction that closed in November 2010, and the costs associated with the beginning of the construction of the physical facility.

As of June 30, 2012, the construction of the physical facility of SRMC was nearly complete, with SRMC receiving a hospital license from the NM Department of Health on July 12, 2012. The assets of SRMC at June 30, 2012 include cash and cash equivalents placed into the trustee controlled accounts amounting to \$69.4 million and another \$1.1 million in operating accounts outside of the trust agreement as noted below. At June 30, 2011 amounts totaled \$161.3 million and another \$136,000, respectively.

| | <u>2012</u> | <u>2011</u> |
|---------------------------------|----------------------|-----------------------|
| Cash and cash equivalents: | | |
| Operating account | \$ 1,055,438 | \$ 135,748 |
| Trust accounts | <u>69,370,137</u> | <u>161,295,642</u> |
| Total cash and cash equivalents | <u>\$ 70,425,575</u> | <u>\$ 161,431,390</u> |

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011

The remaining assets of SRMC as of June 30, 2012 and 2011 include the construction related expenditures to date (including architectural fees, labor, supplies, etc.), capitalized interest on the bonds related to the construction, medical supplies inventory acquired and costs incurred upon the issuance of the Bonds.

| | <u>2012</u> | <u>2011</u> |
|--------------------------------|-----------------------|----------------------|
| Other current assets | | |
| Inventory and prepaid expenses | \$ 461,324 | \$ - |
| Noncurrent assets: | | |
| Bond issuance costs, net | 3,405,386 | 3,619,632 |
| Construction in progress | <u>129,759,992</u> | <u>39,899,863</u> |
| Total noncurrent assets | <u>\$ 133,165,378</u> | <u>\$ 43,519,495</u> |

As of June 30, 2012 and 2011, total assets for SRMC are \$204,052,277 and \$204,950,885, respectively.

The liabilities of SRMC consist of: 1) Accounts payable and other accrued liabilities, 2) the Bonds issued and related interest costs associated with those Bonds, and 3) an amount due to UNM Medical Group, Inc. (UNMMG) for amounts advanced to SRMC for operating expenditures and a balance of funds used for a fund required at closing to escrow future potential interest costs incurred during the construction period. These liabilities are segregated into long-term and short term components on the balance sheet of SRMC, and amounts to the following as of June 30:

| | <u>2012</u> | <u>2011</u> |
|---------------------------------|-----------------------|-----------------------|
| Current liabilities: | | |
| Accounts payable | \$ 16,879,350 | \$ 2,878,202 |
| Accrued salaries and benefits | 640,250 | - |
| Due to UNMH | 208,055 | 81,687 |
| Due to UNMMG | 3,584,631 | 5,315,883 |
| Interest payable | 2,892,719 | 2,892,719 |
| Bonds payable - current portion | <u>1,540,000</u> | <u>-</u> |
| Total current liabilities | <u>25,745,005</u> | <u>11,168,491</u> |
| Noncurrent liabilities: | | |
| Bonds payable | 141,885,000 | 143,425,000 |
| Due to UNMMG | <u>-</u> | <u>3,520,187</u> |
| Total noncurrent liabilities | <u>141,885,000</u> | <u>146,945,187</u> |
| Total liabilities | <u>\$ 167,630,005</u> | <u>\$ 158,113,678</u> |

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011**

As of June 30, 2012 and 2011, the net assets of SRMC amounted to \$36,422,272 and \$46,837,207, respectively.

Operating Expenses

SRMC's primary operating expense during 2012 and 2011 was for labor and other pre-opening costs. SRMC incurred \$3,997,351 and \$1,145,175 in labor costs during fiscal years 2012 and 2011, respectively. Other operating expenditures for 2012 and 2011, amounting to \$2,349,659 and \$353,978, respectively include rent for office space and related costs, small equipment acquisition, supply costs, consulting fees, and recruitment costs.

Factors Impacting Future Periods

Mill Levy Funding

Pursuant to a Health Facility Agreement with the Board of County Commissioners of Sandoval County, New Mexico, after opening on July 16, 2012, SRMC will be entitled to receive the proceeds of a mill levy (the "Mill Levy") adopted by the Board of County Commissioners of Sandoval County and approved by the voters of Sandoval County. SRMC will recognize Mill Levy Funds upon receipt, and will record the funds received as Non-operating revenues. Sandoval County estimates that the proceeds of the Mill Levy accumulated prior to opening will approximate \$13,784,451 and be distributed to SRMC within 90 days of the opening date of July 16, 2012. SRMC will be entitled to receive, on an ongoing basis, an amount equal to 20% of the total proceeds of the Mill Levy for the inpatient behavioral health services it will provide, and 50% of the remaining proceeds of the Mill Levy. SRMC anticipates that the annual amount of the Mill Levy proceeds that it will receive will approximate \$8,000,000.

Patient Protection and Affordable Care Act

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA). This National Health Reform includes private insurance market reforms, expanded Medicaid eligibility provisions, Medicare and Medicaid funding reforms, value-based purchasing requirements, and amended time periods for filing Medicare fee-for-service (FFS) claims to one year from the date of service as one of many provisions aimed at curbing fraud, waste, and abuse in the Medicare program.

Medicaid expansion under PPACA includes new eligibility criteria establishing a minimum floor for Medicaid coverage of 133% of the Federal Poverty Level (FPL), eliminating other non-income based criteria (such as age, disability, or asset testing). This FPL criterion is mandatory for State implementation January 2014 and optional for years 2010 through 2013. The population most impacted by the new eligibility criteria is expected to be childless adults. States are also prohibited from reducing Medicaid or CHIP eligibility that was in place on the date of PPACA enactment. PPACA provides additional federal financing through the Federal Medical Assistance Percentage (FMAP) for newly eligible Medicaid patients.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2012 AND 2011**

The Human Services Division of the State of New Mexico (HSD) implemented cost containment measures on December 1, 2009, including a 3% reduction to the Medicaid physician fee schedule.

Contacting SRMC's Financial Management

This financial report is designed to provide the public with a general overview of SRMC's finances. If you have questions about this report or need additional financial information, contact the SRMC's Controller's office at 3001 Broadmoor Blvd NE, Rio Rancho, NM 87144.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF UNIVERSITY OF NEW MEXICO)
BALANCE SHEETS
June 30, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|-----------------------|-----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,055,438 | \$ 135,748 |
| Restricted cash and cash equivalents | 69,370,137 | 161,295,642 |
| Inventory and prepaid expenses | 461,324 | - |
| Total current assets | <u>70,886,899</u> | <u>161,431,390</u> |
| Noncurrent assets: | | |
| Bond issuance costs, net | 3,405,386 | 3,619,632 |
| Capital assets | <u>129,759,992</u> | <u>39,899,863</u> |
| Total noncurrent assets | <u>133,165,378</u> | <u>43,519,495</u> |
| Total assets | <u>\$ 204,052,277</u> | <u>\$ 204,950,885</u> |
| Liabilities and Net Assets | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 16,879,350 | \$ 2,878,202 |
| Accrued salaries and benefits | 640,250 | - |
| Due to UNMH | 208,055 | 81,687 |
| Due to UNMMG | 3,584,631 | 5,315,883 |
| Interest payable | 2,892,719 | 2,892,719 |
| Bonds payable - current portion | <u>1,540,000</u> | <u>-</u> |
| Total current liabilities | <u>25,745,005</u> | <u>11,168,491</u> |
| Noncurrent liabilities: | | |
| Bonds payable | 141,885,000 | 143,425,000 |
| Due to UNMMG | <u>-</u> | <u>3,520,187</u> |
| Total noncurrent liabilities | <u>141,885,000</u> | <u>146,945,187</u> |
| Total liabilities | <u>167,630,005</u> | <u>158,113,678</u> |
| Net assets: | | |
| Invested in capital assets, net of related debt | 2,163,000 | 4,083,846 |
| Restricted | 37,124,103 | 39,133,729 |
| Unrestricted | <u>(2,864,831)</u> | <u>3,619,632</u> |
| Total net assets | <u>36,422,272</u> | <u>46,837,207</u> |
| Total liabilities and net assets | <u>\$ 204,052,277</u> | <u>\$ 204,950,885</u> |

See Notes to Financial Statements.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF UNIVERSITY OF NEW MEXICO)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year ended June 30, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Operating expenses: | | |
| Labor costs | \$ 3,997,351 | \$ 1,145,175 |
| Other operating expenses | <u>2,349,659</u> | <u>353,978</u> |
| Total operating expenses | <u>6,347,010</u> | <u>1,499,153</u> |
| Operating loss | <u>(6,347,010)</u> | <u>(1,499,153)</u> |
| Nonoperating revenues (expenses): | | |
| Federal bond subsidy | 2,326,495 | 1,660,822 |
| Amortization of bond issuance costs | (214,246) | - |
| Interest expense | (6,228,294) | - |
| Interest income | <u>48,120</u> | <u>1,066,812</u> |
| Total nonoperating revenues (expenses) | <u>(4,067,925)</u> | <u>2,727,634</u> |
| (Loss) income before capital contribution | (10,414,935) | 1,228,481 |
| Capital contribution | <u>-</u> | <u>46,000,000</u> |
| Change in net assets | (10,414,935) | 47,228,481 |
| Net assets, beginning of year | <u>46,837,207</u> | <u>(391,274)</u> |
| Net assets, end of year | <u>\$ 36,422,272</u> | <u>\$ 46,837,207</u> |

See Notes to Financial Statements.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF UNIVERSITY OF NEW MEXICO)
STATEMENTS OF CASH FLOWS
Year ended June 30, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|-----------------------|-----------------------|
| Cash flows from operating activities: | | |
| Cash payments for operations | \$ (3,619,974) | \$ (1,422,369) |
| Cash payments to employees/labor costs | (3,357,101) | - |
| Net cash used in operating activities | <u>(6,977,075)</u> | <u>(1,422,369)</u> |
| Cash flows from noncapital financing activity: | | |
| Cash received from capital contribution | - | 46,000,000 |
| Net cash provided by noncapital financing activity | <u>-</u> | <u>46,000,000</u> |
| Cash flows from capital and related financing activities: | | |
| Cash received from the issuance of bonds | - | 143,425,000 |
| Cash received from federal bond subsidy | 2,326,495 | 1,660,822 |
| Cash received from UNMMG for negative arbitrage fund | - | 10,125,000 |
| Cash payments to UNMMG for negative arbitrage fund | (3,800,000) | (1,685,000) |
| Purchases of capital assets | (80,658,941) | (32,728,084) |
| Cash payments for bond issuance costs | - | (3,619,632) |
| Cash payments for interest | (1,944,414) | (1,391,160) |
| Net cash (used in) provided by capital and related financing activities | <u>(84,076,860)</u> | <u>115,786,946</u> |
| Cash flows from investing activity: | | |
| Cash received from interest income | 48,120 | 1,066,813 |
| Net cash provided by investing activity | <u>48,120</u> | <u>1,066,813</u> |
| Net (decrease) increase in cash and cash equivalents | (91,005,815) | 161,431,390 |
| Cash and cash equivalents, beginning of year | <u>161,431,390</u> | <u>-</u> |
| Cash and cash equivalents, end of year | <u>\$ 70,425,575</u> | <u>\$ 161,431,390</u> |
| Reconciliation of operating loss to net cash used in operating activities: | | |
| Operating loss | \$ (6,347,010) | \$ (1,499,153) |
| Adjustments to reconcile operating loss to net cash used in operations: | | |
| Changes in assets and liabilities: | | |
| Inventory and prepaid expenses | (461,324) | - |
| Accounts payable and accrued expenses | 642,448 | 4,796 |
| Accrued salaries and benefits | 640,250 | - |
| Due to UNMMG | (1,451,439) | 71,988 |
| Net cash used in operating activities | <u>\$ (6,977,075)</u> | <u>\$ (1,422,369)</u> |

See Notes to Financial Statements.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011**

Note 1 – Description of Business

UNM Sandoval Regional Medical Center Inc. (SRMC) is a corporation organized by the Regents of the University of New Mexico (UNM) and existing as a New Mexico government non-profit and University Research Park and Economic Development Act (URPEDA) corporation. SRMC is governed by its Board of Directors (the Board), which is empowered to do all things necessary for the proper operation of SRMC. UNM, by and through its Board of Regents, is the sole member of SRMC. UNM made an initial equity contribution to SRMC of \$46,000,000.

SRMC is located in Rio Rancho, New Mexico. SRMC is a community teaching hospital completing the final stages of construction of the facility and is in the pre-opening phase of its business cycle as of June 30, 2012. SRMC opened and began to provide patient care on July 16, 2012. SRMC provides inpatient and outpatient services primarily to the residents of Sandoval County, New Mexico.

SRMC consists of an approximately 200,000 square foot, 72 acute bed, community teaching hospital and corresponding 40,000 square foot medical office building on a site located adjacent to the new City Center in Rio Rancho, New Mexico. In 2006, UNM acquired the land on which SRMC is sited and owns it fee simple. SRMC is a component unit of the UNM and is reported as such in the basic financial statements of UNM. SRMC has no component units.

Note 2 – Summary of Significant Accounting Policies and Practices

Basis of Presentation - The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting, in accordance with U.S. generally accepted accounting principles for state and local governments as prescribed by the Governmental Accounting Standards Board (GASB). As a special purpose government entity engaged in business type activities, SRMC's financial statements present financial information in a form similar to that used by corporations.

Effective July 1, 2010, SRMC adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Contained in Pre-November 30, 1989 and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. GASB 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. The adoption of GASB 62 had no impact on SRMC's accounting policies, as SRMC had previously elected in accordance with GASB 20 to not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, and applicable FASB pronouncements issued on or before November 30, 1989 have now been incorporated into GASB pronouncements.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 2 – Summary of Significant Accounting Policies and Practices (continued)

Net Assets – For accounting and reporting purposes, SRMC reports its net assets in the following net asset categories as applicable:

- *Invested in capital assets, net of related debt*—Capital assets, net of outstanding principal balances of debt attributable to the construction plus the unspent proceeds of the related debt.
- *Restricted*— balance of remaining funds from UNM contribution and net gains with restrictions on purpose of use.
- *Unrestricted* – Net assets that are not subject to externally imposed constraints. Unrestricted net assets may be designated for specific purposes by action of the Board.

Use of Estimates – The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the financial statement dates, and the reported amount of revenues and expenses during the reporting periods. Due to uncertainties inherent in the estimation process, actual results could differ from those estimates.

Cash and Cash Equivalents – SRMC considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Deposits are in demand accounts with a local financial institution. State statute requires financial institutions to pledge qualifying collateral to SRMC to cover at least 50% of the uninsured deposits.

One hundred percent of the demand deposit balance at June 30, 2012 and 2011 were guaranteed under the FDIC Temporary Liquidity Guarantee Program or the Dodd-Frank Wall Street Reform and Consumer Protection Act signed into law on July 21, 2010 which permanently raised the maximum deposit insurance amount to \$250,000 for amounts in interest bearing accounts and extended the full guarantee for non-interest bearing accounts through December 31, 2012. SRMC's demand deposits do not reside in interest bearing accounts and therefore are covered up to the full amount of the balance.

Bond Issuance Costs – Bond Issuance Costs totaled \$3,619,632 and are being amortized over the life of the bonds. Amortization expense totaled \$214,246 and \$0 for the years ended June 30, 2012 and 2011, respectively.

Capital Assets – Capital assets consist primarily of construction in process related to the construction of the hospital facility. Capital assets with a cost of \$5,000 or greater are capitalized. Capital assets are accumulated on the balance sheet and will be depreciated once the asset is placed in service. Repairs and maintenance costs are charged to expense as incurred. Qualifying interest amounts during the construction phase is capitalized as part of the value of the asset. Capitalized interest in the amount of \$6,760,374 and \$4,283,879 is included in the value of capital assets at June 30, 2012 and 2011, respectively.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 2 – Summary of Significant Accounting Policies and Practices (continued)

Operating and Non-operating Revenues and Expenses – SRMC’s statement of revenues, expenses, and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating expenses are all expenses incurred that are not classified for the procurement of capital assets. Non-operating revenues reflect interest income and federal bond interest subsidy.

Federal Bond Subsidy – SRMC receives subsidy payments related to interest payments under the federal Build America Bond and Taxable Revenue Recovery Zone Economic Development Bond programs. These sources of funds are accounted for as non-operating revenues and recorded as they are received. Under the program SRMC applies for subsidy funds commensurate with each bond payment, so the application for the subsidy is made semiannually. For the year ended June 30, 2012 and 2011, SRMC recognized \$2,326,495 and \$1,660,822 in federal bond subsidy revenue, respectively.

Labor Costs – From inception through September 30, 2011, all of SRMC’s employees were contracted for their services from UNM Medical Group (UNMMG) or other UNM Health Science Center (UNM HSC) entities. From October 1, 2011 through June 30, 2012, SRMC employed all of its own staff and maintained responsibility for that staff under its own Federal Employer Identification number (FEIN).

Other Operating Expenses – Other operating expenditures include expenditures such as office space and related costs, small equipment acquisition, supply costs, consulting fees, and recruitment costs.

Income Taxes – SRMC has received a determination letter from the Internal Revenue Service (IRS) that it is an organization described in Internal Revenue Code section 501(c)(3). As such it would be exempt from federal income tax on income generated from activities related to its exempt function. Furthermore, SRMC previously received a discretionary ruling from the IRS under Revenue Procedure 95-48, excluding it from the requirement to file certain information returns. Changes made by the Pension Protection Act removed the IRS’s discretionary authority to waive these filing requirements. Subsequent failures to file would result in automatic revocation of exempt status. The IRS is expected to issue further guidance to assist organizations with Rev. Proc. 95-48 rulings in maintaining exempt status. SRMC intends to monitor and comply with this guidance. Accordingly, no provision for income taxes has been made.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 3 – Cash, Cash Equivalents, and Investments

Cash and Cash Equivalents – At June 30, 2012 and 2011, SRMC had cash and cash equivalents held in demand accounts with a local financial institution in the name of SRMC amounting to \$1,055,438 and \$135,748, respectively. Also included in cash and cash equivalents at June 30, 2012 and 2011, are secured money market account balances in the amount of \$69,370,137 and \$161,295,642, respectively. These accounts are held under Trust Indenture and Financing Agreement by the trustee in connection with the 2011 Financing Transaction (See Note 6). The money market funds are invested in short-term high quality municipal securities. State statute requires financial institutions to pledge qualifying collateral to SRMC to cover at least 50% of the uninsured deposits.

Bank balances are categorized at June 30, as follows:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|-----------------------|
| Operating accounts | \$ 1,055,438 | \$ 135,748 |
| Amounts held with trustee in accordance with the Trustee Indenture and Financing Agreement | <u>69,370,137</u> | <u>161,295,642</u> |
| Total cash & cash equivalents | <u>\$ 70,425,575</u> | <u>\$ 161,431,390</u> |

In connection with the 2011 Financing Transaction, as a requirement of the Trust Indenture and the Financing Agreement (See Note 6), SRMC was required to establish trust funds for the deposit of restricted bond proceeds, the required capital contribution, and other restricted contributions by SRMC. The balances of the trust funds were as follows at June 30:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|-----------------------|
| Bond Fund | \$ 2,552,277 | \$ 696,937 |
| Acquisition Fund | 32,246,035 | 107,608,983 |
| Negative Arbitrage Fund | 2,316,947 | 7,698,325 |
| Subsidy Escrow Fund | 1,215,899 | 1,163,226 |
| FHA-Required Operating Capital Escrow Fund | <u>26,457,015</u> | <u>30,613,021</u> |
| | 64,788,173 | 147,780,492 |
| Funds placed as collateral for letter of credit | <u>4,581,964</u> | <u>13,515,150</u> |
| Total funds held by trustee or collateral | <u>\$ 69,370,137</u> | <u>\$ 161,295,642</u> |

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011**

Note 3 – Cash, Cash Equivalents, and Investments – (continued)

Bond Fund – Established to collect the interest income and necessary funds to make the semi-annual coupon payments for the bonds.

Acquisition Fund – Proceeds from the sale of the bonds were placed in this fund. Draws on this fund are made to offset the certificates issued from the mortgagor during the construction period.

Negative Arbitrage Fund – Established to provide a debt service contingency fund throughout the construction process. This fund is drawn upon if the funds in the Bond Fund are insufficient at the time a coupon payment is made from the Bond Fund.

Subsidy Escrow Fund – Established as a depository account for the proceeds received from the Build America Bond and Taxable Revenue Recovery Zone Economic Development Bond payments. Once received, these funds are transferred to the Bond Fund.

Operating Capital Escrow Fund – Established to hold the portion of the equity contribution that was made for working capital purposes, as required by the Federal Housing Administration. Draws against this fund are requested from and approved by HUD to cover monthly pre-opening and post-opening expenses.

Note 4 – Capital Assets

Capital Assets of at June 30, 2012 and 2011 totaled \$129,759,992 and \$39,899,863, respectively, and include capitalized interest of \$6,760,374 and \$5,578,444, and construction in process of \$122,999,618 and \$34,321,419, respectively.

Note 5 – Short Term Obligations

In connection with the 2011 Financing Transaction SRMC secured a letter of credit from Bank of America in the amount of \$13,515,150 as collateral for the HUD-required equity contribution by UNM to be made prior to the completion of the construction. Simultaneously SRMC deposited \$13,515,150 with Bank of America, as collateral for the letter of credit, and invested those funds in a short term collateralized certificate of deposit. During fiscal year 2012, the letter of credit was drawn upon and equity funds amounting to \$8,933,186 were used to pay the contractor and other vendors. As of June 30, 2012, \$4,581,964 remained with Bank of America to be applied against future payment requests.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 6 – 2011 Financing Transaction

In November 2010, SRMC issued \$133,425,000 in aggregate principal amount of its Taxable Revenue Build America Bonds (Direct Pay) (GNMA Collateralized - UNM Sandoval Regional Medical Center Project) Series 2010A with a maturity date of July 20, 2036 and \$10,000,000 in aggregate principal amount of its Taxable Revenue Recovery Zone Economic Development Bonds (Direct Pay) (GNMA Collateralized - UNM Sandoval Regional Medical Center Project) Series 2010B with a maturity date of July 20, 2037. The Bonds were issued pursuant to a Trust Indenture, dated as of October 1, 2010, by and between SRMC and Wells Fargo Bank, National Association, as Trustee for the purpose of financing SRMC's hospital facility and to pay certain costs associated with the issuance of the bonds.

The bonds were issued as special limited obligations of SRMC and are secured primarily by fully modified mortgage backed securities in the aggregate principal amount of \$143,425,000 (the "GNMA Securities"), to be issued by Prudential Huntoon Paige Associates, Ltd. (the "Lender"), guaranteed as to principal and interest by the Government National Mortgage Association ("GNMA"), with respect to the Mortgage Note.

Under the GNMA Mortgage Backed Securities Program, the GNMA Securities are a "fully modified pass-through" mortgage-backed security issued and serviced by the Lender. The face amount of the GNMA Securities is to be the same amount as the outstanding principal balance of the Mortgage Note. The Lender is required to pass through to the Trustee, as the holder of the GNMA Securities, by the 15th day of each month, the monthly scheduled installments of principal and interest on the Mortgage Note (less the GNMA guarantee fee and the Lender's servicing fee), whether or not the Lender receives such payment from SRMC under the Mortgage Note, plus any unscheduled prepayments of principal of the Mortgage Note received by the Lender. The GNMA Securities are issued solely for the benefit of the Trustee on behalf of the Bondholders and any and all payments received with respect to the GNMA Securities are solely for the benefit of the Bondholders.

Effective October 1, 2010, SRMC entered into a Financing Agreement with the Lender and the Trustee. Under the Financing Agreement, the Lender agreed to originate a Mortgage Note in favor of the Lender and secured by a leasehold mortgage on the project. The Mortgage Note is insured by the Federal Housing Administration ("FHA") pursuant to Section 242 of the National Housing Act of 1934 and to provide security for the Bonds, the Trustee will use the proceeds of the Bonds to purchase from the Lender the GNMA Securities. SRMC has agreed to use the proceeds of the Mortgage Note to acquire, construct, and equip the construction of the hospital.

Under the terms of the Trust Indenture, SRMC has granted to the Trustee all rights, title, and interests to all revenues, receipts, interest, income, investment earnings and other monies received or to be received by the Trustee, including monies received or to be received from the GNMA Securities and all investment earnings from the GNMA Securities. Upon issuance of the Bonds, the proceeds were placed in trust with the Trustee, and the proceeds are to be used to purchase from the lender the GNMA Securities, or to redeem the bonds according to the various early, optional, and mandatory redemption provisions of the Bonds.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 6 - 2011 Financing Transaction (continued)

As of June 30, 2012 and 2011, the balance of the Mortgage Note equals the balance of the GNMA securities, and as SRMC has determined the Mortgage Note is secured by the GNMA Securities, the amounts have been offset and are not reported in the accompanying financial statements.

Series 2010 A and Series 2010 B Bonds

The following summarizes the holdings of the Trustee and the respective outstanding balances of the bonds as of June 30:

| | <u>2012</u> | <u>2011</u> |
|---|-----------------------|-----------------------|
| Bond Trust Assets | | |
| Acquisition fund | | |
| Cash equivalents | \$ 32,246,035 | \$ 107,608,983 |
| GNMA Securities at fair value | 138,900,939 | 41,267,711 |
| Bond fund - cash equivalents | 2,552,277 | 696,937 |
| Subsidy escrow fund - cash equivalents | 1,215,899 | 1,163,226 |
| Bonds Negative Arbitrage - cash equivalents | 2,316,947 | 7,698,325 |
| | <u>\$ 177,232,097</u> | <u>\$ 158,435,182</u> |
| Bonds - Principal Outstanding | | |
| Bonds - Series 2010A | \$ 133,425,000 | \$ 133,425,000 |
| Bonds - Series 2010B | 10,000,000 | 10,000,000 |
| | <u>\$ 143,425,000</u> | <u>\$ 143,425,000</u> |

The terms of the Bonds Issued are as follows:

| Bond | Maturity Date | Principal Amount | Interest Rate |
|--------------|---------------|------------------|---------------|
| Series 2010A | July 20, 2036 | \$ 133,425,000 | 4.50% |
| Series 2010B | July 20, 2037 | \$ 10,000,000 | 5.00% |

SRMC is eligible to receive cash subsidy payments from the United States Department of Treasury equal to 35% of the interest payable on the Build America Bonds (Series 2010A), and 45% of the interest payable on the Recovery Zone Economic Development Bonds (Series 2010B), payable on or about each respective interest payment date, which payments lower the overall true cost of the bonds to 3.33%.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

Note 6 -- 2011 Financing Transaction (continued)

The following schedule summarizes the scheduled mandatory redemption requirements of the Series 2010A and Series 2010B bonds as of June 30, 2012:

| Fiscal Year | Series 2010A Bonds | | Series 2010B Bonds | | Total | |
|--------------|-----------------------|----------------------|----------------------|----------------------|-----------------------|----------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2013 | \$ 1,540,000 | \$ 3,002,063 | \$ - | \$ 250,000 | \$ 1,540,000 | \$ 3,252,063 |
| 2014 | 3,160,000 | 5,899,725 | - | 500,000 | 3,160,000 | 6,399,725 |
| 2015 | 3,310,000 | 5,755,838 | - | 500,000 | 3,310,000 | 6,255,838 |
| 2016 | 3,470,000 | 5,605,088 | - | 500,000 | 3,470,000 | 6,105,088 |
| 2017 | 3,635,000 | 5,447,138 | - | 500,000 | 3,635,000 | 5,947,138 |
| 2018-2022 | 20,980,000 | 24,586,201 | - | 2,500,000 | 20,980,000 | 27,086,201 |
| 2023-2027 | 26,525,000 | 19,328,964 | - | 2,500,000 | 26,525,000 | 21,828,964 |
| 2028-2032 | 33,545,000 | 12,680,889 | - | 2,500,000 | 33,545,000 | 15,180,889 |
| 2033-2037 | 37,260,000 | 4,282,651 | 5,170,000 | 2,488,375 | 42,430,000 | 6,771,026 |
| 2038 | - | - | 4,830,000 | 359,125 | 4,830,000 | 359,125 |
| Total | \$ 133,425,000 | \$ 86,588,557 | \$ 10,000,000 | \$ 12,597,500 | \$ 143,425,000 | \$ 99,186,057 |

The bonds are subject to various redemption provisions as set forth in the Trust Indenture, including Special Mandatory Redemption, Scheduled Mandatory Redemption, and Optional Redemption. The Special Mandatory Redemption provisions are contingent on various events, including but not limited to circumstances that result in the trust estate receiving early payments on the GNMA Securities, or in the event the balance of GNMA Securities after completion of the construction are less than the amount of outstanding bonds. The Optional Redemption provision allows an early redemption of the bonds in whole or in part on or after January 20, 2021.

Mortgage Note

The Mortgage Note with the Lender is funded to SRMC during the course of construction. As of June 30, 2012 and 2011, the draws against the FHA insured Mortgage Note amounted to \$111,415,780 and \$35,992,318, respectively. The Mortgage Note bears interest at an initial rate of 7.5%, which is expected to be reduced upon final endorsement of the project by FHA (after completion of construction) to 4.86%. The Mortgage Note has a term of 299 months following the commencement of amortization and matures on July 1, 2037. Principal and interest are payable in equal monthly installments upon commencement of amortization. The Mortgage Note is subject to optional prepayment beginning on January 20, 2021 or thereafter, and mandatory prepayment at any time based on the occurrence of certain events, including the receipt of any mortgage insurance proceeds.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011**

Note 6 – 2011 Financing Transaction (continued)

In connection with FHA insuring the Mortgage Note, during 2011 the Regents of UNM made an equity contribution of \$46,000,000 to SRMC, which was placed in an escrow account (titled the "Operating Capital Fund Escrow") with the Trustee. These funds were to sustain the pre-opening operational costs and working capital needs of SRMC.

Note 7 – Related Party Transactions

SRMC has entered into various agreements with UNM Hospital, UNMMG, and UNM HSC for the provision of services. These include services such as construction management, marketing development and administration, and contract labor. SRMC's operational expenses were paid primarily by UNMMG through June 30, 2012, with an expense reimbursement, at cost, made on a periodic basis. During fiscal years 2012 and 2011, SRMC paid operational expenses of \$3,619,974 and \$1,422,369 respectively, to UNMMG. At June 30, 2012 and 2011, SRMC had remaining amounts due from/(to) UNMMG of \$1,055,369 and \$(396,071), respectively, and amounts due to UNMH of \$208,055 and \$81,687, respectively. The due from balance at June 30, 2012 is netted within the due to UNMMG balance as described below.

Additionally, UNMMG extended funds to SRMC for the funding of the Negative Arbitrage Account fund as required by the bond rating agencies. UNMMG advanced SRMC \$10,125,000 in November of 2010. As of June 30, 2012 and 2011, SRMC had repaid \$5,485,000 and \$1,685,000, respectively. As the required funds balance is recalculated every six months, up until the final endorsement from HUD, all funds authorized to be released are remitted to UNMMG. The remaining balance due to UNMMG of \$4,640,000 as of June 30, 2012, is expected to be repaid prior to June 30, 2013.

UNM and SRMC have entered into a Ground Lease under which SRMC will lease approximately 18.4 acres of land from the UNM. The Ground lease provides for rent of \$1.00 per year for the primary and extended terms of the Ground Lease. The Ground Lease further provides that the primary term of the Ground Lease will be for a term of 74 years and grants SRMC the option to renew the Ground Lease for an extended term of 25 years.

During 2011, UNM made an equity contribution to SRMC of \$46,000,000, which has been recorded as a capital contribution in the accompanying statement of revenues, expenses, and changes in net assets. No contributions were received by SRMC during fiscal year 2012.

SUPPLEMENTARY INFORMATION

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
 (A COMPONENT UNIT OF UNIVERSITY OF NEW MEXICO)
 PLEDGED COLLATERAL BY BANKS
 June 30, 2012

Schedule 1

| | Wells Fargo | Prudential |
|---|--------------------|--------------------|
| Deposits per bank: | \$ 1,054,088 | \$ 4,581,964 |
| Less: | | |
| FDIC coverage | <u>(1,054,088)</u> | <u>(4,581,964)</u> |
| Total uninsured public funds | <u>\$ -</u> | <u>\$ -</u> |
| State of New Mexico: Collateral Requirement - 50% | \$ - | \$ - |
| Pledged collateral: | | |
| None required | <u>-</u> | <u>-</u> |
| Total pledged collateral | <u>-</u> | <u>-</u> |
| Over (under) collateralized | <u>\$ -</u> | <u>\$ -</u> |

See accompanying report of independent auditors.

UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
 (A COMPONENT UNIT OF UNIVERSITY OF NEW MEXICO)
 DEPOSIT AND INVESTMENT ACCOUNT BALANCES
 June 30, 2012

Schedule 2

| Account | Type of Account Name of Asset | Bank Balance | Reconciling Items | Book Balance |
|-------------|---|---------------|-------------------|---------------|
| Petty cash | | \$ 1,350 | - | \$ 1,350 |
| Wells Fargo | Checking (Operating) | 623,354 | - | 623,354 |
| | Payroll | 8,113 | - | 8,113 |
| | Capital Projects | 422,621 | - | 422,621 |
| Wells Fargo | Wells Fargo Bank Secured Institutional Money Market Account | 64,788,173 | - | 64,788,173 |
| Prudential | Money Market Certificate of Deposit | 4,581,964 | - | 4,581,964 |
| | Total money market | 69,370,137 | - | 69,370,137 |
| | Total cash and cash equivalents | \$ 70,425,575 | - | \$ 70,425,575 |

See accompanying report of independent auditors.

**Report of Independent Auditors 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***

The Board of Directors
UNM Sandoval Regional Medical Center, Inc.
and
Mr. Hector Balderas, State Auditor

We have audited the financial statements of UNM Sandoval Regional Medical Center, Inc. (SRMC), a component unit of the University of New Mexico, as of and for the year ended June 30, 2012, and have issued our report thereon dated November 2, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of SRMC is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered SRMC'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 SRMC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SRMC'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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2012-01, to be a material weakness.

The Board of Directors
UNM Sandoval Regional Medical Center, Inc.
and
Mr. Hector Balderas, State Auditor

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. We consider the deficiency described in the accompanying schedule of findings and responses as item 2012-02, to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SRMC'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

This report is intended solely for the information and use of management, the board of directors, others within the entity, and the New Mexico State Auditor, and is not intended to be and should not be used by anyone other than these specified parties.

Mess Adams LLP

Albuquerque, New Mexico
November 2, 2012

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2012**

12-01 – Capitalization of Interest

Condition:

For the year ended June 30, 2011, interest costs of approximately \$4.3 million were improperly capitalized.

Criteria:

Generally accepted accounting principles (GAAP) require interest costs on taxable bonds be calculated by applying a borrowing rate to incurred qualifying expenditures, which treatment is substantially different from tax-exempt bond interest.

Cause:

SRMC did not follow the interest capitalization requirements for taxable borrowings, which were applicable to the Build America Bonds, as the bonds are taxable.

Effect:

Interest expense was understated, and construction in progress was overstated by approximately \$4.3 million in the 2011 financial statements.

Recommendation:

We recommend that SRMC revise the interest capitalization calculations to comply with GAAP.

Management's response:

SRMC has adopted and implemented a policy regarding the capitalization of interest that is consistent with GAAP. Executive Level review by the CFO of the capitalization of interest and the underlying calculations is required under the new policy to ensure adherence to the policy.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
YEAR ENDED JUNE 30, 2012**

12-02 - Cutoff of Accounts Payable and Accrued Liabilities

Condition:

As of June 30, 2012, SRMC did not properly accrue for approximately \$12,645,000 of goods and services received during fiscal year 2012.

Criteria:

Proper internal controls over financing reporting include the design and implementation of procedures to ensure transactions are recorded in the proper period as required under the accrual basis of accounting.

Cause:

SRMC set a closing date for fiscal year 2012 of July 9, 2012. The majority of the amount that was not accrued for were for invoices that were date stamped July 9, 2012 or later. Due to the closing date set by SRMC, many of the invoices that came subsequent to that date were not accrued, and there was no post-closing process to ensure invoices were properly accrued.

Effect:

As of June 30, 2012, accounts payable was understated by approximately \$12,645,000, of which approximately \$12,561,000 was related to construction in progress.

Recommendation:

We recommend that SRMC establish proper internal controls over cutoff at each reporting period, with special attention to the year-end cutoff.

Management's response:

During FY 2012, SRMC was in a pre-opening/under construction scenario. As such, many processes, including the Purchase Order, Receiving, and Accounting processes were manual in nature. Thus, several items for which invoices were not received until 30-45 days after year end were inappropriately recorded in period one of the following fiscal year. Beginning in July of 2012, SRMC went live on the Lawson accounting system, and now maintains a process whereby items that have been received but not invoiced, can be properly accrued into the proper accounting period.

**UNM SANDOVAL REGIONAL MEDICAL CENTER, INC.
(A COMPONENT UNIT OF THE UNIVERSITY OF NEW MEXICO)
EXIT CONFERENCE
YEAR ENDED JUNE 30, 2012**

An exit conference was conducted on October 26, 2012, with members of the board of directors and members of SRMC management. During this meeting, the contents of this report were discussed with the following board members, management personnel, and Moss Adams LLP representatives present:

| | |
|----------------|---------------------------------------|
| Steve McKernan | Board Member |
| Dick Mason | Board Member |
| Kevin Rogols | President and Chief Executive Officer |
| Erica Hamilton | Vice President of Patient Services |
| Troy Clark | Vice President of Financial Services |
| Brandon Fryar | Engagement Partner, Moss Adams LLP |
| Adam Cavin | Senior Manager, Moss Adams LLP |

SRMC's management prepared the financial statements and is responsible for the contents.