

CONSOLIDATED FINANCIAL STATEMENTS

Capital Health System, Inc. and Subsidiaries
Years Ended December 31, 2023 and 2022
With Report of Independent Auditors

Ernst & Young LLP



Capital Health System, Inc. and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2023 and 2022

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Report of Independent Auditors

The Board of Directors
Capital Health System, Inc.

Opinion

We have audited the consolidated financial statements of Capital Health System, Inc. (Capital Health), which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes (collectively referred to as the “financial statements”).

In our opinion, based on our audits and the report of the other auditors, the accompanying financial statements present fairly, in all material respects, the financial position of Capital Health at December 31, 2023 and 2022, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of Capital Region Insurance Company, SPC (CRIC), a wholly owned subsidiary, which statements reflect total assets of \$41,589,000 and \$49,782,000, as of December 31, 2023 and 2022, respectively. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for CRIC, is based solely on the report of the other auditors.

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 Capital Health 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 of 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 Capital Health’s ability to continue as a going concern for one year after the date that the financial statements are 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 of 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 Capital Health'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 financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Capital Health'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.

Ernst + Young LLP

April 29, 2024

Capital Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2023	2022
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 76,915	\$ 74,743
Short-term investments	25,536	51,667
Assets whose use is limited – current portion	2,559	2,700
Patient accounts receivable, net	189,633	139,801
Supplies	15,589	14,723
Prepaid expenses and other current assets	85,759	65,335
Total current assets	395,991	348,969
Investments	9,355	8,363
Assets whose use is limited – noncurrent portion	137,405	149,380
Property, plant, and equipment, net	501,285	508,159
Operating lease assets, net	76,634	75,400
Other noncurrent assets	21,308	27,723
Total assets	\$ 1,141,978	\$ 1,117,994
Liabilities and net assets		
Current liabilities:		
Long-term debt – current portion	\$ 65,200	\$ 32,347
Operating lease liabilities – current portion	10,611	11,012
Accounts payable	123,453	107,706
Accrued expenses	107,003	98,249
Accrued interest	2,181	2,264
Estimated third-party payor settlements, net – current portion	826	2,206
Total current liabilities	309,274	253,784
Long-term debt – noncurrent portion	538,765	562,601
Operating lease liabilities – noncurrent portion	66,919	64,288
Estimated third-party payor settlements and other long-term liabilities, net – noncurrent portion	49,382	60,197
Total liabilities	964,340	940,870
Commitments and contingencies		
Net assets:		
Without donor restrictions	159,024	158,735
With donor restrictions	17,844	17,478
Total Capital Health System net assets	176,868	176,213
Non-controlling interest	770	911
Total net assets including non-controlling interest	177,638	177,124
Total liabilities and net assets	\$ 1,141,978	\$ 1,117,994

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Operations

	Year Ended December 31	
	2023	2022
	<i>(In Thousands)</i>	
Net assets without donor restrictions:		
Revenue:		
Net patient service revenue	\$ 1,139,991	\$ 1,052,491
Other revenue	33,630	31,150
Contributions	545	443
Total revenue	<u>1,174,166</u>	<u>1,084,084</u>
Expenses:		
Salaries and wages	579,167	504,808
Employee benefits	76,221	66,312
Supplies and other expenses	450,383	413,245
Interest	30,780	31,536
Depreciation and amortization	45,788	41,480
Total expenses	<u>1,182,339</u>	<u>1,057,381</u>
(Loss) gain from operations prior to items below	(8,173)	26,703
Inherent contribution of net assets without donor restrictions received in the acquisition of St. Francis	–	26,106
Non-operating net periodic pension cost	(2,415)	(863)
Investment income and realized gains and losses, net	(1,208)	4,357
Net change in unrealized gains and losses on equity securities	1,510	(13,929)
(Deficiency) excess of revenue over expenses, before non-controlling interest	(10,286)	42,374
Less: gain attributable to non-controlling interest	2,912	2,775
(Deficiency) excess of revenue over expenses	<u>(13,198)</u>	<u>39,599</u>
Net change in unrealized gains and losses on fixed income securities	6,940	(9,048)
Grant contributions received and expended – capital portion	2,918	2,408
Pension-related changes other than net periodic pension cost	3,527	(4,065)
Net assets released from restrictions for equipment	102	103
Other changes in net assets without donor restrictions	–	820
Change in net assets without donor restrictions	<u>\$ 289</u>	<u>\$ 29,817</u>

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Without Donor Restrictions	With Donor Restrictions	Non-controlling Interest	Total
	<i>(In Thousands)</i>			
Net assets at December 31, 2021	\$ 128,918	\$ 14,051	\$ 1,215	\$ 144,184
Excess of revenue over expenses	39,599	–	2,775	42,374
Net change in unrealized gains and losses on fixed income securities	(9,048)	–	–	(9,048)
Grant contributions received and expended – capital portion	2,408	–	–	2,408
Pension-related changes other than net periodic pension cost	(4,065)	–	–	(4,065)
Inherent contribution of net assets with donor restrictions received in the acquisition of St. Francis	–	1,480	–	1,480
Member distributions, net	–	–	(3,079)	(3,079)
Donor restricted contributions	–	2,752	–	2,752
Net assets released from restrictions for equipment	103	(103)	–	–
Net assets released from restrictions for operations	–	(702)	–	(702)
Other changes in net assets without donor restrictions	820	–	–	820
Change in net assets	<u>29,817</u>	<u>3,427</u>	<u>(304)</u>	<u>32,940</u>
Net assets at December 31, 2022	158,735	17,478	911	177,124
(Deficiency) excess of revenue over expenses	(13,198)	–	2,912	(10,286)
Net change in unrealized gains and losses on fixed income securities	6,940	–	–	6,940
Grant contributions received and expended – capital portion	2,918	–	–	2,918
Pension-related changes other than net periodic pension cost	3,527	–	–	3,527
Member distributions, net	–	–	(3,053)	(3,053)
Donor restricted contributions	–	2,016	–	2,016
Net assets released from restrictions for equipment	102	(102)	–	–
Net assets released from restrictions for operations	–	(1,548)	–	(1,548)
Change in net assets	<u>289</u>	<u>366</u>	<u>(141)</u>	<u>514</u>
Net assets at December 31, 2023	<u>\$ 159,024</u>	<u>\$ 17,844</u>	<u>\$ 770</u>	<u>\$ 177,638</u>

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2023	2022
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ 514	\$ 32,940
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Inherent contribution received in the acquisition of St. Francis	-	(27,586)
Depreciation and amortization	45,788	41,480
Amortization of deferred financing fees	657	684
Net change in unrealized gains and losses on investments	(8,450)	22,977
Gain on disposal of fixed assets	-	(2,312)
Grant contributions for capital	(2,918)	(2,408)
Pension-related changes other than net periodic pension cost	(3,527)	4,065
Member distributions, net, related to non-controlling interest	3,053	3,079
Changes in operating assets and liabilities:		
Patient accounts receivable, net	(49,832)	(26,379)
Supplies	(866)	1,457
Prepaid expenses and other current assets	(20,424)	(13,883)
Other noncurrent assets	6,415	14,639
Accounts payable	15,747	31,703
Accrued pension	3,527	(4,065)
Accrued expenses	8,754	2,689
Accrued interest	(83)	(112)
Estimated third-party payor settlements and other long-term liabilities	(12,195)	(43,960)
Net cash (used in) provided by operating activities	<u>(13,840)</u>	<u>35,008</u>
Investing activities		
Net sales of assets whose use is limited	12,729	332
Net sales of investments	43,620	26,670
Distribution to members	(3,053)	(3,079)
Cash proceeds from sale of property and equipment	-	19,471
Cash received in the acquisition of St. Francis	-	14,500
Purchases of property, plant and equipment, net	(38,914)	(37,398)
Net cash provided by investing activities	<u>14,382</u>	<u>20,496</u>
Financing activities		
Payments on finance leases	(2,393)	(493)
Grant contributions for capital	2,918	2,408
Repayment of long-term debt	(30,649)	(28,643)
Proceeds of long-term debt	41,402	106
Net cash provided by (used in) financing activities	<u>11,278</u>	<u>(26,622)</u>
Net increase in cash and cash equivalents and restricted cash and restricted cash equivalents	11,820	28,882
Cash and cash equivalents and restricted cash and restricted cash equivalents at beginning of year	<u>81,926</u>	<u>53,044</u>
Cash and cash equivalents and restricted cash and restricted cash equivalents at end of year	<u>\$ 93,746</u>	<u>\$ 81,926</u>
Supplemental disclosures of cash flow information		
Assets acquired under finance lease obligations	\$ -	\$ 16,374
Cash paid for interest expense	<u>\$ 30,206</u>	<u>\$ 30,964</u>

See accompanying notes.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

December 31, 2023

1. Organization and Summary of Significant Accounting Policies

Capital Health System, Inc. (Capital Health), a New Jersey nonprofit corporation, consists of two operating divisions: Capital Health Regional Medical Center (Regional) and Capital Health Medical Center – Hopewell (Hopewell). Regional is a separately licensed acute care hospital with 245 licensed beds, located in Trenton, New Jersey and operates a satellite emergency department, Capital Health at East Trenton, located in Trenton, New Jersey (as of December 21, 2022). Hopewell consists of a separately licensed acute care hospital with 238 licensed beds, located in Hopewell Township, New Jersey and an ambulatory care facility located in Hamilton, New Jersey. Hopewell also operates a satellite emergency department, Capital Health at Deborah – Emergency Services, located in Browns Mills, New Jersey. Capital Health is the sole member of Capital Health Foundation (the Foundation), a nonprofit corporation, and Population Health Management Service LLC (PHM), which is a disregarded entity for tax purposes. Capital Health is the sole member of Capital Health – East Trenton, Inc. (CH – East Trenton, Inc.) Capital Health is also the sole shareholder of: Mercer Holding Corporation (Mercer Holding) and Capital Region Insurance Company SPC (CRIC), a wholly-owned captive insurance company domiciled in the Cayman Islands. Capital Health is also the sole shareholder of Bifurcated System Resource Risk Retention Group, Inc. (BSR-RRG) which commenced operations on October 1, 2022, as a risk retention group under the captive insurance laws of the State of South Carolina. Capital Health is the sole member of Capital Health Accountable Care Organization Limited Liability Company (ACO) and Capital Health Medical Group (CHMG), two limited liability companies, both disregarded entities for tax purposes, with no activity in 2023 or 2022.

Capital Healthcare, Inc. (CHI), a New Jersey nonprofit corporation, is the sole member of Capital Health. CHI is also the sole member of Leading Integrated Network of Clinicians, LLC (LINC), a limited liability company with no activity in 2023 or 2022.

Mercer Holding owns 100% of the capital stock of Bellevue Avenue Management, Inc. (Bellevue), a for-profit company which provides management services; Oasis Spa at Hopewell, LLC (Oasis Spa), a for-profit company which provides spa services at Hopewell; Capital Pharmacy LLC (Capital Pharmacy), a for-profit company with no activity in 2023 or 2022; and Comprehensive Imaging and Diagnostics LLC (CI), a for-profit company which provides radiology services. Mercer Holding has a 40.7% and 40.5% ownership interest at December 31, 2023 and 2022, respectively, in Hamilton Surgery Center, LLC (Hamilton Surgery Center) and has majority control of the Board of Directors. Mercer Holding accounts for the non-controlling interest in Hamilton Surgery Center in accordance with Accounting Standards Codification (ASC) 810, *Consolidation*.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

CRIC is a captive insurance company formed under the laws of the Cayman Islands, which provides professional and general liability coverage for Capital Health and its employees.

Capital Health System Condominium Association, Inc. (the Association) is a nonprofit corporation that provides maintenance, preservation and control of the common areas within Hopewell. Capital Health is grantor of the Association and has majority control of its Board of Trustees. As such, the Association is consolidated in the accompanying consolidated financial statements.

Acquisition of St. Francis Medical Center

On December 21, 2022 (the Acquisition Date), Capital Health acquired St. Francis Medical Center and its controlled organizations (St. Francis), a not-for-profit community health care provider located in Trenton, New Jersey.

St. Francis was renamed Capital Health – East Trenton, Inc. (CH– East Trenton, Inc.) which is the sole member of Capital Health Life (LIFE), Central New Jersey Heart Services LLC, Capital Health Foundation – East Trenton, Inc. (merged into the Foundation during 2023) and Capital Health Medical Group – East Trenton, P.A. As of the Acquisition Date, a majority of operations had ceased at the at the St. Francis location, where only a satellite emergency room and other select services remain in operation.

Capital Health acquired St. Francis by means of an inherent contribution, where no consideration was transferred by Capital Health. Capital Health accounted for this business combination by applying the acquisition method and, accordingly, the inherent contribution received was valued as the excess of assets acquired over liabilities assumed. In determining the inherent contribution received, all assets acquired, and liabilities assumed are required to be measured at fair value as of the Acquisition Date. The results of St. Francis' operations have been included in the consolidated financial statements since the Acquisition date.

Assets acquired at the Acquisition date consisted primarily of cash of \$14,500, equipment of \$7,098, supplies and other current assets of \$4,184 and donor restricted net assets of \$1,480. No liabilities were assumed as part of the transaction.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

COVID-19 Pandemic and CARES Act Funding

The Coronavirus Disease 2019 (COVID-19) has materially adversely affected the state and national economies and, accordingly, negatively impacted Capital Health's operations and financial results. The impact of COVID-19 continues to affect patient service patterns, revenue and the costs of providing health care services.

In response to COVID-19, the Coronavirus Aid, Relief and Economic Security Act (the CARES Act) was signed into law on March 27, 2020. Under the CARES Act, Capital Health had elected to defer the payment of the employer portion of social security taxes totaling approximately \$13,400 that otherwise would have been due between March 27, 2020 and December 31, 2020. The remaining balance of \$7,096 was paid in during 2023 in accordance with the terms of the program.

Capital Health has applied for reimbursement for qualifying expenses under the Federal Emergency Management Agency (FEMA) Disaster Relief Fund. During the year December 31, 2023, Capital Health received \$1,501 in FEMA reimbursement payments and recognized the full amount within other revenue on the consolidated statement of operations.

Significant Accounting Policies

A summary of significant accounting policies of Capital Health follows:

Principles of Consolidation

The consolidated financial statements include the accounts of Capital Health, the Foundation, Mercer Holding, the Association, PHM, CRIC, BSR-RRG and CH – East Trenton, Inc. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, such as estimated allowances for accounts receivable for services to patients, estimated settlements with third-party payors,

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

professional liability insurance, and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the amounts of revenue and expenses reported during the period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates and assumptions.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly-liquid instruments with a maturity of three months or less when purchased. Capital Health does not hold any money market funds with significant liquidity restrictions that would require the funds to be excluded from cash equivalents.

Cash and cash equivalents (unrestricted and restricted), as reported in the accompanying consolidated statements of cash flows, are reported within the following categories in the accompanying consolidated balance sheets as of December 31, 2023 and 2022:

	<u>2023</u>	<u>2022</u>
Cash and cash equivalents	\$ 76,915	\$ 74,743
Investments: cash and cash equivalents	14,181	2,466
Assets whose use is limited: cash and cash equivalents	<u>2,650</u>	<u>4,717</u>
Total cash and cash equivalents and restricted cash and restricted cash equivalents	<u>\$ 93,746</u>	<u>\$ 81,926</u>

Patient Accounts Receivable and Net Patient Service Revenue

Patient accounts receivable for which Capital Health receives payment under prospective payment formulae, negotiated rates, or cost reimbursement, which cover the majority of patient services, are stated at the estimated net amount receivable from such payors, which are generally less than the established billing rates of Capital Health (see Note 3).

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Investments

Short-term investments are readily marketable and not subject to donor restriction. Investments include amounts under donor restrictions.

Investments in equity securities (including mutual funds) with readily determinable fair values and all investments in fixed income securities are measured at fair value in the consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, other than temporary impairments of investments, and interest and dividends) and unrealized gains and losses on equity securities are included in the (deficiency) excess of revenue over expenses, unless the income or loss is restricted by donor or law. Unrealized gains and losses on fixed income securities, except for those unrealized losses which are deemed to be other than temporary impairments, are excluded from the (deficiency) excess of revenue over expenses on the accompanying consolidated statements of operations. The fair value of marketable investments is determined by reference to quoted market prices.

Assets Whose Use is Limited

Assets whose use is limited include investments held by CRIC (see Note 4), restricted investments for collateral, assets held under the debt agreement and assets held under a supplemental retirement plan. Assets whose use is limited are recorded at fair value determined by reference to quoted market prices.

Supplies

Supplies are carried at the lower of cost or net realizable value. Supplies are used in the provision of patient care and are not held for sale.

Deferred Financing Costs

Deferred financing costs include the costs of obtaining financing and are amortized over the period the obligation is outstanding using the effective interest method. Unamortized deferred financing costs of \$5,017 and \$5,674 at December 31, 2023 and 2022, respectively, have been reported as a direct reduction from long-term debt in the consolidated balance sheets. Deferred financing fees are reported net of accumulated amortization of \$11,672 and \$11,015 at December 31, 2023 and 2022, respectively.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost, except those acquired by gift or bequest which are recorded at their fair value established at the date of contribution.

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. The estimated lives range from three to fifty years.

Capital Health continually evaluates whether later events and circumstances have occurred that indicate that the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, Capital Health uses an estimate of the related undiscounted operating income over the remaining life of the long-lived asset, or determines the fair value of the long-lived asset in measuring whether the long-lived asset is recoverable.

Estimated Professional Liabilities

Insurance reserves represent estimated unpaid losses and loss adjustment expenses. Such amounts are established using management's estimates on the basis of claims records and an independent actuarial review and include an amount for the adverse development of reported claims. Adjustments to the estimate of the liability for losses are reflected in earnings in the period in which the adjustment is determined. The insurance reserves are based on estimates and, while management believes that the amount is adequate, the ultimate liability may vary significantly from the amount provided. Amounts are recorded within other long-term liabilities within the accompanying consolidated balance sheets.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Classification of Net Assets

Capital Health separately accounts for and reports net assets without donor restrictions and net assets with donor restrictions. Net assets without donor restrictions are not externally restricted for identified purposes by donors. Net assets without donor restrictions include resources that the governing board may use for any designated purpose and resources whose use is limited by agreement between Capital Health and an outside party other than the donor.

Net assets with donor restrictions are those whose use by Capital Health has been limited by donors to a specific time period or purpose or have been restricted by donors as permanent endowments to be maintained in perpetuity. When the donors' intentions are met or a time restriction expires for net assets limited by donors to a specific time period or purpose, the net assets are reclassified to net assets without donor restriction and reported on the consolidated statements of operations as other revenue if intended for operations, or below (deficiency) excess of revenue over expenses, if intended for capital purposes, and on the consolidated statements of changes in net assets as net assets released from restrictions. Income earned from net assets with donor restrictions is included in investment income and realized gains and losses, net, unless the income is restricted by the donor.

Capital Health follows the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as it relates to its net assets with donor restrictions to be maintained in perpetuity, as enacted by the State of New Jersey in 2009. Capital Health expends the income distributed from the related assets according to donor stipulations.

Advertising Costs

Capital Health expenses advertising costs as incurred. Total amounts charged to advertising expense during the years ended December 31, 2023 and 2022 are \$5,005 and \$6,981, respectively, recorded within supplies and other expenses.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

(Deficiency) Excess of Revenue Over Expenses

The consolidated statements of operations include the (deficiency) excess of revenue over expenses as the performance indicator. Changes in net assets without donor restrictions which are excluded from the (deficiency) excess of revenue over expenses, include the net change in unrealized gains and losses on fixed income securities (excluding those considered to be other than temporary), grant contributions received and expended – capital portion, and pension-related changes other than net periodic pension cost.

Transactions deemed by management to be ongoing, major or central to the provision of health care services are reported within (loss) gain from operations.

Income Taxes

The majority of the consolidated entities of Capital Health are exempt from Federal income tax on related function income under Sections 501(a) and 501(c)(3) of the Internal Revenue Code as well as New Jersey State and local income taxes pursuant to the corresponding state exemption provisions. The effects of income taxes are not material to the consolidated financial statements.

Pension Plan

Capital Health operates the plan in accordance with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA). Capital Health recognizes in its consolidated balance sheets an asset for its defined benefit pension plan's (the Plan) overfunded status or a liability for the Plan's underfunded status, measures the Plan's assets and obligations that determine its funded status as of the end of its fiscal year, and recognizes changes in the funded status of the Plan in changes in net assets without donor restrictions in the year in which the changes occur (see Note 9).

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

1. Organization and Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements:

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The main objective of ASU 2016-13 and related ASU updates is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments affect loans, fixed income securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this update were effective for Capital Health for fiscal years beginning after December 15, 2022. Capital Health adopted ASU 2016-13 in 2023 with no material impact on its consolidated financial statements.

2. Charity Care

Capital Health provides care to patients who meet certain criteria defined by the New Jersey Department of Health (DOH) without charge or at amounts less than established rates. Because Capital Health does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Capital Health's records identify and monitor the level of charity care it provides and include the amount of charges forgone for services and supplies furnished. DOH allows retroactive application for charity care up to two years from the date of service.

The cost of charity care is derived from both estimated and actual data. The estimated cost of charity care includes the direct and indirect cost of providing such services and is estimated utilizing Capital Health's ratio of cost to gross charges, which is then multiplied by the gross uncompensated charges associated with providing care to charity patients. Charity care provided, at cost, during 2023 and 2022 totaled approximately \$60,198 and \$56,196, respectively.

Capital Health receives payments from the New Jersey Health Care Subsidy Funds for charity care and such amounts totaled approximately \$22,222 and \$20,868 for the years ended December 31, 2023 and 2022, respectively (Note 3).

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue

Patient Accounts Receivable and Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which Capital Health 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 include variable consideration (reductions to revenue) in determining a transaction price.

Capital Health 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 major payor classes and types of services provided for outpatient revenue. Based on historical collection trends and other analyses, Capital Health believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Capital Health's initial estimate of the transaction price for services provided to patients subject to revenue recognition is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to Capital Health's standard charges. Capital Health determines the transaction price associated with services provided to patients who have third-party payor coverage on the basis of contractual or formula-driven rates for the services rendered (see description of third-party payor payment programs below). The estimates for contractual allowances and discounts are based on contractual agreements, Capital Health's discount policies and historical experience.

For uninsured and underinsured patients who do not qualify for charity care, Capital Health determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on Capital Health's historical collection experience for applicable patient portfolios. Under Capital Health's hospital collections and financial assistance policy, a patient who has no insurance or is underinsured and is ineligible for any government assistance program has his or her bill reduced to (1) the lesser of amounts generally billed or (2) 115% of the Medicare diagnostic-related group for inpatient or 115% of the Medicare fee-for-service rates for outpatient. Patients who meet Capital Health's criteria for charity care are provided care without charge; such amounts are not reported as revenue.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Generally, Capital Health bills patients and third-party payors several days after the services are performed and/or the patient is discharged. Net patient service revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by Capital Health. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. Capital Health believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services or patients receiving services in Capital Health's outpatient and ambulatory care facilities. Capital Health measures the performance obligation from admission into the hospital or the commencement of an outpatient service to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or the completion of the outpatient visit.

Substantially all of its performance obligations relate to contracts with a duration of less than one year. The unsatisfied or partially unsatisfied performance obligations primarily relate to inpatient acute care services at the end of the reporting period for patients who remain admitted at that time (in-house patients). The performance obligations for in-house patients are generally completed when the patients are discharged, which for the majority of Capital Health's in-house patients occurs within days or weeks after the end of the reporting period.

Subsequent changes to the estimate of the transaction price (determined on a portfolio basis when applicable) are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2023 and 2022, changes in Capital Health's estimates of implicit price concessions, discounts, contractual adjustments or other reductions to expected payments for performance obligations satisfied in prior periods were not significant. Portfolio collection estimates are updated quarterly based on collection trends. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay based on current or future estimated credit losses (determined on a portfolio basis when applicable) are recorded as bad debt expense. Bad debt expense for the years ended December 31, 2023 and 2022 was not significant.

Capital Health has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the following factors: payors, lines of business and timing of when revenue is recognized. Tables providing details of these factors are presented below.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Net patient service revenue by major payor source for the years ended December 31, 2023 and 2022, based on primary insurance designation is as follows:

	<u>2023</u>	<u>2022</u>
Medicare and Medicaid	\$ 202,312	\$ 159,295
Managed Medicare, Managed Medicaid and Commercial	904,531	868,349
Self-pay and other	33,148	24,847
	<u>\$ 1,139,991</u>	<u>\$ 1,052,491</u>

Deductibles, copayments and coinsurance under third-party payment programs, which are the patient's responsibility, are included within their respective payor categories above.

Net patient service revenue for the years ended December 31, 2023 and 2022 by line of business is as follows:

	<u>2023</u>	<u>2022</u>
Hospital and Physician services	\$ 1,092,088	\$ 1,035,692
Ambulatory services	47,903	16,799
	<u>\$ 1,139,991</u>	<u>\$ 1,052,491</u>

Capital Health does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to Capital Health's 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.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue (continued)

At December 31, 2023 and 2022, patient accounts receivable is comprised of the following components:

	<u>2023</u>	<u>2022</u>
Patient receivables	\$ 178,827	\$ 133,466
Contract assets	7,806	6,335
	<u>\$ 189,633</u>	<u>\$ 139,801</u>

Contract assets are related to in-house patients who were provided services during the reporting period but were not discharged as of the reporting date and for which the Capital Health may not have the right to bill.

Third-Party Payment Programs

Capital Health has agreements with third-party payors that provide for payment for services rendered at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: Hospitals are paid for most Medicare inpatient and outpatient services under the national prospective payment system and other methodologies of the Medicare program for certain other services. Federal regulations provide for certain adjustments to current and prior years' payment rates, based on industry-wide and hospital-specific data. Medicare cost reports of Capital Health have been audited and settled for years through 2019 as of December 31, 2023.

Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under cost-based and fee schedule methodologies. Capital Health is reimbursed for outpatient services at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary. The Medicaid cost reports of Capital Health for years through 2020 have been audited and settled as of December 31, 2023.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Other Third Party Payors: Capital Health also has entered into payment agreements with certain commercial insurance carriers and health maintenance organizations. The basis for payment to Capital Health under these agreements includes prospectively determined rates per discharge or days of hospitalization and discounts from established charges.

Settlements with third-party payors for cost report filings and retroactive adjustments due to ongoing and future 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 Capital Health's historical settlement activity (for example, cost report final settlements or repayments related to recovery audits), 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. Such estimates are determined through either a probability-weighted estimate or an estimate of the most likely amount, depending on the circumstances related to a given estimated settlement item. 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. For the years ended December 31, 2023 and 2022, adjustments arising from a change in the transaction price, were not significant.

Capital Health has appealed certain items in audited cost reports. The outcome of these appeals is uncertain and, therefore, potential revenue associated with these appeals is not included within the accompanying consolidated statements of operations as the most likely amount or expected value could not be determined.

There are various proposals at the federal and state levels that could, among other things, significantly reduce payment rates or modify payment methods. The ultimate outcome of these proposals and other market changes, including the potential effects of health care reform that has been enacted by the federal government, cannot presently be determined. Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse impact on Capital Health.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Capital Health believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that could have a material adverse effect on its consolidated financial statements. Noncompliance with such laws and regulations could result in fines, penalties and exclusion from such programs.

Capital Health grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. Significant concentrations of patient accounts receivable at December 31, 2023 and 2022 are as follows:

	2023	2022
Medicare	14%	21%
Medicaid	7	6
Commercial carriers, including Medicare and Medicaid managed care, worker's compensation and auto	78	72
Self-pay patients	1	1
	100%	100%

State Subsidy Funds

The New Jersey Health Care Subsidy Funds were established for various purposes, including the distribution of charity care payments to hospitals statewide.

The following is a summary of subsidy revenue included in net patient service revenue for the year ended December 31:

	2023	2022
Charity care (Note 2)	\$ 22,222	\$ 20,868
Quality Improvement Program	6,219	8,015
New Jersey county option hospital fee program	57,911	56,634
Mental health	1,266	957
	\$ 87,618	\$ 86,474

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

3. Net Patient Service Revenue (continued)

Capital Health received \$22,061 and \$22,594 in charity care subsidies during the year ended December 31, 2023 and 2022, respectively, of which \$1,565 and \$1,726 is recorded as a deferred liability at December 31, 2023 and 2022, respectively, representing payments received for the subsequent fiscal year.

Subsidy funds are also paid under the Quality Improvement Program (QIP) for certain performance improvement activities. Payments received totaled \$6,219 and \$8,015 for the year ended December 31, 2023 and 2022, respectively.

Capital Health receives additional Medicaid funding under the New Jersey County Option Hospital Fee Program. This program is administered through the New Jersey Department of Human Services-Division of Medical Assistance and Health Services and began in 2021 in certain counties in New Jersey. The program requires that participating hospitals pay quarterly assessed fees based on estimated Medicaid utilization data within the county, and such payments are then pooled with federal Medicaid matching funds and redistributed to the participating hospitals as State Directed Payments. The State Directed Payments are subject to annual settlement based actual Medicaid utilization data and other factors. The program resulted in fees paid by Capital Health in 2023 and 2022 of \$21,264 and \$19,352, respectively, (included within supplies and other expense) and Medicaid State Directed Payments received of \$57,911 and \$56,634 in 2023 and 2022, respectively, (included within net patient service revenue).

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

4. Assets Whose Use is Limited

Assets whose use is limited consist of the following:

	December 31	
	2023	2022
Restricted investments for collateral	\$ 8,556	\$ 8,054
Assets held under supplemental retirement plan	5,728	5,830
Assets held under debt agreement	113,902	116,148
Assets held by CRIC (see Note 12)	11,778	22,048
Total assets whose use is limited	139,964	152,080
Less: assets whose use is limited – current portion	2,559	2,700
	\$ 137,405	\$ 149,380

Assets held under debt agreements are maintained for the following purposes:

	December 31	
	2023	2022
Mortgage reserve fund	\$ 111,255	\$ 112,832
Accrued interest	88	616
Mortgage insurance premium	2,559	2,700
	\$ 113,902	\$ 116,148

Capital Health's gross unrealized losses and fair value of individual fixed income securities, classified as assets whose use is limited, which have been in a continuous unrealized loss position less than 12 months and greater than 12 months at December 31, 2023 and 2022 are not significant. At December 31, 2023 and 2022, the unrealized losses were not deemed to be other than temporary based on Capital Health's ability and intent to hold the funds until recovery.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

5. Investments

Investments consist of the following:

	December 31	
	2023	2022
Cash and cash equivalents	\$ 14,181	\$ 2,466
Mutual funds – fixed income securities	9,928	23,746
Mutual funds – equity securities	10,724	33,773
Accrued interest	58	45
Total investments	<u>34,891</u>	<u>60,030</u>
Less: short-term investments	<u>25,536</u>	<u>51,667</u>
	<u>\$ 9,355</u>	<u>\$ 8,363</u>

Amounts included within investment income and realized gains and losses, net, consist of the following:

	Year Ended December 31	
	2023	2022
Interest and dividend income	\$ 1,150	\$ 1,237
Net realized (losses) gains	(2,358)	3,120
Total investment income	<u>\$ (1,208)</u>	<u>\$ 4,357</u>

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

6. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level hierarchy for fair value measurements exists based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or 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.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

6. Fair Value Measurements (continued)

The following tables present the financial instruments carried at fair value by caption on the consolidated balance sheet based on the valuation hierarchy defined above:

	December 31, 2023			Total
	Level 1	Level 2	Level 3	
Assets				
Cash and cash equivalents	\$ 76,915	\$ -	\$ -	\$ 76,915
Assets whose use is limited:				
Assets held by CRIC (see Note 12):				
Equity funds	-	5,368	-	5,368
Fixed income funds	-	6,410	-	6,410
Investments restricted for collateral:				
Mutual funds – fixed income securities	8,556	-	-	8,556
Assets held under supplemental retirement plan:				
Mutual funds – fixed income securities	684	-	-	684
Mutual funds – equity securities	2,786	-	-	2,786
Investment contract with insurance company	-	2,258	-	2,258
Assets held under debt agreement:				
Cash and cash equivalents	2,650	-	-	2,650
U.S. government securities	-	111,252	-	111,252
Total assets whose use is limited	14,676	125,288	-	139,964
Investments:				
Cash and cash equivalents	14,181	-	-	14,181
Mutual funds – fixed income securities	9,928	-	-	9,928
Mutual funds – equity securities	10,782	-	-	10,782
Total investments	34,891	-	-	34,891
Total assets at fair value	\$ 126,482	\$ 125,288	\$ -	\$ 251,770
Pension assets (see Note 9)				
Mutual funds – fixed income securities	\$ 36,741	\$ -	\$ -	\$ 36,741
Money market funds	6,655	-	-	6,655
U.S. government securities	-	8,944	-	8,944
Total pension assets	\$ 43,396	\$ 8,944	\$ -	\$ 52,340

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

6. Fair Value Measurements (continued)

	December 31, 2022			Total
	Level 1	Level 2	Level 3	
Assets				
Cash and cash equivalents	\$ 74,743	\$ –	\$ –	\$ 74,743
Assets whose use is limited:				
Assets held by CRIC (see Note 12):				
Equity securities funds	–	10,008	–	10,008
Fixed income funds	–	12,040	–	12,040
Investments restricted for collateral:				
Mutual funds – fixed income securities	8,054	–	–	8,054
Assets held under supplemental retirement plan:				
Mutual funds – fixed income securities	762	–	–	762
Mutual funds – equity securities	2,359	–	–	2,359
Investment contract with insurance company	–	2,709	–	2,709
Assets held under debt agreement:				
Cash and cash equivalents	4,717	–	–	4,717
U.S. government securities	–	111,431	–	111,431
Total assets whose use is limited	15,892	136,188	–	152,080
Investments:				
Cash and cash equivalents	2,466	–	–	2,466
Mutual funds – fixed income securities	23,746	–	–	23,746
Mutual funds – equity securities	33,818	–	–	33,818
Total investments	60,030	–	–	60,030
Total assets at fair value	\$ 150,665	\$ 136,188	\$ –	\$ 286,853
Pension assets (See note 9)				
Mutual funds – fixed income securities	\$ 38,638	\$ –	\$ –	\$ 38,638
Money market funds	2,043	–	–	2,043
U.S. government securities	–	13,965	–	13,965
Total pension assets	\$ 40,681	\$ 13,965	\$ –	\$ 54,646

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

7. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	December 31	
	2023	2022
Land	\$ 41,845	\$ 41,845
Land improvements	37,626	37,483
Buildings, leasehold improvements and fixed equipment	790,357	786,391
Major movable equipment/software	374,766	356,761
	1,244,594	1,222,480
Accumulated depreciation and amortization	(779,764)	(736,399)
	464,830	486,081
Construction in progress	36,455	22,078
Property, plant, and equipment, net	\$ 501,285	\$ 508,159

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

8. Long-Term Debt

Long-term debt consists of the following:

	December 31	
	2023	2022
FHA Taxable Insured Mortgage Loan	\$ 551,935	\$ 581,855
Finance lease obligations with interest rates ranging from 1.4% to 3.8% payable monthly and quarterly	13,986	16,377
Other loans	13,061	2,390
Line of credit	30,000	–
	608,982	600,622
Less: unamortized deferred financing costs	5,017	5,674
Less: current portion	65,200	32,347
	\$ 538,765	\$ 562,601

On April 7, 2009, Capital Health closed on a \$755,875 mortgage insured by HUD through the Federal Housing Administration's (FHA's) Section 242 Hospital Mortgage Insurance Program. Interest rates on the mortgage note are 4.67% from January 1, 2021 through August 31, 2026 and 4.57% from September 1, 2026 through maturity date of January 1, 2037. The following table outlines the principal and interest payments due and payable on the first day of each month:

February 1, 2021 – September 1, 2026	\$ 4,705
October 1, 2026 – January 1, 2037	4,682

The mortgage note is collateralized by a security interest and a mortgage on substantially all of the property, plant and equipment at the Regional and Hopewell divisions. Interest costs resulting from the portion of debt related to construction were capitalized accordingly.

Also in connection with the construction funded by the mortgage loan, Capital Health was required to provide a security interest in and lien on certain of its investments as collateral. As of December 31, 2023 and 2022, \$8,556 and \$8,054, respectively, of investments were pledged as collateral for the outstanding letters of credit. These investments are included in assets whose use is limited as of December 31, 2023 and 2022.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

8. Long-Term Debt (continued)

Under the terms of the mortgage loan, Capital Health is required to maintain certain financial ratios, mortgage reserve fund balances, and comply with other restrictive covenants as described in the respective agreements in order to enter into additional indebtedness or to transfer funds to an affiliate without HUD approval. Capital Health did not meet all of these requirements during the year ended December 31, 2023 and 2022 and therefore obtained HUD approval for certain transactions as required.

In December 2023, Capital Health entered into a \$30,000 line of credit with a bank. The agreement provides for variable interest at 1.25 percentage points above the applicable variable loan rate as defined in the agreement. The interest rate at December 31, 2023 was 6.625%. At December 31, 2023, there was \$30,000 outstanding under this line of credit. The line of credit is to be paid monthly due back within one year of drawdown.

Scheduled payments of long-term debt and finance lease obligations at December 31, 2023, net of interest, are as follows:

	FHA/ GNMA	Finance Leases	Other Loans	Line of Credit	Total
2024	\$ 31,348	\$ 2,393	\$ 1,459	\$ 30,000	\$ 65,200
2025	32,843	2,463	1,612	–	36,918
2026	34,458	2,423	1,644	–	38,525
2027	36,226	2,194	1,756	–	40,176
2028	37,916	2,280	1,873	–	42,069
Thereafter	379,144	2,233	4,717	–	386,094
Total long-term debt	<u>\$ 551,935</u>	<u>\$ 13,986</u>	<u>\$ 13,061</u>	<u>\$ 30,000</u>	<u>\$ 608,982</u>

As of December 31, 2023 and 2022, Capital Health had outstanding letters of credit totaling \$5,205 and \$5,800, respectively, related to vendor arrangements. No amounts have been drawn on the letters of credit at December 31, 2023 and 2022. The letters of credit expires in December 2024 and automatically renew for a term of one year.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

9. Retirement Plans

Capital Health has a non-contributory defined benefit pension plan and a defined contribution plan that operates under Section 403(b) of the Internal Revenue Code. Both plans cover substantially all of its employees. The benefits are based on years of service and compensation. Capital Health's funding policy provides that payments to the defined benefit pension plan shall be equal to the minimum funding requirement of ERISA plus additional amounts, which may be approved by Capital Health. In 2023 and 2022, Capital Health incurred \$3,694 and \$3,168, respectively, in pension expense for employer contributions to the defined contribution plan, which is included in employee benefits expense in the accompanying consolidated statements of operations.

As noted in Note 1, Capital Health recognizes in its consolidated balance sheets an asset, for the defined benefit plan's overfunded status, or a liability, for the plan's underfunded status; measures the defined benefit plan's assets and obligations that determine funded status as of the end of its fiscal year; and recognizes the periodic change in the funded status of the defined benefit plan as a component of changes in net assets without donor restrictions in the year in which the change occurs. Amounts that are recognized as a component of other changes in net assets without donor restrictions will be subsequently recognized as a component of net periodic pension cost.

Capital Health froze its defined benefit pension plan as of December 31, 2007. In March 2023, the Board of Trustees of Capital Health adopted a resolution to terminate the Plan effective November 30, 2023.

Included in net assets without donor restrictions is unrecognized actuarial loss at December 31, 2023 and 2022 of \$9,149 and \$12,677, respectively, which has not yet been recognized in net periodic pension cost. At December 31, 2023 and 2022, Capital Health has a defined benefit asset of \$3,963 and \$2,851, respectively, which is reported within other noncurrent assets in the accompanying consolidated balance sheets.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

9. Retirement Plans (continued)

The following table sets forth the funded status of the plan at December 31, 2023 and 2022 and the amounts recognized in the consolidated financial statements:

	<u>2023</u>	<u>2022</u>
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 51,795	\$ 61,679
Interest cost	2,416	1,433
Actuarial gain	(1,030)	(6,281)
Benefits paid	(2,067)	(1,994)
Settlements	(2,737)	(3,042)
Benefit obligation, end of year	<u>48,377</u>	<u>51,795</u>
Change in plan assets		
Fair value of plan assets, beginning of year	54,646	69,457
Actual return on plan assets	2,498	(9,775)
Benefits paid and settlements	(4,804)	(5,036)
Fair value of plan assets, end of year	<u>52,340</u>	<u>54,646</u>
Funded status	<u>\$ 3,963</u>	<u>\$ 2,851</u>

The net periodic pension cost includes the following components:

	<u>2023</u>	<u>2022</u>
Interest cost	\$ 2,416	\$ 1,433
Expected return on plan assets	(1,423)	(1,662)
Recognized actuarial loss	904	348
Settlement loss	518	744
Net periodic pension cost	<u>\$ 2,415</u>	<u>\$ 863</u>

The benefit obligations represent the projected and accumulated benefit obligations.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

9. Retirement Plans (continued)

The following assumptions were used in determining the benefit obligations and net periodic pension costs:

	<u>2023</u>	<u>2022</u>
Weighted-average assumptions used to determine benefit obligations at December 31:		
Discount rate	4.87%	5.15%
Cash balance interest credit rate	1.65%	3.30%
Weighted-average assumptions used to determine net periodic pension cost for the years ended December 31:		
Discount rate	5.15%	2.47%
Expected long-term return on plan assets	2.85%	2.57%

The expected long-term rate of return on plan assets assumption of 2.85% was selected using the “building block” approach described by the Actuarial Standards Board in Actuarial Standards of Practice No. 27 – Selecting Economic Assumptions for Measuring Pension Obligations. Based on Capital Health’s investment policy for the pension plan in effect as of the beginning of the fiscal year, a best estimate range was determined for both the real rate of return (net of inflation) and for inflation based on historical 30-year period rolling averages. An average inflation rate within the range equal to 4.0% was selected and added to the real rate of return range to arrive at a best estimate. The actuarial loss in 2023 and 2022 primarily relate to changes in discount rate and mortality assumptions used to measure the projected benefit obligation.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

9. Retirement Plans (continued)

Capital Health’s pension plan weighted-average asset allocations at December 31, 2023 and 2022 by asset category are as follows:

	Plan Assets at December 31	
	2023	2022
U.S. government securities	17%	26%
Mutual funds – fixed income securities	70	71
Money market funds	13	3
	100%	100%

Capital Health expects to pay future benefits as follows:

2024	\$	5,741
2025		5,666
2026		5,085
2027		4,432
2028		4,270
2029-2033		15,588

Capital Health’s investment policies and strategies for plan assets include allocations of a diversified portfolio of equity investments, fixed income securities and cash equivalents. Though these assets are long-term in nature, a reasonable amount of liquidity should be maintained.

Capital Health does not expect to contribute to its defined benefit pension plan in 2024 due to the plan termination described above.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

10. Net Assets With Donor Restrictions

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

	December 31	
	2023	2022
Health care services	\$ 3,510	\$ 4,208
Education	1,196	1,243
Equipment	6,496	5,118
Charity care	3,769	3,737
Other	2,873	3,172
	\$ 17,844	\$ 17,478

Net assets were released from restrictions for the following purposes:

	Year Ended December 31	
	2023	2022
Health care services	\$ 709	\$ 363
Education	284	109
Equipment	102	103
Other	555	230
	\$ 1,650	\$ 805

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

10. Net Assets With Donor Restrictions (continued)

Changes in donor endowment funds for the years ended December 31, 2023 and 2022, consisted of the following:

	Without Donor Restrictions	With Donor Restrictions
Endowment funds at December 31, 2022	\$ 5,641	\$ 5,111
Investment return on endowments	1,650	–
Appropriations	(25)	–
Contributions	–	7
Endowment funds at December 31, 2023	<u>\$ 7,266</u>	<u>\$ 5,118</u>
	Without Donor Restrictions	With Donor Restrictions
Endowment funds at December 31, 2021	\$ 4,838	\$ 5,102
Investment return on endowments	805	–
Appropriations	(2)	–
Contributions	–	9
Endowment funds at December 31, 2022	<u>\$ 5,641</u>	<u>\$ 5,111</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Capital Health to retain as a fund of perpetual duration. Deficiencies of this nature are reported in net assets without donor restrictions. Individual donor-restricted endowment funds with deficiencies will retain future income and appreciation to restore the required fair value of the assets. There were no such deficiencies as of December 31, 2023 or 2022.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

11. Operating Leases and Other Commitments and Contingencies

Leases

Capital Health leases certain property and equipment under finance and operating leases. Leases are classified as either finance or operating leases based on the underlying terms of the agreement and certain criteria, such as the term of the lease relative to the useful life of the asset and the total lease payments to be made as compared to the fair value of the asset, amongst other criteria. Finance leases result in an accounting treatment similar to an acquisition of the asset.

For leases with initial terms greater than a year (or initially, greater than one year remaining under the lease at the date of adoption of ASU 2016-02), Capital Health records the related right-of-use assets and liabilities at the present value of the lease payments to be paid over the life of the related lease. Capital Health's leases may include variable lease payments and renewal options. Variable lease payments are excluded from the amounts used to determine the right-of-use assets and liabilities unless the variable lease payments depend on an index or rate or are in substance fixed payments. Lease payments related to periods subject to renewal options are also excluded from the amounts used to determine the right-of-use assets and liabilities unless Capital Health is reasonably certain to exercise the option to extend the lease. The present value of lease payments is calculated by utilizing the discount rate stated in the lease, when readily determinable. For leases for which this rate is not readily available, Capital Health has elected to use a risk-free discount rate determined using a period comparable with that of the lease term. Capital Health has made an accounting policy election not to separate lease components from non-lease components in contracts when determining its lease payments for its asset classes as permitted by ASU 2016-02. As such, Capital Health accounts for the applicable non-lease components together with the related lease components when determining the right-of-use assets and liabilities.

Capital Health has made an accounting policy election not to record leases with an initial term of less than a year as right-of-use assets and liabilities.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

11. Operating Leases and Other Commitments and Contingencies (continued)

The following schedule summarizes information related to the lease assets and liabilities as of and for the year ended December 31, 2023 and 2022:

	December 31	
	2023	2022
Lease cost:		
Finance lease cost:		
Amortization of right-of-use asset	\$ 2,547	\$ 525
Interest on lease liabilities	539	59
Operating lease cost	13,952	11,201
Short-term lease cost	669	297
Variable lease cost	3,469	2,638
Sublease and lessor income	(1,338)	(1,249)
Total lease cost	<u>\$ 19,838</u>	<u>\$ 13,471</u>
Right-of-use assets and liabilities:		
Right-of-use assets – finance leases	\$ 13,751	\$ 16,374
Lease liability – finance leases	13,986	16,377
Right-of-use assets – operating leases	76,634	75,400
Lease liability – operating leases	77,530	75,300
Other information:		
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from finance leases	\$ 539	\$ 59
Operating cash flows from operating leases	13,090	11,139
Financing cash flows from finance leases	2,314	494
Right-of-use assets obtained in exchange for new finance lease liabilities	–	16,857
Right-of-use assets obtained in exchange for new operating lease liabilities	13,881	7,028
Weighted-average remaining lease term – finance leases	5.68	6.63
Weighted-average remaining lease term – operating leases	9.09	9.12
Weighted-average discount rate – finance leases	3.61%	3.59%
Weighted-average discount rate – operating leases	1.91%	1.73%

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

11. Operating Leases and Other Commitments and Contingencies (continued)

For finance leases, right-of-use assets are recorded in property, plant and equipment, net and lease liabilities are recorded in long-term debt in the accompanying consolidated balance sheets. For operating leases, right-of-use assets are recorded in operating lease assets, net and lease liabilities are recorded in operating lease liability, current and non-current, in the accompanying consolidated balance sheets.

The future minimum rental payments required under the non-cancelable operating leases are as follows:

	Finance Leases	Operating Leases
	<hr/>	<hr/>
2024	\$ 2,851	\$ 11,980
2025	2,842	10,762
2026	2,718	9,929
2027	2,408	8,565
2028	2,408	7,680
Thereafter	2,246	35,616
Total lease payment	<hr/> 15,473	<hr/> 84,532
Less: imputed interest	1,487	7,002
Total lease obligation	<hr/> 13,986	<hr/> 77,530
Less: current portion	2,393	10,611
Long-term portion	<hr/> <hr/> \$ 11,593	<hr/> <hr/> \$ 66,919

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

11. Operating Leases and Other Commitments and Contingencies (continued)

Other Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in appeal against Capital Health. Such lawsuits and claims are either specifically covered by insurance or are not material. While the outcome of these lawsuits cannot be determined at this time, management believes that any loss which may arise from Capital Health's actions will not have a material adverse effect on the consolidated financial position or consolidated results of operations.

In November 2023, Capital Health was impacted by a cybersecurity incident. With the assistance of external cybersecurity experts, Capital Health investigated to determine the scope of the incident and to restore operations of its systems. On or about December 1, 2023, Capital Health's investigation determined that personal information of certain patients may have been subject to unauthorized access. In December 2023, Capital Health made notifications as required by federal and certain state data privacy and security laws to: (a) the Office of Civil Rights of the U.S. Department of Health & Human Services; (b) certain state attorney general and law enforcement agencies as required under state law; and (c) impacted individuals via a substitute notification on their website. Capital Health's investigation is ongoing, and the ultimate outcome of events related to the incident is unknown.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

12. Professional Liability Insurance

Capital Health purchased first dollar claims made insurance coverage prior to April 5, 2003 through a commercial carrier. Under this program, the professional and general liabilities were insured under two policies. A “package policy” covered those risks related to Capital Health’s general and professional liability as well as certain employed physicians. A “master physician policy” covered all other physicians for whom Capital Health provided coverage. The master physician policy also included an automatic tail provision. In addition to the two primary policies mentioned above, Capital Health purchased umbrella and excess insurance on a claims-made basis.

As of April 5, 2003, Capital Health purchases coverage for its professional and general liability exposures through CRIC. The reinsurance purchased by CRIC covers, on a claims-made basis, any incidents or claims reported during the policy period with a retroactive date of August 10, 1976.

For the insurance coverage years June 1, 2021 to May 31, 2022 CRIC insures Capital Health for its professional liability in the amount of \$67,000 per claim and \$67,000 in the annual aggregate. CRIC retains professional liability losses of \$5,000 per claim and no aggregate. CRIC also retains \$2,000 for each claim over \$5,000 with \$2,000 aggregate. CRIC, therefore, cedes \$60,000 per claim and \$60,000 in the annual aggregate to “A” rated reinsurers. During the same insurance coverage year, CRIC insures Capital Health for its general liability in the amount of \$61,000 per claim and \$61,000 in the annual aggregate, of which \$60,000 per claim and \$60,000 in the annual aggregate is ceded to “A” rated reinsurers. CRIC, therefore, retains general liability losses of \$1,000 per claim and no aggregate.

For the insurance coverage year June 1, 2022 to May 31, 2023 CRIC insures Capital Health for its professional liability in the amount of \$67,000 per claim and \$67,000 in the annual aggregate. CRIC retains professional liability losses of \$6,000 per claim and no aggregate. CRIC also retains \$2,000 for each claim over \$6,000 with \$2,000 aggregate. CRIC, therefore, cedes \$60,000 per claim and \$60,000 in the annual aggregate to “A” rated reinsurers. During the same insurance coverage year, CRIC insures Capital Health for its general liability in the amount of \$61,000 per claim and \$61,000 in the annual aggregate, of which \$60,000 per claim and \$60,000 in the annual aggregate is ceded to “A” rated reinsurers. CRIC, therefore, retains general liability losses of \$1,000 per claim and no aggregate.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars In Thousands)

12. Professional Liability Insurance (continued)

For the insurance coverage year June 1, 2023 to May 31, 2024 CRIC insures Capital Health for its professional liability in the amount of \$68,000 per claim and \$68,000 in the annual aggregate. CRIC retains professional liability losses of \$8,000 per claim and no aggregate. CRIC also retains \$2,000 for each claim over \$8,000 with \$2,000 aggregate. CRIC, therefore, cedes \$60,000 per claim and \$60,000 in the annual aggregate to “A” rated reinsurers. During the same insurance coverage year, CRIC insures Capital Health for its general liability in the amount of \$61,000 per claim and \$61,000 in the annual aggregate, of which \$60,000 per claim and \$60,000 in the annual aggregate is ceded to “A” rated reinsurers. CRIC, therefore, retains general liability losses of \$1,000 per claim and no aggregate.

At December 31, 2023 and 2022, CRIC has recorded an estimated reserve for claims of \$31,328 and \$39,592, respectively, included in other long-term liabilities within the accompanying consolidated balance sheets, which includes an estimate for claims incurred but not reported. These undiscounted reserves are not offset by estimates of reinsurance claims. Estimated receivables for reinsurance recoveries recorded by CRIC of \$11,570 and \$20,063 at December 31, 2023 and 2022, respectively, are included in other noncurrent assets within the accompanying consolidated balance sheets.

Liabilities arising from incidents which occurred prior to April 5, 2003 which were known to Capital Health are the responsibility of Capital Health. No estimates were required as of December 31, 2023 and 2022.

BSR-RRG operates as a risk retention group under the Federal Liability Risk Retention Act of 1986 and was formed to provide medical professional liability coverage to practitioners who practice more than 50% of their time in the State of Pennsylvania. For insured physicians practicing in Pennsylvania, BSR-RRG limits of liability are \$500 per claim with an annual aggregate of \$1,500. For insured physicians practicing in New Jersey, limits of liability are \$1,000 per claim with an annual aggregate of \$3,000. For vicarious liability of insured entities, limits of liability are \$1,000 per claim with a \$3,000 annual aggregate. Coverage is provided on a claims-made basis. Policy limits include indemnity only and are unlimited with respect to claim adjustment expenses until the associated indemnity limit is exhausted.

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

13. Functional Expenses

Capital Health provides health care services to residents within its geographic region. Expenses related to providing these services were as follows:

	Year Ended December 31, 2023		
	Program Expenses	General and Administrative Expenses	Total Expenses
Salaries and wages	\$ 398,070	\$ 181,097	\$ 579,167
Employee benefits	52,205	26,431	78,636
Supplies and other expenses	397,419	52,964	450,383
Interest	27,339	3,441	30,780
Depreciation and amortization	37,704	8,084	45,788
	\$ 912,737	\$ 272,017	\$ 1,184,754

	Year Ended December 31, 2022		
	Program Expenses	General and Administrative Expenses	Total Expenses
Salaries and wages	\$ 343,671	\$ 161,137	\$ 504,808
Employee benefits	44,019	23,156	67,175
Supplies and other expenses	340,368	72,877	413,245
Interest	28,002	3,534	31,536
Depreciation and amortization	32,280	9,200	41,480
	\$ 788,340	\$ 269,904	\$ 1,058,244

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars In Thousands)

14. Liquidity and Availability

Financial assets available for general expenditures within one year of December 31, 2023 and 2022, consist of the following:

	2023	2022
Cash and cash equivalents	\$ 76,915	\$ 74,743
Short-term investments	25,536	51,667
Patient accounts receivable, net	189,633	139,801
	\$ 292,084	\$ 266,211

Capital Health has assets whose use is limited for collateral, held under supplemental retirement plan, held under debt agreement and held by CRIC. These assets whose use is limited, which are more fully described in Note 4, are not available for general expenditures within the next year and are not reflected in the amounts above. As part of Capital Health's liquidity management plan, cash in excess of daily requirements are invested in cash equivalents and short-term investments.

15. Other Revenue

Other operating revenue consists of the following:

	Year Ended December 31	
	2023	2022
FEMA Disaster Relief Fund	\$ 1,501	\$ —
Purchasing rebates and settlements	2,731	1,712
Grant revenue	5,071	7,263
Investment income	6,211	2,066
Food services	926	879
Rental income	1,162	1,152
Settlements	—	8,000
Other	16,028	10,078
	\$ 33,630	\$ 31,150

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

16. Department of Education Title IV – Financial Responsibility Ratios

During September 2019, the United States Department of Education issued regulations, effective for audit reporting filed after June 30, 2020, regarding additional disclosures deemed necessary to calculate certain ratios for determining sufficient financial responsibility under Title IV regulations. The information as of and for the year ended December 31, 2023 is as follows (in thousands):

Secured and unsecured related party receivable	\$	–
Unsecured related party receivables		–
Property, plant and equipment, net		
Property, plant and equipment, net at December 31, 2022	\$	508,159
Property, plant and equipment, net acquired with debt during 2023		–
Property, plant and equipment, net acquired without debt during 2023		(21,251)
Net change in construction in progress		14,377
Total property, plant and equipment, net, at December 31, 2023	<u>\$</u>	<u>501,285</u>
Total revenues and gains, net without donor restrictions		
Total operating revenue	\$	1,174,166
Net change in unrealized gains and losses on equity securities		1,510
	<u>\$</u>	<u>1,175,676</u>
Right-of-use assets at December 31, 2023		
Operating lease right of use assets, net	\$	76,634
Finance lease right of use assets, net		13,751
	<u>\$</u>	<u>90,385</u>
Right-of-use assets at December 31, 2022		
Operating lease right of use assets, net	\$	75,400
Finance lease right of use assets, net		16,374
	<u>\$</u>	<u>91,774</u>
Long-term debt at December 31, 2023		
Current installments of long-term debt	\$	65,200
Long-term debt, net of current installments		538,765
	<u>\$</u>	<u>603,965</u>

Capital Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars In Thousands)

16. Department of Education Title IV – Financial Responsibility Ratios (continued)

Long-term debt at December 31, 2022

Current installments of long-term debt	\$ 32,347
Long-term debt, net of current installments	562,601
	<u>\$ 594,948</u>

Right-of-use liabilities at December 31, 2023

Operating lease right of use liabilities, current	\$ 10,611
Finance lease right of use liabilities, current	2,393
Operating lease right of use liabilities, long-term	66,919
Finance lease right of use liabilities, long-term	11,593
	<u>\$ 91,516</u>

Right-of-use liabilities at December 31, 2022

Operating lease right of use liabilities, current	\$ 11,012
Finance lease right of use liabilities, current	2,322
Operating lease right of use liabilities, long-term	64,288
Finance lease right of use liabilities, long-term	14,055
	<u>\$ 91,677</u>

Total net assets without donor restrictions December 31, 2023

Restricted in perpetuity	\$ 5,118
Net assets restricted by purpose and time	12,726
	<u>\$ 17,844</u>

17. Subsequent Events

Subsequent events have been evaluated through April 29, 2024 which is the date the accompanying consolidated financial statements were available to be issued. Except as disclosed below, no subsequent events have occurred that require disclosure in or adjustment to the accompanying consolidated financial statements.

On February 21, 2024, Change Healthcare, a subsidiary of UnitedHealth Group, reported a cyber security breach. Capital Health utilizes Change Healthcare in its revenue cycle process, primarily as a clearinghouse for patient billing and cash posting related to certain payors. Capital Health is in the process of evaluating the impact on its operations and its liquidity, and the ultimate impact of this incident is unknown.

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