

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2025 AND 2024



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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, 2025 and 2024, 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, 2025 and 2024, 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). 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.

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 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, 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.



CliftonLarsonAllen LLP

Denver, Colorado
October 29, 2025

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
MAY 31, 2025 AND 2024

ASSETS	2025	2024
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 15,084,501	\$ 13,652,204
Restricted Cash	-	1,454,114
Short-Term Investments	32,020	30,902
Patient Accounts Receivable	7,802,524	7,955,237
Estimated Amounts Due from Third-Party Payors	-	462,645
HDAA Receivable	9,715,932	-
Other Receivables	744,452	676,360
Inventory Supplies	1,064,449	997,481
Prepaid Expenses and Other	1,557,804	1,394,308
Total Current Assets	36,001,682	26,623,251
ASSETS LIMITED AS TO USE - BOARD-DESIGNATED	100,670	94,955
PROPERTY AND EQUIPMENT, NET	16,942,108	12,748,059
RIGHT-OF-USE ASSETS, NET - FINANCE	1,917,034	1,251,979
RIGHT-OF-USE ASSETS, NET - OPERATING	1,529,054	1,608,669
GOODWILL, NET	110,967	132,168
Total Assets	\$ 56,601,515	\$ 42,459,081

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS (CONTINUED)
MAY 31, 2025 AND 2024

	2025	2024
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable	\$ 9,136,615	\$ 7,861,455
Accrued Expenses	3,186,395	2,585,396
Estimated Amounts Due to Third-Party Payors	480,513	-
Current Portion of Operating Lease Obligations	408,732	651,193
Current Portion of Finance Lease Obligations	362,360	316,422
Deferred Revenue	44,570	41,536
Total Current Liabilities	13,619,185	11,456,002
LONG-TERM LIABILITIES		
Operating Lease Obligations, Less Current Portion	1,137,540	966,612
Finance Lease Obligations, Less Current Portion	1,554,674	935,557
Total Long-Term Liabilities	2,692,214	1,902,169
Total Liabilities	16,311,399	13,358,171
NET ASSETS		
Net Assets Without Donor Restrictions	39,838,390	27,234,881
Net Assets With Donor Restrictions	451,726	1,866,029
Total Net Assets	40,290,116	29,100,910
Total Liabilities and Net Assets	\$ 56,601,515	\$ 42,459,081

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED MAY 31, 2025 AND 2024

	2025	2024
OPERATING REVENUE		
Patient Service Revenue	\$ 76,732,140	\$ 73,982,749
HDAA Revenue	17,972,370	-
Other Operating Revenue	6,006,231	7,868,249
Net Assets Released from Restrictions Used for Operations	162,370	183,024
Total Operating Revenue	100,873,111	82,034,022
OPERATING EXPENSES		
Salaries and Wages	39,842,599	34,630,731
Purchased Services	13,929,122	15,036,563
Supplies and Minor Equipment	12,265,302	13,266,959
Payroll Taxes and Benefits	8,801,470	7,323,840
Professional Fees	3,120,917	3,110,910
Depreciation and Amortization	2,051,580	1,863,163
Leases and Rentals	1,658,435	1,308,914
Repairs and Maintenance	1,876,527	1,643,248
Other	7,293,969	5,325,954
Insurance	2,321,588	2,657,905
Telephone and Utilities	678,918	597,085
Travel, Meals, and Entertainment	136,079	106,183
Interest	47,872	45,846
Total Operating Expenses	94,024,378	86,917,301
GAIN (LOSS) FROM OPERATIONS	6,848,733	(4,883,279)
NONOPERATING GAINS (LOSSES)		
Investment Income	116,090	63,720
Tax Revenues	4,169,401	4,399,928
Other Income (Loss)	15,171	(14,715)
Net Nonoperating Gains	4,300,662	4,448,933
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	\$ 11,149,395	\$ (434,346)

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF NET ASSETS
YEARS ENDED MAY 31, 2025 AND 2024

	2025	2024
NET ASSETS WITHOUT DONOR RESTRICTIONS		
Excess (Deficit) of Revenues Over Expenses	\$ 11,149,395	\$ (434,346)
Net Assets Released from Restrictions for Capital	1,454,114	-
Increase (Decrease) in Net Assets Without Donor Restrictions	12,603,509	(434,346)
NET ASSETS WITH DONOR RESTRICTIONS		
Restricted Grants and Donations	202,181	1,614,915
Net Assets Released from Restrictions	(1,616,484)	(183,024)
Increase (Decrease) in Net Assets with Donor Restrictions	(1,414,303)	1,431,891
INCREASE IN NET ASSETS	11,189,206	997,545
Net Assets - Beginning of Year	29,100,910	28,103,365
NET ASSETS - END OF YEAR	\$ 40,290,116	\$ 29,100,910

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED MAY 31, 2025 AND 2024

	2025	2024
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in Net Assets	\$ 11,189,206	\$ 997,545
Adjustment to Reconcile Increase in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	2,051,580	1,863,163
Loss on Disposal of Property and Equipment	-	30,590
Net Unrealized Gains on Assets Limited as to use	(1,582)	(2,856)
Noncash Lease Expense	389,664	9,136
Change in Current Assets and Liabilities:		
Patient Accounts Receivable	152,713	(912,938)
Other Receivables	(9,784,024)	(333,158)
Inventory Supplies	(66,968)	631,876
Prepaid Expenses and Other	(163,496)	(88,510)
Accounts Payable	98,558	89,861
Accrued Expenses	604,033	316,634
Net Amounts Due from Third-Party Payors	943,158	1,106,441
Net Cash Provided by Operating Activities	5,412,842	3,707,784
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(5,047,826)	(434,677)
Net Purchases of Assets Limited as to Use	(5,251)	(4,147)
Net Cash Used by Investing Activities	(5,053,077)	(438,824)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal Payments Under Finance Lease Obligations	(381,582)	(374)
Net Cash Used by Financing Activities	(381,582)	(374)
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH	(21,817)	3,268,586
Cash, Cash Equivalents, and Restricted Cash - Beginning of Year	15,106,318	11,837,732
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH - END OF YEAR	\$ 15,084,501	\$ 15,106,318
RECONCILIATION OF CASH, CASH EQUIVALENTS, AND RESTRICTED CASH		
Cash and Cash Equivalents	\$ 15,084,501	\$ 13,652,204
Restricted Cash	-	1,454,114
Total Cash, Cash Equivalents, and Restricted Cash	\$ 15,084,501	\$ 15,106,318
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Payments For Interest	\$ 47,872	\$ 45,846
Assets Acquired through Lease Arrangements	\$ 1,371,653	\$ 1,771,459
Property and Equipment Purchases Included in Accounts Payable	\$ 1,176,602	\$ -

See accompanying Notes to Consolidated Financial Statements.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

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 comprised 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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

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, 2025 and 2024, the board of directors has designated assets to be used for the First Steps Program.

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, 2025 and 2024, 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.

Restricted Cash

Restricted cash consists of a donation received in fiscal year 2024 that had yet to be spent for the purpose of the donation. The amount was spent in fiscal year 2025.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

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 consist of amounts due for the provision of health care services which are recorded in the accompanying consolidated balance sheets at amortized cost at the net amount expected to be collected. In evaluating the collectability of patient accounts receivable, management regularly reviews data and develops a loss rate to determine expected credit losses based on several factors including whether a patient has third party payor coverage or is uninsured, the aging of receivables, historical collection and loss experience, current contract prices or claims paid data, trends for each of its major payors sources of revenue, and future economic conditions. 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. Management has determined the estimate of expected credit losses is not material to the consolidated financial statements.

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, over which the Board retains control and may at its discretion subsequently use for other purposes.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 2025 and 2024 was \$2,030,379 and \$1,841,962, respectively.

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, 2025 and 2024.

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 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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Leases (Continued)

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.

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 is 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, 2025 and 2024, the Organization has determined that there is no impairment of goodwill.

Amortization expense related to goodwill was \$21,201 for the years ending May 31, 2025 and 2024.

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

<u>Year Ending May 31,</u>	<u>Amount</u>
2026	\$ 21,201
2027	21,201
2028	21,201
2029	21,201
2030	21,201
Thereafter	4,962
Total	<u>\$ 110,967</u>

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 (decrease) 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.

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 \$952,000 and \$651,000 in 2025 and 2024, 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, 2025 and 2024, the Organization recorded \$1,869,000 and \$1,730,606, respectively, in revenue from the mill levy which is included in tax revenues on the consolidated statements of operations.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Tax Revenues (Continued)

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, 2025 and 2024, the Organization recorded \$2,620,740 and \$2,669,322, 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, 2025 and 2024 were \$128,287 and \$113,291 respectively.

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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value of Financial Instruments (Continued)

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.

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.

Subsequent Events

In preparing the consolidated financial statements, the Organization has considered events and transactions that have occurred through October 29, 2025, 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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

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, 2023	\$ 7,042,299
Balance as of May 31, 2024	7,955,237
Balance as of May 31, 2025	7,802,524

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.

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 explicit price concessions 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 explicit price concessions 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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

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:

Medicare

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, 2023. 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.

Medicaid

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.

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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

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.

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, 2025 and 2024.

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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 2 PATIENT SERVICE REVENUE (CONTINUED)

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, 2025 and 2024, 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 46% and 22%, respectively, of the Organization's patient service revenue for the year ended May 31, 2025, and 48% and 18%, respectively, of the Organization's patient service revenue for the year ended May 31, 2024.

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. The HAP and TAP program ended on June 30, 2024.

Health Care Delivery and Access Act (HDAA)

In 2024, the State of New Mexico adopted a provider fee program, approved by the Centers for Medicare and Medicaid Services (CMS), under which all hospitals in the state were assessed a provider fee. The inpatient fee is based on inpatient days, excluding Medicare days, for the reporting period and the outpatient fee is based on outpatient net patient service revenue, excluding Medicare. The State of New Mexico uses the provider fees to supplement state budget funds for the Medicaid program, which brings federal matching funds into the program, enabling the State of New Mexico to fund Medicaid payments at a higher rate than otherwise would be possible.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

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:

	<u>2025</u>	<u>2024</u>
Financial Assets at Year-End:		
Cash and Cash Equivalents	\$ 15,084,501	\$ 13,652,204
Short-Term Investments	32,020	30,902
Receivables:		
Patient Accounts Receivable	7,802,524	7,955,237
Estimated Amounts Due from Third-Party Payors	-	462,645
HDAA Receivable	9,715,932	-
Other	744,452	676,360
Assets Limited as to Use - Board-Designated	100,670	94,955
Total Financial Assets Available Within One Year	<u>\$ 33,480,099</u>	<u>\$ 22,872,303</u>

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.

NOTE 4 INVESTMENTS AND INVESTMENT INCOME

Assets Limited as to Use

The composition of assets limited as to use at May 31, 2025 and 2024 are shown in the following table. Assets limited as to use are stated at fair value.

	<u>2025</u>	<u>2024</u>
Internally Designated For First Step Program		
Cash and Cash Equivalents	\$ 13	\$ 18
Mutual Funds	100,657	94,937
Total Assets Limited as to Use	<u>\$ 100,670</u>	<u>\$ 94,955</u>

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:

	<u>2025</u>	<u>2024</u>
Interest and Dividend Income, Net	\$ 50,316	\$ 55,250
Realized and Unrealized Gains on Investments, Net	65,774	8,470
Total Investment Income	<u>\$ 116,090</u>	<u>\$ 63,720</u>

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 5 PROPERTY AND EQUIPMENT, NET

A summary of property and equipment at May 31 follows:

	<u>2025</u>	<u>2024</u>
Land	\$ 2,253,077	\$ 2,184,324
Leasehold Improvements	3,419,103	3,387,772
Buildings	14,280,063	13,963,296
Equipment	24,941,089	21,509,957
Construction in Progress	<u>2,404,492</u>	<u>173,678</u>
Total Property and Equipment	47,297,824	41,219,027
Less: Accumulated Depreciation	<u>(30,355,716)</u>	<u>(28,470,968)</u>
Property and Equipment, Net	<u>\$ 16,942,108</u>	<u>\$ 12,748,059</u>

Construction in progress as of May 31, 2025, consists of various projects which are expected to be completed in fiscal years 2026 and 2027. The expected total cost of these projects are approximately \$3,800,000 and the projects are being funded internally and through potential grants.

NOTE 6 NET ASSETS WITH DONOR RESTRICTIONS

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

	<u>2025</u>	<u>2024</u>
Subject to Expenditure for Specified Purpose:		
Health Education	\$ 27,914	\$ 36,242
Purchase of Equipment	36,022	1,490,136
Health Care Programs	387,790	339,651
Total	<u>\$ 451,726</u>	<u>\$ 1,866,029</u>

NOTE 7 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:

	<u>2025</u>	<u>2024</u>
Medicare	31 %	38 %
Medicaid	19	19
Other Third-Party Payors	34	24
Patients	16	19
Total	<u>100 %</u>	<u>100 %</u>

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 8 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, 2025 and 2024:

	2025			
	Level 1	Level 2	Level 3	Total
Investments:				
Mutual Funds	\$ 100,657	\$ -	\$ -	\$ 100,657
Beneficial Interest in Taos Community Foundation Investments	-	32,020	-	32,020
Total Investments	\$ 100,657	\$ 32,020	\$ -	\$ 132,677
	2024			
	Level 1	Level 2	Level 3	Total
Investments:				
Mutual Funds	\$ 94,937	\$ -	\$ -	\$ 94,937
Beneficial Interest in Taos Community Foundation Investments	-	30,902	-	30,902
Total Investments	\$ 94,937	\$ 30,902	\$ -	\$ 125,839

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 9 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. In n fiscal year 2025 a new collective bargaining agreement was entered into through August 31, 2027.

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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 9 PENSION PLAN (CONTINUED)

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 \$745,000 and \$589,000 for fiscal years 2025 and 2024, respectively.

NOTE 10 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:

2025	Health Care Services	General and Administrative	Total
Salaries and Wages	\$ 30,503,177	\$ 9,339,422	\$ 39,842,599
Purchased Services	10,858,182	3,070,940	13,929,122
Supplies and Minor Equipment	11,007,126	1,258,176	12,265,302
Payroll Taxes and Benefits	6,738,335	2,063,135	8,801,470
Professional Fees	3,084,917	36,000	3,120,917
Depreciation	1,456,622	594,958	2,051,580
Leases and Rentals	1,006,300	652,135	1,658,435
Repairs and Maintenance	1,046,962	829,565	1,876,527
Other	600,340	6,693,629	7,293,969
Insurance	1,974,686	346,902	2,321,588
Telephone and Utilities	63,682	615,236	678,918
Travel, Meals, and Entertainment	30,569	105,510	136,079
Interest	-	47,872	47,872
Total	<u>\$ 68,370,898</u>	<u>\$ 25,653,480</u>	<u>\$ 94,024,378</u>

2024	Health Care Services	General and Administrative	Total
Salaries and Wages	\$ 26,307,770	\$ 8,322,961	\$ 34,630,731
Purchased Services	11,518,964	3,517,599	15,036,563
Supplies and Minor Equipment	12,060,486	1,206,473	13,266,959
Payroll Taxes and Benefits	5,563,668	1,760,172	7,323,840
Professional Fees	3,090,744	20,166	3,110,910
Depreciation	1,322,846	540,317	1,863,163
Leases and Rentals	821,499	487,415	1,308,914
Repairs and Maintenance	1,071,306	571,942	1,643,248
Other	459,001	4,866,953	5,325,954
Insurance	2,095,943	561,962	2,657,905
Telephone and Utilities	58,431	538,654	597,085
Travel, Meals, and Entertainment	15,586	90,597	106,183
Interest	-	45,846	45,846
Total	<u>\$ 64,386,244</u>	<u>\$ 22,531,057</u>	<u>\$ 86,917,301</u>

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 11 LEASES

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 or 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 or 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 consolidated balance sheets. Lease expense for these arrangements is recognized on a straight-line basis over the lease term. The Organization paid approximately \$461,000 and \$448,000 towards operating leases during fiscal years 2025 and 2024, respectively. The Organization paid approximately \$445,000 and \$205,000 towards finance leases during fiscal years 2025 and 2024, respectively.

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, 2025 and 2024 was approximately \$469,000 and \$455,000, respectively. Finance lease expense for the year ending May 31, 2025 and 2024 was approximately \$445,000 and \$205,000, respectively.

As of May 31, 2025 and 2024, the average remaining lease terms on operating leases were 4.25 years and 5.5 years, respectively, and the average discount rate was 4.04%.

As of May 31, 2025 and 2024, the average remaining lease terms on finance leases were 5.58 years and 5.08 years, respectively, and the average discount rate was 4.01% and 3.85%, respectively.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 11 LEASES (CONTINUED)

The following table summarized the maturity of the lease liabilities for the next five years as of May 31, 2025:

<u>Fiscal Years Ending,</u>	<u>Operating Leases</u>	<u>Finance Leases</u>
2026	\$ 463,261	\$ 432,307
2027	419,948	432,307
2028	330,143	416,484
2029	260,109	242,428
2030	80,000	242,428
Thereafter	126,667	369,475
Total Operating Lease Payments	1,680,128	2,135,429
Less: Amounts Representing Interest	(133,856)	(218,395)
Total Operating Lease Liabilities	\$ 1,546,272	\$ 1,917,034

NOTE 12 COMMITMENTS AND CONTINGENCIES

Labor Agreements

At May 31, 2025, 101 of the Organization's 354 union-eligible employees were active under the collective bargaining agreements. At May 31, 2024, 92 out of the Organization's 340 union-eligible employees were active. Total employee count at year-end May 31, 2025 and 2024 was 449 and 526, 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. In fiscal year 2025 a new collective bargaining agreement was entered into through August 31, 2027.

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, 2025 and 2024, the Organization accrued employee insurance claims of approximately \$501,000 and \$300,000, respectively, which are included in Accounts Payable in the accompanying consolidated balance sheets.

Stop-loss premiums and claims payments totaling \$4,896,431 and \$3,909,343 were expended during the years ended May 31, 2025 and 2024, 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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 12 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Professional Liability Insurance (Continued)

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 \$2,025,000 and \$2,376,000 as of May 31, 2025 and 2024, 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 \$335,000 and \$255,000 in workers' compensation premiums during 2025 and 2024, respectively. Such amounts are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

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.

TAOS HEALTH SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2025 AND 2024

NOTE 12 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Health Care Legislation and Regulation

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.

NOTE 13 SENATE BILL 161

The State of New Mexico passed Senate Bill 161 (SB161) which provides subsidies to certain eligible healthcare facilities to provide certain care and services to sick and indigent patients. As part of SB161, the Organization was awarded a maximum of \$2,850,000 for fiscal year 2025 and \$2,850,000 for fiscal year 2026. Payments to the Organization contingency upon sufficient appropriations from the State of New Mexico. The Organization plans to use these funds to reduce contract labor costs, increase expand laboratory and radiology services, upgrade medical equipment, and maintain emergency services. During fiscal year 2025, the Organization recorded \$2,850,000 of revenue from SB161 which is included in other operating revenue.



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