

Pinnacle Healthcare, LLC
and Affiliate
(A Limited Liability Company)

Consolidated Financial Report
December 31, 2023

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Independent Auditor's Report

RSM US LLP

Board of Directors
Pinnacle Healthcare, LLC and Affiliate

Opinion

We have audited the consolidated financial statements of Pinnacle Healthcare, LLC and Affiliate (the Companies), which comprise the consolidated balance sheets as of December 31, 2023 and 2022, the related consolidated statements of income, members' (deficit) equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Companies as of December 31, 2023 and 2022, and the results of their operations 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 Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Companies 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 Financial Statements

Management is responsible for the preparation and fair presentation of the 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 financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's 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 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 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 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 Companies' 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 financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Companies' 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.

RSM US LLP

Mishawaka, Indiana
July 30, 2024

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

**Consolidated Balance Sheets
December 31, 2023 and 2022**

	2023	2022
Assets		
Current assets:		
Cash	\$ 5,508,787	\$ 4,230,787
Patient accounts receivable	7,881,845	9,271,503
Other receivables, net	738,811	890,277
Inventories	1,082,028	1,243,000
Prepaid expenses and other current assets	457,137	441,433
Total current assets	15,668,608	16,077,000
Interest rate swap	245,845	404,104
Right-of-use assets for operating leases, net	379,331	166,852
Right-of-use assets for finance leases, net	2,749,996	3,405,672
Property and equipment, net	12,625,506	13,554,894
Total assets	\$ 31,669,286	\$ 33,608,522
Liabilities and Members' (Deficit) Equity		
Current liabilities:		
Current portion of long-term debt	\$ 1,242,911	\$ 1,193,821
Line of credit	1,067,771	567,771
Current portion of operating lease liabilities	176,852	141,376
Current portion of finance lease liabilities	987,062	1,083,321
Accounts payable	12,265,651	7,822,591
Accrued wages and benefits	1,431,985	1,964,777
Other accrued expenses	817,887	818,143
Total current liabilities	17,990,119	13,591,800
Operating lease liabilities, less current portion	220,627	26,124
Finance lease liabilities, less current portion	1,529,186	2,148,691
Long-term debt, less current portion	17,147,597	18,382,809
Total liabilities	36,887,529	34,149,424
Members' (deficit) equity:		
Members' (deficit), Pinnacle Healthcare, LLC	(15,172,512)	(9,221,939)
Noncontrolling interest, Medical Realty Associates, LLC	9,954,269	8,681,037
Total members' (deficit) equity	(5,218,243)	(540,902)
	\$ 31,669,286	\$ 33,608,522

See notes to consolidated financial statements.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

**Consolidated Statements of Income
Years Ended December 31, 2023 and 2022**

	2023	2022
Patient service revenue	\$ 51,257,933	\$ 57,318,460
Operating expenses	53,708,207	56,258,074
Operating (expense) income	(2,450,274)	1,060,386
Other (expense) income:		
Interest income	116,364	22,686
Interest expense	(928,029)	(935,594)
Other income	505,237	316,182
Adjustment to fair value of interest rate swaps	(158,259)	895,196
Other (expense) income	(464,687)	298,470
Consolidated net (loss) income	(2,914,961)	1,358,856
Noncontrolling interest, Medical Realty Associates, LLC net income	(1,273,232)	(2,263,811)
Net loss attributable to Pinnacle Healthcare, LLC and Subsidiary	\$ (4,188,193)	\$ (904,955)

See notes to consolidated financial statements.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

**Consolidated Statements of Members' (Deficit) Equity
Years Ended December 31, 2023 and 2022**

	Pinnacle Healthcare, LLC Members' (Deficit)	Medical Realty Associates, LLC, Non-controlling Interest	Total
Balance, December 31, 2022	\$ (5,239,126)	\$ 6,417,226	\$ 1,178,100
Distributions to members	(3,577,558)	-	(3,577,558)
Contributions from members	499,700	-	499,700
Net (loss) income	(904,955)	2,263,811	1,358,856
Balance, December 31, 2022	(9,221,939)	8,681,037	(540,902)
Distributions to members	(1,762,380)	-	(1,762,380)
Net (loss) income	(4,188,193)	1,273,232	(2,914,961)
Balance, December 31, 2023	\$ (15,172,512)	\$ 9,954,269	\$ (5,218,243)

See notes to consolidated financial statements.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

**Consolidated Statements of Cash Flows
Years Ended December 31, 2023 and 2022**

	2023	2022
Cash flows from operating activities:		
Consolidated net (loss) income	\$ (2,914,961)	\$ 1,358,856
Adjustments to reconcile consolidated net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	2,407,939	1,952,643
Gain on disposal of equipment	(10,150)	(32,297)
Change in fair value of interest rate swap agreement	158,259	(895,196)
Reduction in operating lease right-of-use assets	166,463	167,500
Cash paid for operating leases	(235,115)	(118,437)
Change in assets and liabilities:		
Patient accounts receivable	1,389,658	(1,188,453)
Other receivables	151,466	181,206
Inventories	160,972	82,536
Prepaid expenses and other current assets	(15,704)	(4,266)
Accounts payable	4,443,060	1,061,733
Accrued expenses	(533,048)	720,100
Net cash provided by operating activities	5,168,839	3,285,925
Cash flows from investing activities:		
Purchases of equipment	(359,498)	(1,112,380)
Net cash used in investing activities	(359,498)	(1,112,380)
Cash flows from financing activities:		
Borrowings from line of credit	500,000	-
Principal payments on long-term debt	(1,186,122)	(1,137,841)
Principal payments on right-of-use finance lease liabilities	(1,082,839)	(1,072,036)
Distributions to members	(1,762,380)	(3,577,558)
Contributions from members	-	499,700
Net cash used in financing activities	(3,531,341)	(5,287,735)
Increase (decrease) in cash	1,278,000	(3,114,190)
Cash:		
Beginning	4,230,787	7,344,977
Ending	\$ 5,508,787	\$ 4,230,787
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 928,029	\$ 935,594

See notes to consolidated financial statements.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Nature of business: Pinnacle Healthcare, LLC (Pinnacle), a limited liability company (LLC), is a privately owned, 18-bed hospital that provides inpatient and outpatient surgery services to patients in Northwest Indiana.

Medical Realty Associates, LLC (MRA), a limited liability company, owns and leases the hospital facility to Pinnacle. MRA is related to Pinnacle through common ownership.

Pinnacle and its affiliate, MRA, are collectively referred to herein as the Companies.

The Companies' consolidated financial statements do not include the personal assets and liabilities of the members. All distributions are reflected as a component of members' (deficit) equity. Members of the limited liability companies have limited liability to the extent of their interest in the LLCs.

A summary of the Companies' significant accounting policies is as follows:

Reporting entity and principles of consolidation: The consolidated financial statements include the accounts of Pinnacle and MRA, a variable interest entity (VIE) for which Pinnacle is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

MRA is a VIE of Pinnacle as a result of a leasing arrangement and because it requires financial support consisting of collateral pledged against the long-term debt of MRA. The primary beneficiary of a VIE is the enterprise that has both (1) the power to direct the activities of the VIE that most significantly impact the entity's economic performance, and (2) the obligation to absorb losses or the right to receive residual returns that potentially could be significant to the VIE. See Note 7 for additional information regarding the consolidated VIE.

Noncontrolling interest: Noncontrolling interest represents the portion of the equity in MRA not attributable directly or indirectly to the Companies. The profit or loss derived from the performance of MRA is allocated to the net income attributable to the noncontrolling interest in the consolidated statements of income.

Use of estimates: The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash: The Companies have cash on deposit with various financial institutions which, at times, may be in excess of Federal Deposit Insurance Corporation limits. At December 31, 2023 and 2022, the Companies' balances exceeded federally insured limits by approximately \$5,100,000 and \$3,800,000, respectively.

Patient accounts receivable, third-party payor settlements and patient service revenue: Patient service revenue and accounts receivable are reported at the amount that reflects the consideration to which the Companies expect 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. Retroactive revenue adjustments due to settlement of audits, reviews and investigations, are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are settled and are no longer subject to such audits, reviews and investigations.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Inventories: The Companies value inventories, consisting of medical supplies and pharmaceuticals, at the lower of cost (using the average cost method) or net realizable value.

Property and equipment: Property and equipment are recorded at cost. Depreciation of property and equipment is computed principally by the straight-line method over the estimated useful lives as follows:

	<u>Years</u>
Buildings and improvements	5-40
Medical equipment	2-10
Office furniture and equipment	5-10

Derivative financial instrument: The Companies' derivative financial instrument, which consists of an interest rate swap agreement, is recognized on the consolidated balance sheets at its fair value. Changes in the fair value of the interest rate swap agreement are recorded as an adjustment to the fair value of interest rate swap on the consolidated statements of income. The Companies have not elected to use hedge accounting for the interest rate swap agreement.

Income taxes: Pinnacle and MRA are limited liability companies and therefore are generally not subject to federal and state income taxes as separate entities. Income tax consequences of Pinnacle and MRA's income and losses are determined at each member's ownership interest. Accordingly, no income taxes have been recognized in the accompanying consolidated financial statements related to Pinnacle and MRA. No provision has been made for amounts which may be advanced or paid as distributions, if any, to the members to assist them in paying their personal income taxes on the income of the Companies.

The Financial Accounting Standards Board (FASB) has issued guidance on accounting for uncertainty in income taxes. Management evaluated the Companies' tax positions and concluded that the Companies have taken no uncertain tax positions that require adjustment to the consolidated financial statements to comply with the provisions of this guidance. The Companies are no longer subject to tax examinations by the U.S. federal, state or local tax authorities for years before 2020.

Concentration of credit risk: The Companies' concentration of credit risk relating to patient accounts receivable and related revenue is limited by the diversity and the number of the Companies' patients and payors. The Companies receive payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies, employers, and patients. The Companies do not believe there are significant credit risks associated with these government agencies, or any other payor that would subject the Companies to any significant credit risks in the collection of patient accounts receivable. Changes in general economic conditions, revenue cycle operations, payor mix, payor claim processing, or federal or state governmental health care coverage could affect collection of patient accounts receivable, cash flows and results of operations.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

The collection of outstanding receivables from Medicare, Medicaid, managed care payors, other third-party payors, and patients represents a significant source of cash and is critical to operating performance. The primary collection risks relate to uninsured patient accounts, including patient accounts for which the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient responsibility amounts (deductibles and copayments) remain outstanding. Implicit price concessions relate primarily to amounts due directly from patients. Estimated implicit price concessions are based upon management's assessment of historical write-offs and expected net collections, business and economic conditions, trends in federal, state, and private employer health coverage and other collection indicators. These factors continuously change and can have an impact on collection trends and estimation processes.

Recent accounting pronouncements adopted: In June 2016, FASB issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which creates a new credit impairment standard for financial assets measured at amortized cost (including patient accounts receivable) to be presented at the net amount expected to be collected, through an allowance for credit losses that are expected to occur over the remaining life of the asset, rather than incurred losses. The ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct write-down. The measurement of credit losses for newly recognized financial assets (other than certain purchased assets) and subsequent changes in the allowance for credit losses are recorded in the statement of operations and changes in net assets as the amounts expected to be collected change. The Companies adopted ASU 2016-13 in the accompanying consolidated financial statements without significant effect.

Leases: The Companies accounts for its leases in accordance with the Accounting Standards Codification (ASC) Topic 842, which requires lessees to recognize most leases on their balance sheets as right-of-use (ROU) assets representing the right to use an underlying asset and a lease liability representing the obligation to make lease payments over the lease term, measured on a discounted basis.

The Companies determine if an arrangement is or contains a lease at inception, which is the date on which the terms of the contract are agreed to, and the agreement creates enforceable rights and obligations. A contract is or contains a lease when (i) explicitly or implicitly identified assets have been deployed in the contract, and (ii) the Companies obtain substantially all of the economic benefits from the use of that underlying asset and directs how and for what purpose the asset is used during the term of the contract. The Companies also consider whether their service arrangements include the right to control the use of an asset.

The Companies do not recognize ROU assets and lease liabilities for leases with a term of 12 months or less and instead recognize the lease payments in net income on a straight-line basis over the lease term. For all other leases, ROU assets and lease liabilities are measured based on the present value of future lease payments over the lease term at the commencement date of the lease (or January 1, 2022, for existing leases upon the adoption of Topic 842). The ROU assets also include any initial direct costs incurred and lease payments made at or before the commencement date and are reduced by any lease incentives. To determine the present value of lease payments, the Companies made an accounting policy election available to non-public companies to utilize a risk-free borrowing rate, which is aligned with the lease term at the lease commencement date (or remaining term for leases existing upon the adoption of Topic 842). The Companies elected to use this risk-free borrowing rate for all leases unless a rate implicit in the lease is readily determinable, in which case that rate must be used instead of the risk-free borrowing rate.

**Pinnacle Healthcare, LLC and Affiliate
(A Limited Liability Company)**

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Future lease payments may include fixed rent escalation clauses or payments that depend on an index (such as the consumer price index), which would be initially measured using the index or rate at lease commencement. Subsequent changes of an index and other periodic market-rate adjustments to base rent would be recorded in variable lease expense in the period incurred. Residual value guarantees or payments for terminating the lease, if present in the lease, are included in the lease payments only when it is probable that they will be incurred.

The Companies account for lease and non-lease components in its contracts as a single lease component for real estate leases. The non-lease components typically represent additional services transferred to the Companies, such as maintenance for medical equipment and common area maintenance for real estate. Additionally, the Companies make payments to or on behalf of the lessor for reimbursement of certain costs, such as property taxes insurance. These payments are non-component costs representing additional consideration in the contract, which is allocated to the single lease component. Non-lease component and non-component costs that are fixed in nature are included with the lease payments in the calculation of the lease liabilities and ROU assets; however, non-lease component and non-component costs that are variable in nature are recorded in variable lease expense in the period incurred.

Subsequent events: The Companies have evaluated subsequent events for potential recognition and/or disclosure through July 30, 2024, the date the consolidated financial statements were available to be issued.

Note 2. Patient Service Revenue and Accounts Receivable

Generally, the Companies bill 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 by the Companies. Substantially, all of the Companies' patient care service revenue relates to performance obligations satisfied over time and is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Companies believe that this method provides a faithful depiction of the transfer of service over the term of the performance obligation based on the inputs needed to satisfy the obligation. For patients receiving inpatient acute care services, the Companies measure 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. For most outpatient and physician services, the patient simultaneously receives and consumes the benefits of the services as the services are provided.

Because all of their performance obligations relate to contracts with a duration of less than one year, the Companies have elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, are not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied performance obligations referred to above that 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 Companies determine the transaction price based on standard charges for goods and services provided to patients, reduced by explicit price concessions, consisting of contractual adjustments provided to third-party payors and discounts provided to uninsured patients in accordance with the Companies' policy, and/or implicit price concessions based on historical collection experience.

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 2. Patient Service Revenue and Accounts Receivable (Continued)

Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as provision for credit losses. The provision for credit losses for the years ended December 31, 2023 and 2022, was not significant.

Certain revenue is subject to estimated retroactive adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period that the related services are rendered, and such amounts are adjusted in future periods as adjustments become known, or as reimbursement periods are settled and are no longer subject to such audits, reviews and investigations. There were no significant changes in estimated amounts due from third-party payors that affected patient service revenue during the years ended December 31, 2023 and 2022.

For the delivery of health care services, the Companies do not require collateral or other security from its patients. However, assignment of benefit payments payable under patients' health insurance programs and plans (e.g., Medicare, Medicaid, health maintenance organizations, and commercial insurance policies) is routinely obtained, consistent with industry practice.

The Companies do not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Companies' expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the Companies do, in certain circumstances, enter into payment arrangements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Significant concentrations of patient accounts receivable due from patients and third-party payors at December 31 are as follows:

	2023	2022
Blue Cross	50%	39%
Other commercial insurance	30%	24%
Medicare	10%	13%
Other	9%	19%
Self-pay	1%	5%
	100%	100%

Significant concentrations of patient service revenue from patients and third-party payors for the years ended December 31 are as follows:

	2023	2022
Blue Cross	27%	28%
Other commercial insurance	24%	31%
Medicare	25%	34%
Other	5%	3%
Self-pay	19%	4%
	100%	100%

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 2. Patient Service Revenue and Accounts Receivable (Continued)

Hospital assessment fee program: During 2012, the Indiana General Assembly approved a hospital assessment fee program (Hospital Assessment Fee (HAF)). Under this program, the Office of Medicaid Policy and Planning collects a fee from eligible hospitals. The fee is used in part to increase reimbursement to eligible hospitals for services provided in both fee-for-service and managed care programs, as the state's share of Medicaid Disproportionate Share (DSH) payments. The HAF has been extended through June 30, 2024.

For the years ended December 31, 2023 and 2022, the reimbursement related to the HAF program was recorded within patient service revenue on the consolidated statements of income. During the years ended December 31, 2023 and 2022, an assessment fee was recognized of approximately \$316,000 and \$751,000, respectively, which is reported within operating expenses on the consolidated statements of income.

Regulatory environment including fraud and abuse matters: 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 limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity continues with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations 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 the Companies are in compliance with regards to fraud and abuse, as well as applicable government laws and regulations governing Medicare, Medicaid and other governmental programs and that adequate provisions have been recorded for any adjustments that may result from final settlements. However, any adjustments to the currently estimated settlements will be recorded in future periods. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or asserted to at this time.

The Companies are privately owned by local physicians. Such investments have been permitted under an exception to the physician self-referral law, or Stark Law, that allows physicians to invest in an entire hospital as opposed to individual hospital departments. Legislation permits existing physician investment in a whole hospital to continue under a grandfather clause if the arrangement satisfies certain requirements and restrictions, but physicians became prohibited, from the time the legislation became effective, from increasing the aggregate percentage of their ownership in the hospital. Legislation also restricts the ability of existing physician-owned hospitals to expand the capacity of their facilities. Management believes the physician ownership at Pinnacle meets legislative requirements.

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 3. Property and Equipment

Property and equipment at December 31, were as follows:

	2023	2022
Land	\$ 2,816,036	\$ 2,816,036
Buildings and improvements	21,831,508	21,772,257
Medical equipment	14,290,848	14,110,369
Office furniture and equipment	2,312,442	2,242,574
	<u>41,250,834</u>	<u>40,941,236</u>
Less accumulated depreciation	(28,625,328)	(27,386,342)
	<u>\$ 12,625,506</u>	<u>\$ 13,554,894</u>

Depreciation expense was approximately \$1,270,415 and \$1,297,841 for the years ended December 31, 2023 and 2022, respectively.

Note 4. Pledged Assets, Line of Credit, Long-Term Debt and Interest Rate Swap

Borrowings under the note and mortgage payable are unconditionally cross-collateralized by the Companies. The agreements in place at December 31, 2023 and 2022, contained, among other provisions, certain financial covenants regarding debt service ratio, minimum tangible net worth and owner distributions.

Long-term debt as of December 31, was as follows:

	2023	2022
Note payable, bank, due in monthly installments of \$72,993, including interest at 3.75%, collateralized by substantially all assets of the Companies final payment due by May, 2025 ⁽¹⁾	\$ 8,883,479	\$ 9,408,817
Mortgage payable, bank, due in monthly installments of \$92,857, including interest at 4.51%, collateralized by real estate, final balloon payment due May 2025. ⁽²⁾	9,557,961	10,218,745
Other	5,747	5,747
	<u>18,447,187</u>	<u>19,633,309</u>
Less current maturities	(1,242,911)	(1,193,821)
Less unamortized loan costs	(56,679)	(56,679)
	<u>\$ 17,147,597</u>	<u>\$ 18,382,809</u>

⁽¹⁾ On March 17, 2021, the Companies entered into a note payable agreement with principal amount of \$10,000,000. The term note bore interest at one-month LIBOR plus a credit spread adjustment of 2.50% through September 2021. After six months, the term note bears interest at a fixed rate of 3.75% until it matures in May 2025.

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 4. Pledged Asset, Line of Credit, Long-Term Debt and Interest Rate Swap (Continued)

(2) The Companies entered into an interest rate swap agreement on May 1, 2019, with an original notional amount of \$12,061,744. The notional amount amortizes with the mortgage payable and was \$9,557,961 and \$10,218,745 at December 31, 2023 and 2022, respectively. The swap agreement is scheduled to expire in May 2025. The swap agreement is a contract to exchange the debt obligation's variable rate for a 4.51% fixed rate for payments over the life of the debt obligation without exchange of the underlying notional amount.

The actual market or credit exposure of this type of financial instrument is significantly less than the notional amount. The primary risk associated with the swap is the inability of the counterparty to meet the terms of the contract. The Companies do not expect the counterparty to fail to meet its respective obligations. The Companies recognize all derivatives as either assets or liabilities in the consolidated balance sheets and measure those instruments at fair value. Based on the Companies' derivative position at December 31, 2023 and 2022, the Companies recorded an asset of \$245,845 and \$404,104, respectively on the interest rate swap. During the years ended December 31, 2023 and 2022, the Companies recognized a change in the fair value of the interest rate swap of (\$158,259) and \$895,196, respectively.

Interest expense totaled \$928,029 and \$935,594 for the years ended December 31, 2023 and 2022, respectively.

The schedule of maturities of long-term debt as of December 31, are as follows:

	Note Payable	Mortgage Payable and Other	Total
Year ending December 31:			
2024	\$ 546,748	\$ 696,163	\$ 1,242,911
2025	8,336,731	8,867,545	17,204,276
	<u>\$ 8,883,479</u>	<u>\$ 9,563,708</u>	<u>\$ 18,447,187</u>

In May 2019, the Companies entered into a revolving line of credit agreement with principal amount not to exceed \$5,000,000. At December 31, 2023 and 2022, the balance on the line was \$1,067,771 and \$567,771, respectively. The line bears interest at a floating interest rate equal to the prime rate, as defined in the agreement. The prime rate was 8.5% and 7.5% at December 31, 2023 and 2022, respectively. The line matures in November 2025.

Financial Instruments: ASC 842, Disclosures about Fair Value of Financial Instruments, requires the Companies to disclose estimated fair values for its financial instruments. Management has reviewed its cash, accounts receivable, accounts payable, and accrued expenses and has determined that their carrying values approximate their fair value due to the short maturity of these instruments. The Companies' carrying value for its lease obligations, revolving loan facility, and long-term debt approximates fair value based on current rates applicable to similar instruments and giving consideration to the effect of the Companies' credit risk.

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 4. Pledged Asset, Line of Credit, Long-Term Debt and Interest Rate Swap (Continued)

Fair value measurement: The Companies use the Fair Value Measurement (Topic 820) for determining the fair value of its interest rate swap agreement, which requires the Companies to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Companies' interest rate swap agreement is reported at fair value utilizing Level 2 inputs. The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date.

Level 2: Pricing inputs other than quoted prices included in the Level 1 that are either directly observable or that can be derived or supported from observable data as of the reporting date.

Level 3: Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. In evaluating the significance of inputs, management generally classifies assets or liabilities as Level 3 when their fair value is determined using unobservable inputs that individually, or in the aggregate, represent more than 5% of the fair value of the assets or liabilities. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value based on assumptions about what market participants would use in pricing the asset or liability.

The Companies obtain the fair value from a financial institution, which utilizes internal models with observable market data inputs to estimate the values of these instruments.

Note 5. Leases

The Companies lease certain real estate under noncancellable operating lease agreements with non-related parties that have initial terms ranging from one to three years. The Companies are required to pay certain costs associated with the leases such as property taxes and insurance. Some leases include one or more options to renew, generally at the Companies' sole discretion, with renewal terms that can extend the lease term an additional one year. In addition, certain leases contain termination options, where the rights to terminate are held by either the Companies, the lessor, or both parties. These options to extend or terminate a lease are included in the lease terms when it is reasonably certain that the Companies will exercise that option. The Companies' operating leases generally do not contain any material restrictive covenants or residual value guarantees.

The Companies also lease certain medical equipment under finance lease agreements with nonrelated parties that have terms ranging from three to seven years and interest rates ranging from 0.78% to 9.24%. The Companies' finance leases generally do not contain any material restrictive covenants or residual value guarantees.

Operating lease expense is recognized on a straight-line basis over the lease term. Finance lease expense is recognized as a combination of the amortization expense for the ROU assets and interest expense for the outstanding lease liabilities, and results in a front-loaded expense pattern over the lease term.

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 5. Leases (Continued)

The components of lease expense for the years ended December 31, 2023 and 2022, are as follows:

	2023	2022
Operating lease cost	\$ 166,463	\$ 163,902
Finance lease cost—amortization of right-of-use assets	1,137,524	1,003,205
Finance lease cost—interest on lease liabilities	71,818	57,124
Short-term lease expense	89,141	195,374
Total lease cost	<u>\$ 1,464,946</u>	<u>\$ 1,419,605</u>

The weighted-average remaining lease term and weighted-average discount rate of the Company's lease liabilities as of December 31, 2023 and 2022, are as follows:

	2023	2022
Weighted-average remaining lease term:		
Operating leases	2.24 years	1.17 years
Finance leases	3.15 years	3.66 years
Weighted-average discount rate:		
Operating leases	4.18%	0.88%
Finance leases	3.34%	2.33%

Cash paid for amounts included in the measurement of lease liabilities for the years ended December 31, 2023 and 2022, is as follows:

	2023	2022
Cash paid for amounts included in measurement of lease liabilities:		
Operating cash outflows—payments on operating leases	\$ 235,115	\$ 118,437
Operating cash outflows—payments on finance leases	71,818	57,124
Financing cash outflows—payments on finance leases	1,082,839	1,003,205
Right-of-use assets obtained in exchange for new lease obligations:		
Operating leases	\$ 397,785	\$ 14,493
Finance leases	451,199	1,893,354

**Pinnacle Healthcare, LLC and Affiliate
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Notes to Consolidated Financial Statements

Note 5. Leases (Continued)

Future undiscounted cash flows for each remaining year, as well as a reconciliation to the total operating and finance liabilities recognized on the consolidated balance sheet are as follows as of December 31, 2023:

	Operating Leases	Finance Leases
Years ending December 31:		
2024	\$ 189,014	\$ 1,053,537
2025	157,601	796,575
2026	69,195	651,256
2027	-	80,420
2028	-	26,084
Thereafter	-	41,300
Total lease payments	415,810	2,649,172
Less imputed interest	(18,331)	(132,924)
Total present value of lease liabilities	397,479	2,516,248
Less current portion of lease liabilities	(176,852)	(987,062)
Long-term lease liabilities	\$ 220,627	\$ 1,529,186

The Companies have multiple agreements that provide for maintenance on its finance ROU assets. The agreements require monthly payments and expire on January 31, 2025. Maintenance expenses for the years ended December 31, 2023 and 2022, were approximately \$827,000 and \$899,000, respectively and recorded in operating expenses on the consolidated statements of income.

Note 6. Commitments and Contingencies

Professional liability litigation: Indiana Medical Malpractice Act, IC 34-18 (the Act), limits the amount of individual claims to \$1,250,000 (effective July 1, 1999 through June 30, 2017), of which \$1,000,000 would be paid by the State of Indiana Patient Compensation Fund (PCF) and \$250,000 by the Companies or by its commercial insurer. Effective July 1, 2017, this limit increased to \$1,650,000, of which \$1,250,000 would be paid by PCF and \$400,000 by the Companies or its commercial insurer. Effective July 1, 2019, this limit increased to \$1,800,000 of which \$1,300,000 would be paid by PCF and \$500,000 by the Companies or its commercial insurer.

The Companies maintain insurance coverage on a claims made basis, which complies with the limits required by the Act, with a deductible of \$0 at December 31, 2023 and December 31, 2022, per occurrence and have coverage through March 2025. The Companies have estimated an amount of approximately \$440,000 for professional liability included in accrued expenses in the accompanying consolidated balance sheets at December 31, 2023 and 2022.

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Notes to Consolidated Financial Statements

Note 6. Commitments and Contingencies (Continued)

Other litigation: The Companies have various claims and pending legal proceedings that generally involve terms and conditions of contract agreements, employment agreements and ownership disputes. While the outcome of these claims and proceedings cannot be predicted with any certainty, these matters are, in the opinion of management, ordinary routine matters incidental to the normal business conducted by the Companies. In the opinion of management, the ultimate dispositions of such proceedings are not expected to have a material adverse effect on the Companies' financial position, results of operations, or cash flows.

Medicare payable: Certain elements of the Medicare program that are paid for on an interim basis and retrospectively settled on the annual Medicare cost report include service outliers relating to inpatient and outpatient services. There were none during the years ended December 31, 2023 and 2022.

Note 7. Variable Interest Entity

Pinnacle is the primary beneficiary of and consolidates a related-party, MRA, that is a VIE. Pinnacle would absorb more than a significant amount of the VIE's expected losses based on leasing and cross-collateralization agreements. Through the lease and cross-collateralization agreements, Pinnacle controls the significant activities of the VIE. No additional support beyond what was previously agreed to has been provided.

Under the terms of the lease agreement with MRA, Pinnacle was initially required to make monthly payments of \$150,000 to MRA. Effective January 2021, the monthly payment to MRA was increased to \$183,333 through maturity in December 2035. In addition, Pinnacle is required to pay for property taxes, insurance and maintenance on the related property, all of which is eliminated in the accompanying consolidated financial statements. The related ROU asset and lease liability are eliminated in the accompanying consolidated financial statements.

The following table summarizes the VIE's assets and liabilities included in the consolidated balance sheets at December 31:

	2023	2022
Assets:		
Current assets	\$ 21,224	\$ 21,224
Property, at depreciated cost	9,854,994	10,170,002
Due from related-party	9,385,972	8,300,246
Interest rate swap	245,845	404,104
	<u>\$ 19,508,035</u>	<u>\$ 18,895,576</u>
Liabilities:		
Accrued expenses	\$ 52,484	\$ 52,473
Long-term debt	9,501,282	10,162,066
	<u>\$ 9,553,766</u>	<u>\$ 10,214,539</u>

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Notes to Consolidated Financial Statements

Note 7. Variable Interest Entity (Continued)

The following table summarizes the VIE's revenue and expenses for the years ended December 31:

	2023	2022
Gross rentals ⁽¹⁾	\$ 2,200,000	\$ 2,200,000
Adjustment to fair value of interest rate swap	(158,259)	895,196
Depreciation expense	(315,007)	(348,403)
Interest expense	(453,502)	(482,982)
Net income	<u>\$ 1,273,232</u>	<u>\$ 2,263,811</u>

⁽¹⁾ Net rental payments from the Companies which eliminate in consolidation.

The VIE is financed primarily through its long-term bank debt (Note 4). The assets of the VIE can be used to settle the obligations of the Companies and the VIE. The bank has recourse to the general credit of the Companies through the collateral provided by the Companies.

Note 8. Limited Liability Company Unit Repurchase Agreements

The Companies have agreements with their members which require the Companies to repurchase their units in the event of death. The agreements establish the purchase price which may be paid over a period up to four years.

Note 9. Retirement Plan

The Companies sponsor a 401(k) profit sharing plan. Employees who are at least 21 years of age and have worked for the Companies for a minimum of one year are eligible to participate in this plan. Under the terms of the plan, the Companies may make discretionary contributions to participants' accounts at any time. Currently, the Companies have a policy of matching 50% of the employee's contributions, up to 6% of the employee's gross wages. Contributions made by the Company for an employee begin to vest when the employee has completed one year of service, and the vesting percentage increases 25% incrementally until the employee becomes fully vested after four years of service. Employer match expense for the 401(k) profit sharing plan for the years ended December 31, 2023 and 2022, was approximately \$171,000 and \$78,000, respectively.