TAOS HEALTH SYSTEMS, INC.

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED MAY 31, 2023 AND 2022

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Taos Health Systems, Inc.
Taos, New Mexico

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Taos Health Systems, Inc. (the Organization), which comprise the consolidated balance sheets as of May 31, 2023 and 2022, and the related consolidated statements of operations, net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of May 31, 2023 and 2022, and the results of their operations, changes in their net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Organization and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter Regarding a Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, in 2023 the Organization adopted new accounting guidance for leases. The guidance requires lessees to recognize a right-of-use asset and corresponding liability for all operating and finance leases with lease terms greater than one year. Our opinion is not modified with respect to that matter.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Organization's ability to continue as a going concern for one year after the date the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and the *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Organization's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Board of Directors
Taos Health Systems, Inc.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2023 on our consideration of the Organization's internal control over financial reporting and on our tests of 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 of the effectiveness of the Organization's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Denver, Colorado
October 25, 2023

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
MAY 31, 2023 AND 2022

	2023	2022
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 11,837,732	$ 14,980,713
Short-Term Investments	29,865	27,928
Patient Accounts Receivable	7,042,299	10,198,668
Estimated Amounts Due from Third-Party Payors	1,569,086	-
Other Receivables	343,202	440,688
Inventory Supplies	1,629,357	1,674,135
Prepaid Expenses and Other	1,305,798	977,281
Total Current Assets	23,757,339	28,299,413
ASSETS LIMITED AS TO USE - BOARD-DESIGNATED	88,989	91,755
EQUITY METHOD INVESTMENT	-	15,218
PROPERTY AND EQUIPMENT, NET	14,185,934	14,264,391
RIGHT-OF-USE ASSETS, NET - OPERATING	1,672,583	-
GOODWILL, NET	153,369	174,570
Total Assets	$ 39,858,214	$ 42,845,347

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS (CONTINUED)
MAY 31, 2023 AND 2022

	2023	2022
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable	$ 7,771,594	$ 9,007,554
Accrued Expenses	2,268,762	2,380,020
Current Portion of Finance Lease Obligations	374	77,047
Current Portion of Operating Lease Obligations	450,578	-
Estimated Amounts Due to Third-Party Payors	-	345,974
Deferred Revenue	41,536	3,489,865
Total Current Liabilities	10,532,844	15,300,460
LONG-TERM LIABILITIES		
Finance Lease Obligations, Less Current Portion	-	7,974
Operating Lease Obligations, Less Current Portion	1,222,005	-
Total Long-Term Liabilities	1,222,005	7,974
Total Liabilities	11,754,849	15,308,434
NET ASSETS		
Net Assets Without Donor Restrictions	27,669,227	27,183,093
Net Assets With Donor Restrictions	434,138	353,820
Total Net Assets	28,103,365	27,536,913
Total Liabilities and Net Assets	$ 39,858,214	$ 42,845,347

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED MAY 31, 2023 AND 2022

	2023	2022
OPERATING REVENUE		
Patient Service Revenue	$ 69,950,074	$ 69,815,369
Other Operating Revenue	10,340,475	12,199,389
Net Assets Released from Restrictions Used for Operations	125,221	112,250
Total Operating Revenues	80,415,770	82,127,008
OPERATING EXPENSES		
Salaries and Wages	31,664,815	31,528,307
Purchased Services	18,854,734	15,699,576
Supplies and Minor Equipment	12,012,724	12,503,229
Payroll Taxes and Benefits	6,495,644	6,441,817
Professional Fees	3,103,629	2,460,681
Depreciation and Amortization	2,081,962	2,276,016
Leases and Rentals	1,416,101	1,368,976
Repairs and Maintenance	1,382,685	1,362,247
Other	4,518,353	3,771,117
Insurance	2,165,731	1,987,747
Telephone and Utilities	664,651	807,678
Travel, Meals, and Entertainment	145,500	74,437
Interest	43,269	19,170
Total Operating Expenses	84,549,798	80,300,998
INCOME (LOSS) FROM OPERATIONS	(4,134,028)	1,826,010
NONOPERATING GAINS		
Investment Income	39,718	9,655
Tax Revenues	4,564,518	3,840,546
Other Income	15,926	220,862
Net Nonoperating Gains	4,620,162	4,071,063
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	$ 486,134	$ 5,897,073

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF NET ASSETS
YEARS ENDED MAY 31, 2023 AND 2022

	2023	2022
NET ASSETS WITHOUT DONOR RESTRICTIONS		
Increase in Net Assets Without Donor Restrictions	$ 486,134	$ 5,897,073
NET ASSETS WITH DONOR RESTRICTIONS		
Restricted Grants and Donations	205,539	229,216
Net Assets Released from Restrictions	(125,221)	(112,250)
Increase in Net Assets with Donor Restrictions	80,318	116,966
INCREASE IN NET ASSETS	566,452	6,014,039
Net Assets - Beginning of Year	27,536,913	21,522,874
NET ASSETS - END OF YEAR	$ 28,103,365	$ 27,536,913

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED MAY 31, 2023 AND 2022

	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in Net Assets	$ 566,452	$ 6,014,039
Adjustment to Reconcile Increase in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization	2,081,962	2,276,016
Loss on Disposal of Property and Equipment	-	41,812
Net Unrealized Losses on Assets Limited as to use	6,076	7,186
Forgiveness of Long-Term Debt	-	(4,843,500)
Loss on Equity Method Investment	15,218	-
Change in Current Assets and Liabilities:		
Patient Accounts Receivable	3,156,369	(2,874,154)
Other Receivables	97,486	(295,114)
Inventory Supplies	44,778	(63,418)
Prepaid Expenses and Other	(328,517)	907,952
Accounts Payable	(1,227,892)	2,156,603
Accrued Expenses	(111,258)	(9,298)
Net Amounts Due from Third-Party Payors	(1,915,060)	3,264,905
Deferred Revenue	(3,448,329)	(3,472,311)
Net Cash Provided (Used) by Operating Activities	(1,062,715)	3,110,718
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(1,990,372)	(1,200,663)
Net (Purchases) Sales of Assets Limited as to Use	(5,247)	8,192
Acquisition of Clinic	-	(271,393)
Net Cash Used by Investing Activities	(1,995,619)	(1,463,864)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal Payments Under Finance Lease Obligations	(84,647)	(294,715)
Net Cash Used by Financing Activities	(84,647)	(294,715)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(3,142,981)	1,352,139
Cash and Cash Equivalents - Beginning of Year	14,980,713	13,628,574
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 11,837,732	$ 14,980,713
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Payments For Interest	$ 43,269	$ 19,170
Property And Equipment Purchases Included in Accounts Payable	$ -	$ 8,068

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Taos Health Systems, Inc. (the Organization), located in Taos, New Mexico, is a nonprofit critical access hospital along with specialty clinics as further described below. The Organization provides inpatient, outpatient, emergency care, and clinical services for residents of Taos County and surrounding areas. The consolidated financial statements of the Organization include Holy Cross Hospital (the Hospital) and Taos Professional Services (TPS).

TPS, formed in 2008, is currently compromised of the following distinct clinical units:

- Holy Cross Women's Health Institute (WHI), which provides obstetrics and gynecology services.
- Taos Surgical Specialties (TSS), which provides surgical services including cardiology.
- Holy Cross Pediatrics and Primary Care, provides basic family clinic services.
- Taos Clinic for Children and Youth, provides basic pediatric clinic services.

Basis of Accounting

The consolidated financial statements of the Organization have been prepared on the accrual basis, whereas, revenue is recognized when earned, and expenses are recognized when incurred, which is in accordance with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of the Hospital and TPS. All material intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Organization and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Include net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. At times, the governing board can designate, from net assets without donor restrictions, net assets for a board-designated endowment or other purposes. At May 31, 2023 and 2022, the board of directors has designated assets to be used for the First Steps Program and nursing scholarships. The nursing scholarships designated assets were released in fiscal year 2022.

Net Assets With Donor Restrictions – Include net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. At May 31, 2023 and 2022, no donor-imposed restrictions were perpetual in nature. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource has been fulfilled, or both.

Revenues are reported as increases in net assets without donor restrictions, unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in net assets without donor restrictions, unless their use is restricted by explicit donor restriction or by law. Expirations of donor restrictions on assets are reported as transfers between the applicable classes of net assets. Contributions with externally imposed restrictions that are met in the same year as received are reported as revenues of the net asset without donor restriction class.

Cash and Cash Equivalents

Cash and cash equivalents primarily consist of demand deposit and money market accounts. For purposes of reporting cash flows, cash includes cash on hand and cash in banks. The Organization has from time to time deposits in excess of Federal Depository Insurance Corporation limits. Management believes any credit risk related to these deposits is minimal.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all debt securities included in investment portfolios are measured at fair value, based on quoted market prices.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in net assets without donor restrictions. Restricted investment income where the restriction is not satisfied in the same year is reflected in the consolidated statements of net assets as with donor restrictions based upon the existence and nature of any donor or legally imposed restrictions.

Patient Accounts Receivable

Patient accounts receivable are recorded in the accompanying consolidated balance sheets at the estimated transaction price based on certain assumptions. In evaluating the collectability of patient accounts receivable, the Organization analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the transaction price. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for implicit price concessions. For receivables associated with services provided to patients who have third party coverage, the transaction price is based on the estimated explicit price concessions, which is based on current contract prices or historical claims paid data by payor. For uninsured patients (which includes both patients without insurance and patients with deductible and copayment balances due which third party coverage exists for a portion of the bill), the estimated transaction price is determined using estimates of historical collection experience. These estimates are adjusted for recoveries and any anticipated changes in trends, including significant changes in payor mix, economic conditions or trends in federal and state governmental health care coverage.

Inventory Supplies

Inventory supplies are valued at the lower of cost (first-in, first-out method) or net realizable value.

Assets Limited as to Use

Assets limited as to use primarily include designated assets set aside by the board of directors (the Board) for the First Steps Program and nursing scholarships, over which the Board retains control and may at its discretion subsequently use for other purposes. During fiscal year 2022 the nursing scholarships funds were released.

Property and Equipment, Net

Property and equipment acquisitions are recorded at cost. The Organization capitalizes property and equipment additions in excess of $5,000. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under finance lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation expense in the consolidated statements of operations. Depreciation and amortization expense for fiscal years 2023 and 2022 was $2,060,761 and $2,267,182, respectively.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment, Net (Continued)

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Buildings and Improvements	3 to 40 Years
Equipment	3 to 10 Years

Impairment of Long-Lived Assets

The Organization reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may be not recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or the fair value less costs to sell. There was no impairment of long-lived assets at May 31, 2023 and 2022.

Leases

The Organization determines if an arrangement is a lease at inception. Operating leases are included in right-of-use (ROU) assets – operating and lease liability – operating, and finance leases are included in ROU assets – financing and lease liability – financing in the consolidated financial statements.

ROU assets represent the Organization’s right to use an underlying asset for the lease term and lease liabilities represent the Organization’s obligation to make lease payments arising from the lease. ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. Lease terms may include options to extend or terminate the lease when it is reasonably certain that the Organization will exercise that option. Lease expense for operating lease payments is recognized on a straight-line basis over the lease term. The Organization has elected to recognize payments for short-term leases with a lease term of 12 months or less as expense as incurred and these leases are not included as lease liabilities or right of use assets on the consolidated balance sheets.

The individual lease contracts do not provide information about the discount rate implicit in the lease. Therefore, the Organization has elected to use a risk-free discount rate determined using a period comparable with that of the lease term for computing the present value of lease liabilities.

Equity Method Investment

The Organization had a 50% ownership in Taos Community Health Plan, Inc., a Physician Hospital Organization (PHO) created to present a united group of health care providers to negotiate contracts with managed care organizations. This investment was accounted for under the equity method of accounting. Under the equity method, the original investment was recorded at cost and adjusted by the Organization’s share of undistributed earnings or losses of the PHO. The PHO was dissolved in fiscal year 2023.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill, Net

In May 2019, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2019-06, *Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. The core principal of the new guidance in that not-for-profit entities have a one-time unconditional option to forgo a preferability assessment the first time they elect a not-for-profit accounting alternative within the scope of ASU 2019-06.

The Organization adopted ASU 2019-06 while simultaneously adopting FASB 2014-02, *Intangibles-Goodwill and Other (Topic 350): Accounting for Goodwill*, effective June 1, 2020.

Goodwill relates to the acquisition of a physician clinic by the Organization and represents the excess of the purchase price of the acquired business over the fair value of the assets acquired and liabilities assumed. Goodwill is reviewed for potential impairment if a triggering event occurs that indicates the Organization’s fair value may be below its carrying value. Measurement of goodwill impairment is based on the excess of the carrying value, including goodwill, over the fair value. At May 31, 2023 and 2022, the Organization has determined that there is no impairment of goodwill.

Amortization expense related to goodwill was $21,201 and $8,834 for the years ending May 31, 2023 and 2022, respectively.

The future annual amortization expense for goodwill subject to amortization is as follows:

Year Ending May 31,	Amount
2024	$ 21,201
2025	21,201
2026	21,201
2027	21,201
2028	21,201
Thereafter	47,364
Total	$ 153,369

Deferred Revenue

Revenue received in advance of the performance of services deemed to be exchange transactions are deferred until such time as related expenditures are incurred and then revenue is recognized.

Performance Indicator

Increase in net assets without donor restrictions, as reflected in the accompanying consolidated statements of operations, is the performance indicator. The performance indicator includes all changes in net assets without donor restrictions, including investment income not restricted by donors and tax revenues.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Patient Service Revenue

The Organization has agreements with third-party payors that provide for payments to the Organization at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Patient service revenue is reported at the estimated transaction price from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Charity Care

The Organization provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue. The Organization's direct and indirect costs for services furnished under its charity care policy aggregated approximately $80,000 and $196,000 in 2023 and 2022, respectively.

Contributions

Contributions without donor restrictions are included in other operating revenue. Contributions restricted by the donors for specific purposes are reported as net assets with donor restrictions. As donor-restricted funds are used for operating expenses, such funds are transferred to net assets without donor restrictions and reported in the consolidated statements of operations.

Tax Revenues

In November 2020, the voters of Taos County, New Mexico passed a levy of one mill for funding infrastructure maintenance and improvements for Holy Cross Hospital. The mill is effective for the 2021 tax year for a period of four years. The taxes are reported as revenue in the year in which the funds are approved to be spent. During the year ended May 31, 2023 and 2022, the Organization recorded $2,513,186 and $1,974,006, respectively, in revenue from the mill levy which is included in tax revenues on the consolidated statements of operations.

In March 2020, the Taos County Board of Commissioners approved a gross receipts tax increase to support operations of the Organization. During the years ended May 31, 2023 and 2022, the Organization recorded $2,051,332 and $1,866,540, respectively in revenue from the gross receipts tax which is included in tax revenues on the consolidated statements of operations.

Advertising Costs

The Organization expenses advertising costs as incurred. Advertising expenses for the years ended May 31, 2023 and 2022 were $84,141 and $85,505 respectively.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Professional Liability Claims

The Organization recognizes an accrual for claim liabilities based on estimated ultimate losses and costs of associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any.

Fair Value of Financial Instruments

The Organization adopted accounting standards regarding the fair value measurement of financial assets and liabilities. Fair value measurement applies to reported balances that are required or permitted to be measured at fair value under an existing accounting standard. The Organization emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability and establishes a fair value hierarchy.

The fair value hierarchy consists of three levels of inputs that may be used to measure fair value as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Organization has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Investments are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Guidance

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases (Topic 842)*. This new standard increases transparency and comparability among organizations by requiring the recognition of right-of-use (ROU) assets and lease liabilities on the consolidated balance sheets. Most prominent amount the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating leases. Under the standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

The Organization adopted the requirements of the guidance effective June 1, 2022 and has elected to apply the provisions of this standard to the beginning of the period of adoption, through a cumulative effect adjustment, with certain practical expedients available. Lease disclosures for the year ended May 31, 2022 are made under prior lease guidance in FASB ASC 840.

The Organization has elected to adopt the package of practical expedients available in the year of adoption. The Organization has elected to adopt the available practical expedient to use hindsight in determining the lease term and in assessing impairment of the Organization's ROU assets. The value of the ROU assets and liabilities recorded as of June 1, 2022 was $2,145,388. Also, the Organization previously had capital lease obligations which have now been updated to be called finance lease obligations.

In fiscal year 2023, the Organization adopted Accounting Standards Update (ASU) 2020-07, *Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*. The new guidance requires nonprofit entities to present contributed nonfinancial assets as a separate line item in the statements of operations, apart from contributions of cash and other financial assets. The standard also increases the disclosure requirements around contributed nonfinancial assets, including disaggregating by category types of contributed nonfinancial assets a nonprofit entity has received. The Organization has applied the adoption of this standard retrospectively to fiscal year 2022. Adoption of this standard did not have a material impact on the Organization's consolidated financial statements.

Tax Status

The IRS has determined that the Organization is a tax-exempt, nonprofit corporation under Section 501(c)(3) of the Internal Revenue Code (IRC).

The Organization follows the guidance in the accounting standards regarding the recognition and measurement of uncertain tax positions. The guidance clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. The guidance further prescribes recognition and measurement of tax provisions taken or expected to be taken on a tax return that are not certain to be realized. The application of this standard has no impact on the Organization's consolidated financial statements.

The Organization's income tax returns are subject to review and examination by federal, state, and local authorities.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsequent Events

In preparing the consolidated financial statements, the Organization has considered events and transactions that have occurred through October 25, 2023, the date in which the consolidated financial statements were available to be issued.

NOTE 2 PATIENT SERVICE REVENUE

Patient service revenue is reported at the amount that reflects the consideration to which the Organization expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Organization bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The Organization believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services or patients receiving services in outpatient clinics.

The opening and closing contract balances were as follows:

	Patient Receivables
Balance as of June 1, 2021	$ 7,270,649
Balance as of May 31, 2022	10,198,668
Balance as of May 31, 2023	7,042,299

The Organization measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and the Organization does not believe it is required to provide additional goods or services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Organization has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

The Organization uses a portfolio approach to account for categories of patient contracts as a collective group, rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. Based on the historical collection trends and other analysis, the Organization believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The Organization determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Organization’s policy, and/or implicit price concessions provided to uninsured patients. Estimated contractual adjustments and discounts are based on contractual agreements, its discount policy (or policies), and historical experience. Estimated implicit price concessions are based on its historical collection experience with this class of patients.

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

<u>Medicare</u>

The Organization has critical access hospital status and is reimbursed by Medicare for inpatient and outpatient services on a cost basis as defined and limited by the Medicare program. The Medicare program’s administrative procedures preclude final determination of amounts due to the Organization for such services until three years after the Organization’s cost reports are audited or otherwise reviewed and settled upon by the Medicare intermediary.

The Organization’s Medicare cost reports have been finalized by the Medicare fiscal intermediary through the year ended May 31, 2020. The Organization’s classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by the peer review organization under contract with the Organization.

<u>Medicaid</u>

Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services and defined capital are paid based on a percentage above the state determined fee schedule. Cost reports are required; however, cost report settlements have been discontinued.

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

Other Third-Party Payors

The Organization has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Organization under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Self-Pay Patients

The Organization recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Organization recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Organization’s uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Organization records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Organization’s compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Organization. In addition, the contracts the Organization has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations.

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Organization also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Organization estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Additional revenue recognized due to the changes in its estimates of implicit price concessions, discounts, and contractual adjustments were not considered material for the years ended May 31, 2023 and 2022.

The Organization provides care to patients regardless of their ability to pay. Therefore, the Organization has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balance (for example, copays, and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amount the Organization expects to collect based on its collection history with those patients.

Patients who meet the Organization’s criteria for charity care are provided care without charge. Such amounts determined to qualify as charity care are not reported as revenue.

The Organization has determined the nature, amount, timing and uncertainty of revenue and cash flows are affected by the following factors:

- Payors (for example, Medicare, Medicaid, managed care or other insurance, patient) have different reimbursement/payment methodologies
- Length of patient’s service/episode of care
- Geography of the service location
- Method of reimbursement (fee for service or capitation)
- The Organization’s line of business that provided the service (for example, hospital inpatient, hospital outpatient, clinic, etc.)

For the years ended May 31, 2023 and 2022, all of the patient revenue recognized by the Organization was from goods and services that transfer to customer over time.

Revenue from the Medicare and Medicaid programs accounted for approximately 48% and 20%, respectively, of the Organization’s patient service revenue for the year ended May 31, 2023, and 42% and 20%, respectively, of the Organization’s patient service revenue for the year ended May 31, 2022.

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

Hospital and Targeted Access Payments

In accordance with federal rule 42 CFR 438.60, the Hospital Access Payments (HAP) program is paid through the Centennial Care Managed Care Organizations (MCOs); payments are not made directly by HSD. HAP program payments are calculated based on each MCO's member utilization, at each hospital, for both inpatient and outpatient discharges. Each discharge has an additional add-on that is paid based on a calculated formula. The add-on payment amount changes each quarter. Since the HAP is based on actual utilization, there will not be a reconciliation of funds. The Targeted Access Payments (TAP) program was designed to alleviate the discrepancy between the HAP payment and the Uncompensated Care (UC) payment under the former Safety Net Care Pool (SNCP) model. Unlike the HAP program, HSD will make payments under TAP directly to the hospitals quarterly. The TAP is determined by taking the calculated HAP payment and comparing that with the UC payment on a quarterly basis. If the HAP payment is less than the UC payment, HSD will make a TAP payment for the difference.

NOTE 3 LIQUIDITY AND AVAILABILITY

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the statement of financial position date, comprise the following:

	2023	2022
Financial Assets at Year-End:		
Cash and Cash Equivalents	$ 11,837,732	$ 14,980,713
Short-Term Investments	29,865	27,928
Receivables:		
Patient Accounts Receivable	7,042,299	10,198,668
Estimated Amounts Due from Third-Party Payors	1,569,086	-
Other	343,202	440,688
Assets Limited as to Use - Board-Designated	88,989	91,755
Total Financial Assets Available Within One Year	$ 20,911,173	$ 25,739,752

The Organization has certain board-designated net assets limited as to use which are available for the First Steps Program and nursing scholarships within one year in the normal course of operations. Accordingly, the assets have been included in the qualitative information above for financial assets to meet general expenditures within one year. During fiscal year 2022 the nursing scholarships funds were released.

NOTE 4 INVESTMENTS AND INVESTMENT INCOME

Assets Limited as to Use

The composition of assets limited as to use at May 31, 2023 and 2022 are shown in the following table. Assets limited as to use are stated at fair value.

	2023	2022
Internally Designated For First Step Program		
Cash and Cash Equivalents	17	17
Mutual Funds	88,972	91,738
Total Assets Limited as to Use	$ 88,989	$ 91,755

Investment Income

Investment income, fees, and gains and losses on assets limited as to use and cash and cash equivalents consist of the following for the years ended May 31:

	2023	2022
Interest and Dividend Income, Net	$ 43,723	$ 34,024
Realized and Unrealized Losses on Investments, Net	(4,005)	(24,369)
Total Investment Income	$ 39,718	$ 9,655

NOTE 5 PROPERTY AND EQUIPMENT, NET

A summary of property and equipment at May 31 follows:

	2023	2022
Land	$ 2,165,031	$ 2,165,031
Leasehold Improvements	3,391,226	3,391,226
Buildings	13,897,958	13,396,433
Equipment	22,920,136	21,215,664
Construction in Progress	401,814	625,508
Total Property and Equipment	42,776,165	40,793,862
Less: Accumulated Depreciation	(28,590,231)	(26,529,471)
Property and Equipment, Net	$ 14,185,934	$ 14,264,391

Construction in progress as of May 31, 2023, consists of various projects which are expected to be completed in fiscal year 2024. The expected total cost of these projects is approximately $450,000 and the projects are being funded internally.

NOTE 6 LONG-TERM DEBT

On April 14, 2020, the Organization received a loan through the U.S. Small Business Administration Paycheck Protection Program (PPP) in the amount of $4,843,500. The loan accrued interest at 1% with principal and interest payments due monthly starting either (1) the date the SBA remits the borrower's loan forgiveness amount to the lender or (2) if the borrower does not apply for loan forgiveness, 10 months after the end of the borrower's loan forgiveness covered period. The loan payments were due over 18 months. There are provisions under the PPP loan program where all or a portion of the loan may be forgiven based on certain requirements being met. On June 11, 2021, the SBA forgave the PPP loan in full. The Organization recognized the full PPP loan amount as other operating revenue in fiscal year 2022 on the consolidated statements of operations. The SBA may review funding eligibility and usage of funds for compliance with program requirements based on dollar thresholds and other factors. The amount of liability, if any, from potential noncompliance cannot be determined with certainty; however, management is of the opinion that any review will not have a material adverse impact on the Organization's financial position.

NOTE 7 DEFERRED REVENUE

As part of the Organization's response to the COVID-19 pandemic it received advanced payments from Medicare in the amount of $7,071,126. These payments were received in April 2020 and will need to start to be repaid within a year from receipt. The Organization has up to twenty-nine months from the date the payments were made to repay the balance. Medicare recouped advanced payments in the amount of $1,966,944 and $5,104,182 during fiscal years 2023 and 2022, respectively. As of May 31, 2023 and 2022, there was $-0- and $1,966,944 remaining of advanced payments to be recouped and the amounts are included in deferred revenue on the consolidated balance sheets.

As part of the Organization's response to the COVID-19 pandemic it received payments from the CARES Act Provider Relief Fund (PRF), which is administered by the U.S. Department of Health and Human Services. The Organization received PRF payments in the amount of $-0- and $2,204,218 and recognized revenues in the amount of $2,204,218 and $616,917 during fiscal years 2023 and 2022, respectively. The revenues recognized are included in other operating revenue on the consolidated statements of operations. The remaining balance of $-0- and $2,204,218 is included in deferred revenues at May 31, 2023 and 2022, respectively. The PRF payments have terms and conditions that the Organization is required to follow and these funds are subject to audit. Include in the PRF terms and conditions is a potential for repayment of these funds if they are not fully used in line with the terms and conditions. Management believes the amounts have been recognized appropriately as of May 31, 2023 and 2022.

NOTE 8 NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are available for the following purposes or periods:

	2023	2022
Subject to Expenditure for Specified Purpose:		
Health Education	$ 33,405	$ 11,628
Purchase of Equipment	53,136	33,136
Health Care Programs	347,597	309,056
Total	$ 434,138	$ 353,820

NOTE 9 CONCENTRATIONS OF CREDIT RISK

The Organization grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at May 31 is as follows:

	2023	2022
Medicare	34 %	30 %
Medicaid	17	26
Other Third-Party Payors	14	13
Patients	35	31
Total	100 %	100 %

NOTE 10 FAIR VALUE MEASUREMENTS

The Organization uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. For additional information on how the Organization measures fair value refer to Note 1 – Summary of Significant Accounting Policies.

The following table disclose the by level the fair value hierarchy of the Organization's assets at fair value as of May 31, 2023 and 2022:

	2023			
	Level 1	Level 2	Level 3	Total
Investments:				
Mutual Funds	$ 88,972	$ -	$ -	$ 88,972
Beneficial Interest in Taos Community Foundation Investments	-	29,865	-	29,865
Total Investments	$ 88,972	$ 29,865	$ -	$ 118,837

NOTE 10 FAIR VALUE MEASUREMENTS (CONTINUED)

	2022			
	Level 1	Level 2	Level 3	Total
Investments:				
Mutual Funds	$ 91,738	$ -	$ -	$ 91,738
Beneficial Interest in Taos Community Foundation Investments	-	27,928	-	27,928
Total Investments	$ 91,738	$ 27,928	$ -	$ 119,666

The Organization has an investment held at the Taos Community Foundation. The investment is a diversified portfolio consisting of various mutual funds. All of the securities are priced on observable inputs. Due to the nature of the valuation inputs, the interest is classified within Level 2 of the hierarchy.

NOTE 11 PENSION PLAN

Under a collective bargaining agreement between the Organization and the Professional Performance Association, affiliated with District 1199 NM, National Union of Hospital and Health Care Employees, AFSCME AFL-CIO, a defined contribution pension plan (the Plan) was established under Section 403(b) of the Internal Revenue Code. The current collective bargaining agreement was renewed on June 1, 2021 through May 31, 2024.

Under the agreement as amended, the Organization maintains a qualified, long-term, tax-deferred savings plan. Effective January 1, 2021, for employees earning less than $35,250 annually, the Organization will match the employee’s contribution to the Plan up to $705 annually. For employees earning more than $35,250 annually and who contribute at least $705, the Organization will match the employee’s contribution up to 3.0% of the employee’s annual compensation, not to exceed $5,000 annually. Only employees eighteen (18) years of age or older qualify. Members of the Plan will be vested in the Plan on a five-year graduated schedule, but fully vested no later than the employee’s sixty-fifth birthday. The Organization appoints a Plan administrator, prepares and distributes summary Plan descriptions, and assists the Plan administrator in distributing reports to individual participants no less frequently than annually. The Organization also pays all direct administrative costs to operate the Plan.

All employees, whether represented by the bargaining unit or not, who meet the eligibility requirements are eligible to participate and receive the contributions as noted above. Pension expense was approximately $509,000 and $515,000 for fiscal years 2023 and 2022, respectively.

NOTE 12 FUNCTIONAL EXPENSES

The consolidated financial statements report certain expense categories that are attributable to more than health care services or support functions. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation, interest, and other occupancy costs, are allocated to a function based on a square-footage or units-of-service basis. Allocated health care services costs not allocated on a units-of-service basis are otherwise allocated based on revenue. At May 31, expenses related to providing these services are as follows:

2023	Health Care Services	General and Administrative	Total
Salaries and Wages	$ 24,190,489	$ 7,474,326	$ 31,664,815
Purchased Services	14,309,735	4,544,999	18,854,734
Supplies and Minor Equipment	10,696,402	1,316,322	12,012,724
Payroll Taxes and Benefits	4,962,379	1,533,265	6,495,644
Professional Fees	3,090,773	12,856	3,103,629
Depreciation	1,478,193	603,769	2,081,962
Leases and Rentals	868,158	547,943	1,416,101
Repairs and Maintenance	986,216	396,469	1,382,685
Other	400,949	4,117,404	4,518,353
Insurance	1,927,276	238,455	2,165,731
Telephone and Utilities	62,519	602,132	664,651
Travel, Meals, and Entertainment	25,064	120,436	145,500
Interest	-	43,269	43,269
Total	$ 62,998,153	$ 21,551,645	$ 84,549,798

2022	Health Care Services	General and Administrative	Total
Salaries and Wages	$ 24,256,504	$ 7,271,803	$ 31,528,307
Purchased Services	11,673,545	4,026,031	15,699,576
Supplies and Minor Equipment	10,952,804	1,550,425	12,503,229
Payroll Taxes and Benefits	4,956,053	1,485,764	6,441,817
Professional Fees	2,448,681	12,000	2,460,681
Depreciation	1,615,971	660,045	2,276,016
Leases and Rentals	808,805	560,171	1,368,976
Repairs and Maintenance	972,214	390,033	1,362,247
Other	339,717	3,431,400	3,771,117
Insurance	1,799,487	188,260	1,987,747
Telephone and Utilities	62,508	745,170	807,678
Travel, Meals, and Entertainment	11,165	63,272	74,437
Interest	-	19,170	19,170
Total	$ 59,897,454	$ 20,403,544	$ 80,300,998

NOTE 13 LEASES

The Organization has entered into various finance leases for equipment. The total cost of the finance leases was $65,840 and $1,720,307 as of May 31, 2023 and 2022, respectively. The finance leases had accumulated depreciation of $54,866 and $1,517,956 as of May 31, 2023 and 2022, respectively.

The finance lease obligations have varying interest rates from 2.8% to 6.6% due through September 1, 2023. The finance lease obligations are collateralized by the leased equipment.

The Organization's operating leases primarily consist of real estate and equipment for various terms under long-term, noncancelable lease agreements. The Organization determines if an arrangement is a lease at contract inception. Operating and finance lease assets and liabilities are recognized based on the present value of the lease payments over the lease term at the commencement date. Because most of the Organization's leases do not provide an implicit rate of return, the Organization uses a risk-free rate based on the daily treasury yield curve at lease commencement in determining the present value of lease payments.

Most leases include one of more options to renew, with renewal terms that can extend the lease term for an additional month to another year. The exercise of such lease renewal options is at that Organization's sole discretion. For purposes of calculating lease liabilities, lease terms include options to extend of terminate the lease when it is reasonably certain that the Organization will exercise the option.

Leases with a term of 12 months or less at commencement are not recorded on the balance sheets. Lease expense for these arrangements is recognized on a straight-line basis over the lease term. The Organization paid $527,978 towards operating leases during fiscal year 2023.

Lease expense for lease payments is recognized on a straight-line basis over the lease term. Operating lease expense for the year ending May 31, 2023 was $527,978.

As of May 31, 2023, the average remaining lease terms were 6.4 years, and the average discount rate was 2.98%.

The following table summarized the maturity of the finance lease liabilities for the next five years as of May 31, 2023:

Year Ending May 31,	Amount
2024	$ 374
Total Payments Due	374
Less: Amount Representing Interest	
Less: Current Maturities	(374)
Noncurrent Portion of Finance Lease Obligations	$ -

NOTE 13 LEASES (CONTINUED)

The following table summarized the maturity of the operating lease liabilities for the next five years as of May 31, 2023:

Fiscal Years Ending,	Amount
2024	$ 450,578
2025	313,293
2026	137,208
2027	129,047
2028	132,893
Thereafter	509,564
Total	$ 1,672,583

The Organization elected to apply the provisions of FASB ASC 842 to the beginning of the period of adoption, through a cumulative effect adjustment, with certain practical expedients available. Lease disclosures for the year ended May 31, 2022 are made under prior lease guidance in FASB ASC 840.

The Organization leases real estate under noncancelable operating leases. Total rent expense under these operating leases was $1,368,883 for 2022. Future minimum rent commitments under this facility lease were as follows:

Fiscal Years Ending,	Amount
2023	$ 672,030
2024	516,975
2025	415,950
2026	373,589
2027	379,206
Thereafter	415,056
Total	$ 1,604,955

NOTE 14 COMMITMENTS AND CONTINGENCIES

Labor Agreements

At May 31, 2023, 94 of the Organization’s 306 union-eligible employees were active under the collective bargaining agreements. At May 31, 2022, 94 out of the Organization’s 298 union-eligible employees were active. Total employee count at year-end May 31, 2023 and 2022 was 482 and 438, respectively. The current collective bargaining agreement was renewed on June 1, 2021 through May 31, 2024, with wage renegotiations permissible in years two and three under the agreement.

NOTE 14 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employee Health Insurance

The Organization maintains a stop-loss agreement with an insurance company to limit its losses on individual claims related to group employee insurance. Under the current terms of this agreement, the Organization's claims liability is limited to $90,000 per employee per plan year. As of May 31, 2023 and 2022, the Organization accrued employee insurance claims of approximately $440,000 and $595,000, respectively, which are included in Accounts Payable in the accompanying consolidated balance sheets.

Stop-loss premiums and claims payments totaling $3,482,206 and $3,334,038 were expended during the years ended May 31, 2023 and 2022, respectively, and are included in Payroll Taxes and Benefits expense in the accompanying consolidated statements of operations.

Professional Liability Insurance

The Organization purchases medical malpractice insurance under a claims-made policy. Under such a policy, only claims made and reported to the insurer during the policy term, regardless when the incidents giving rise to the claims occurred, are covered. The Organization also purchases excess umbrella liability coverage, which provides additional coverage above the basic policy limits up to the amount specified in the umbrella policy.

Based upon the Organization's claims expense, an accrual has been made for the Organization's estimated medical malpractice costs, including costs associated with litigating or settling claims, under its malpractice insurance policy, amounting to approximately $2,006,000 and $1,545,000 as of May 31, 2023 and 2022, respectively. Professional liability reserve estimates represent the estimated cost of reported and unreported losses incurred through the respective consolidated balance sheet dates. The reserve for unpaid losses and loss expenses are estimated using individual case-basis valuations. Those estimates are subject to the effects of trends in loss severity and frequency. The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The time period required to resolve these claims can vary depending upon whether the claim is settled or litigated. The estimation of the timing of payments beyond a year can vary significantly. Although considerable variability is inherent in professional liability reserve estimates, we believe the reserves for losses and loss expenses are adequate based on information currently known. It is reasonably possible that this estimate could change materially in the near term.

Workers' Compensation Insurance

The Organization is insured under the New Mexico Hospital Workers' Compensation Group for purpose of providing insurance coverage for worker's compensation. The policy is a retrospectively rated policy whose premiums accrue based on the ultimate cost of the experience of a group of participating health care entities. The Organization expensed approximately $227,000 and $301,000 in workers' compensation premiums during 2023 and 2022, respectively. Such amounts are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

NOTE 14 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Risk Management

The Organization is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. These risks are covered by commercial insurance purchased from independent third parties. This coverage has not changed significantly from the previous year.

Health Care Legislation and Regulation

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

Management believes that the Organization is in substantial compliance with fraud and abuse as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations is subject to government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Other

In the normal course of business, there could be various outstanding contingent liabilities such as, but not limited to, the following:

- Lawsuits alleging negligence in care
- Environmental pollution
- Violation of regulatory body’s rules and regulations
- Violation of federal and/or state laws

No contingent liabilities such as, but not limited to those described above, are reflected in the accompanying consolidated financial statements. No such liabilities have been asserted and, therefore, no estimate of loss, if any, is determinable.

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*

Board of Directors
Taos Health Systems, Inc.
Taos, New Mexico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Taos Health Systems, Inc. (the Organization), which comprise the consolidated balance sheet as of May 31, 2023, and the related consolidated statements operations, net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated October 25, 2023.

Report on Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that have not been identified.

Board of Directors
Taos Health Systems, Inc.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the consolidated financial statements. 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*.

Purpose of this Report

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Denver, Colorado
October 25, 2023