Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2019 and 2018

Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
December 31, 2019 and 2018

Contents

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Independent Auditor's Report

Board of Directors
Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
Indianapolis, Indiana

We have audited the accompanying consolidated financial statements of Indiana Orthopaedic Hospital, LLC d/b/a OrthoIndy Hospital, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, members' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Indiana Orthopaedic Hospital, LLC d/b/a OrthoIndy Hospital as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, in 2019, the entity adopted new accounting guidance regarding recognition of revenue with customers. Our opinion is not modified with respect to this matter.

BKD, LLP

Indianapolis, Indiana
March 9, 2020

Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
Consolidated Balance Sheets
December 31, 2019 and 2018

Assets

	2019	2018
Current Assets		
Cash	$ 14,059,978	$ 11,840,827
Patient accounts receivable, net of 2018 allowance of $3,600,000	23,031,337	23,178,834
Supplies	810,476	910,754
Prepaid expenses and other	4,382,808	2,642,371
Total current assets	42,284,599	38,572,786
Property and Equipment, at cost		
Land and land improvements	4,947,195	4,947,195
Buildings and improvements	3,753,536	3,337,909
Equipment	33,743,713	32,708,481
	42,444,444	40,993,585
Less accumulated depreciation	25,646,098	24,793,629
	16,798,346	16,199,956
Other Assets		
Other	65,000	65,000
Total assets	$ 59,147,945	$ 54,837,742

Liabilities and Members' Equity

	2019	2018
Current Liabilities		
Accounts payable	$ 6,934,314	$ 6,818,370
Accrued expenses	4,024,997	3,850,459
Current maturities of long-term obligations	1,066,969	2,980,157
Total current liabilities	12,026,280	13,648,986
Long-Term Obligations	2,905,068	1,721,234
Total liabilities	14,931,348	15,370,220
Members' Equity	44,216,597	39,467,522
Total liabilities and members' equity	$ 59,147,945	$ 54,837,742

Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
Consolidated Statements of Income
Years Ended December 31, 2019 and 2018

	2019	2018
Operating Revenues		
Net patient service revenue (net of contractual discounts and allowance		$ 175,210,438
Provision for uncollectible accounts		(3,868,397)
Net patient service revenue, less provision for uncollectible accounts	$ 181,573,166	171,342,041
Other	571,182	582,510
Total operating revenues	182,144,348	171,924,551
Expenses and Losses		
Salaries and wages	29,205,295	28,517,469
Employee benefits	6,411,918	6,581,023
Purchased services and professional fees	7,740,969	7,782,428
Medical supplies and pharmaceuticals	36,618,446	37,000,111
Facility expense	12,428,960	12,050,262
Management fees	9,902,933	9,903,740
Depreciation and amortization	3,001,494	2,661,677
Interest	119,620	128,253
Provider hospital assessment fee	2,516,734	2,077,389
Other expenses	2,610,830	2,830,731
Total operating expenses	110,557,199	109,533,083
Net Income	$ 71,587,149	$ 62,391,468

Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
Consolidated Statements of Members' Equity
Years Ended December 31, 2019 and 2018

Balance, January 1, 2018	$ 37,268,074
Net income	62,391,468
Membership units issued	287,980
Membership units redeemed	(480,000)
Distributions to members	(60,000,000)
Balance, December 31, 2018	39,467,522
Net income	71,587,149
Membership units redeemed	(527,200)
Distributions to members	(66,310,874)
Balance, December 31, 2019	$ 44,216,597

Indiana Orthopaedic Hospital, LLC
d/b/a OrthoIndy Hospital
Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
Operating Activities		
Net income	$ 71,587,149	$ 62,391,468
Items not requiring cash		
Depreciation and amortization	3,001,494	2,661,677
Provision for uncollectible accounts	-	3,868,397
Changes in		
Patient accounts receivable, net	147,497	(3,205,592)
Accounts payable and accrued expenses	132,109	(19,115)
Other current and noncurrent assets	(1,640,159)	(1,015,476)
Net cash provided by operating activities	73,228,090	64,681,359
Investing Activities		
Proceeds from sale of property and equipment	-	1,045,000
Purchase of property and equipment	(3,441,511)	(1,752,633)
Net cash used in investing activities	(3,441,511)	(707,633)
Financing Activities		
Borrowings on long-term obligations	354,000	278,500
Principal payments under long-term obligations	(1,083,354)	(1,022,358)
Proceeds from issuance of membership units	-	287,980
Distributions to members	(66,310,874)	(60,000,000)
Unit redemption	(527,200)	(480,000)
Net cash used in financing activities	(67,567,428)	(60,935,878)
Increase in Cash	2,219,151	3,037,848
Cash, Beginning of Year	11,840,827	8,802,979
Cash, End of Year	$ 14,059,978	$ 11,840,827
Supplemental Cash Flows Information		
Interest paid	$ 119,620	$ 128,253
Fixed assets purchases included in accounts payable	580,482	-
Capital lease obligations incurred for capital assets	-	1,479,200

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Indiana Orthopaedic Hospital, LLC d/b/a OrthoIndy Hospital primarily earns revenues by providing inpatient and outpatient musculoskeletal and related surgical services to patients in the greater Indianapolis, Indiana area.

NNS, LLC was formed for the purpose to own, manage, invest, develop, lease and otherwise deal in real property.

Principles of Consolidation

The consolidated financial statements include the accounts of Indiana Orthopaedic Hospital, LLC d/b/a OrthoIndy Hospital and NNS, LLC (collectively, the Hospital). All material inter-organizational accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash

At December 31, 2019, the Hospital's cash accounts exceeded federally insured limits by approximately $17,000,000.

Investment Return

Investment return is comprised primarily of interest income earned on the operating cash accounts.

Patient Accounts Receivable

Patient accounts receivable reflects the outstanding amount of consideration to which the Hospital 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. As a service to the patient, the Hospital bills third-party payors directly and bills the patient when the patient's responsibility for co-pays, coinsurance and deductibles is determined. Patient accounts receivable are due in full when billed.

Contract Assets and Liabilities

Amounts related to health care services provided to patients which have not been billed and that do not meet the conditions of an unconditional right to payment at the end of the reporting period are contract assets. Contract assets consist primarily of health care services provided to patients who are still receiving inpatient care in the Hospital at the end of the year.

Contract assets at December 31, 2019 approximated $5,500,000 and are included in patient accounts receivable. At December 31, 2018, amounts related to health care services provided to patients which have not been billed and did not meet the conditions of an unconditional right to payment as of the year then ended are included on the consolidated balance sheet in accounts receivable, less allowance for doubtful accounts.

Amounts received related to health care services that have not yet been provided to patients are contract liabilities. Contract liabilities consist of payments made by patients and third-party payors for services not yet performed.

As of December 31, 2019, the Hospital had no contract liabilities. At December 31, 2018, the Hospital had no amounts related to payments received for future health care services which would be included on the consolidated balance sheet in deferred revenue.

Supplies

The Hospital states supply inventories at the lower of cost, determined using the first-in, first-out (FIFO) method or net realizable value.

Property and Equipment

Property and equipment is stated at cost and is depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Buildings and leasehold improvements	5-40 years
Equipment	2-20 years

At December 31, 2019, the Hospital has $444,047 of costs related to construction in progress included within equipment.

Long-Lived Asset Impairment

The Hospital evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended December 31, 2019 and 2018.

Patient Service Revenue

Patient service revenue is recognized as the Hospital satisfies performance obligations under its contracts with patients. Patient service revenue is reported at the estimated transaction price or amount that reflects the consideration to which the Hospital expects to be entitled in exchange for providing patient care. The Hospital determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Hospital's policies and implicit price concessions provided to uninsured patients.

The Hospital determines its estimates of explicit price concessions which represent adjustments and discounts based on contractual agreements, its discount policies and historical experience by payor groups. The Hospital determines its estimate of implicit price concessions based on its historical collection experience by classes of patients. The estimated amounts also include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations by third-party payors.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were $1,664,760 and $1,658,737 for 2019 and 2018, respectively. Total cost for these charges based on the Hospital's overall cost-to-charge ratio was approximately $460,000 and $458,000 for 2019 and 2018, respectively.

Estimated Malpractice Costs

The Hospital recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Malpractice claims are described more fully later in these notes.

Income Taxes

The Hospital is organized as a pass-through limited liability company under the Internal Revenue Code. As such, the Hospital is not taxed at the entity level, and income is passed through to the members of the Hospital. Accordingly, the Hospital does not recognize income taxes in the accompanying consolidated financial statements.

Note 2: Change in Accounting Principle

Topic 606, *Revenue from Contracts with Customers*

On January 1, 2019, the Hospital adopted the Financial Accounting Standards Board *Revenue from Contracts with Customers (Topic 606)* using a modified-retrospective method of adoption to all contracts with customers (patients) at January 1, 2019. The core guidance in Topic 606 is to recognize revenue to depict the transfer of promised goods or services to customers or patients in amounts that reflect the consideration to which the Hospital expects to be entitled in exchange for those goods or services. The amount to which the Hospital expects to be entitled is calculated as the transaction price and recorded as revenue in exchange for providing patient care services to its patients. Adoption of Topic 606 resulted in changes in presentation of the financial statements and related disclosures in the notes to the consolidated financial statements.

Prior to the adoption of Topic 606, the majority of the provision for doubtful accounts related to patients without insurance, as well as patient responsibility balances for co-pays, co-insurance and deductibles for patients with insurance. Under Topic 606, the estimated amounts due from patients for which the Hospital does not expect to be entitled or collect from the patients are considered implicit price concessions and excluded from the Hospital's estimation of the transaction price or revenue recorded.

The adoption had no impact on operating income, overall change in net assets or net cash provided by operating activities.

Note 3: Patient Service Revenue

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

Performance Obligations

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving inpatient acute care services or patients receiving services in its outpatient centers. The Hospital measures the performance obligation from inpatient admission, 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 completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to its patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Hospital does not believe it is required to provide additional goods related to the patient.

Transaction Price

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

Third-Party Payors

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

Medicare. Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Outpatient services are paid using prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Medicaid. Reimbursements for Medicaid services are generally paid at prospectively determined rates per discharge, per occasion of service or per covered member. These rates vary according to a patient classification system that is based on clinical diagnostic and other factors.

Other. Payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Hospital's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Hospital. In addition, the contracts the Hospital has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Hospital's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known based on newly available information or as years are settled or are no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price related to settlements of prior fiscal years' cost reports, Medicaid settlements, and the disposition of other payor audits were not significant in 2019 or 2018.

Refund Liabilities

From time to time, the Hospital will receive overpayments of patient balances from third-party payors or patients resulting in amounts owed back to either the patients or third-party payors. These amounts are excluded from revenues and are recorded as liabilities until they are refunded. As of December 31, 2019 and 2018, the Hospital has a liability for refunds to third-party payors and patients included on the consolidated balance sheets as other liabilities of approximately $70,000 and $88,000, respectively.

Patient and Uninsured Payors

The Hospital has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances, such as copays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Hospital expects to collect based on its collection history with those patients.

Patients who meet the Hospital's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Hospital also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The Hospital estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient care service revenue in the period of the change. For the years ended December 31, 2019 and 2018, additional revenue recognized for performance obligations satisfied in prior years was not significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Revenue Composition

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

- Payors (for example, Medicare, Medicaid, managed care or other insurance, patient) have different reimbursement and payment methodologies
- Length of patient's service or episode of care
- Geography of the service location
- Method of reimbursement
- Hospital's line of business that provided the service (for example, hospital inpatient, hospital outpatient, outpatient therapy, etc.)

For the years ended December 31, 2019 and 2018, the Hospital recognized all of its revenue for goods and services transferred to the customer over time. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. The Hospital believe that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving inpatient acute care services or patients receiving services in its outpatient centers. The Hospital measures the performance obligation from inpatient admission, 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 completion of the outpatient services.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates. Approximately 27% and 29% of the Hospital's receivables are due from a single commercial insurance carrier for each of the years ended December 31, 2019 and 2018, respectively.

The composition of patient service revenue recognized over time by primary payor for the years ended December 31, was:

	2019	2018
Medicaid	$ 1,632,677	$ 1,570,730
Medicare	37,752,767	36,041,851
Other third-party payors and self-pay	142,187,722	137,597,857
Total	$ 181,573,166	$ 175,210,438

Contract Balances

The following table provides information about the Hospital's receivable from contracts with customers:

	2019
Patient accounts receivable, beginning of year	$ 23,178,834
Patient accounts receivable, end of year	23,031,337

Note 4: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of which are area residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31, 2019 and 2018 is:

	2019	2018
Medicaid	3%	1%
Medicare	12%	12%
Other third-party payors	73%	75%
Self-pay	12%	12%
Total	100%	100%

At December 31, 2019 and 2018, an immaterial amount of uninsured patient accounts receivable is included in self-pay.

Note 5: Limited Liability Company

The Hospital is organized as an Indiana limited liability company and is owned by four classes of units and members, referred to as Classes A, B, C and D.

Effective January 1, 2013, the Hospital's individual Class A and Class B members, which are more fully described below, entered into an agreement with Orthopaedics-Indianapolis, Inc. (OI). The terms of the agreements provided that the Class A and Class B individual members exchanged their units of the Hospital for additional shares of OI, thereby, resulting in OI becoming the majority member in the Hospital. In connection with this agreement, the Hospital amended its Operating Agreement permitting the exchange of units and permitting OI to become a Class A member of the Hospital. The Hospital's Amended and Restated Operating Agreement also permits a new entity, APM Holdings, LLC, to become a Class A member; total Class A shares represent approximately 73.76% of members' equity. The previous Class D member will continue to own 20% as a Class C member (a new Class of units) and an irrevocable trust established by the Hospital will own approximately 1.58% as a Class D member.

Founding individual members of the Hospital continue to hold a founding member's interest approximating 4.66% profits interest in the Hospital as Class B members as set forth in the Amended and Restated Operating Agreement. Classes A and C vote their respective ownership interests, while Class B have certain reserve powers, as defined in the operating agreement. The Class D member does not have a vote.

The Class C member owns 20% of the Hospital's outstanding units, and is entitled to a single vote equal to 20% interest in all of the Hospital's issues other than issues related to the issuance or redemption of Class A units or any of the Hospital's solely owned subsidiaries. Effective May 1, 2016, the Class C member acquired from Class A members a 20% profits interest attributed to the South Campus. The purchase of the profits interest of the South Campus required the Hospital's amended and restated Operating Agreement to prospectively provide for the change in pro-rata profit distribution. In connection with the purchase of the profits interest and the associated Amended and Restated Operating Agreement, the Hospital has certain call rights that provides the Hospital the right to repurchase the profits interest in the South Side Campus. Under the terms of the Class C units, for any reason, the Class C member may elect to require the Hospital to purchase the Class C units. Additionally, voting Class A members may elect to call the outstanding Class C units. Such transactions will be based upon the then fair market value, as defined in the operating agreement.

NNS, LLC (Company) was organized as a limited liability company and was formed in October 2008. Indiana Orthopaedic Hospital, LLC d/b/a OrthoIndy Hospital is the sole member of NNS, LLC with complete authority, power and discretion to manage and control the business affairs and properties of the Company, to make all decisions regarding those matters and to perform any and all other acts or activities customary or incident to the management of NNS, LLC's business. The Hospital holds 100 units of the Company.

Note 6: Medical Malpractice Coverage and Claims

Medical Malpractice Claims

The Hospital is a qualified health care provider under the Indiana Medical Malpractice Act and is fully insured under a claims-made policy on a fixed premium basis. The Indiana Medical Malpractice Act limits a qualified provider's liability for an occurrence to the amount of required insurance. The Indiana patient compensation fund is liable for the excess up to an overall damage cap. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 7: Line of Credit

The Hospital is a party to a $5,000,000 line of credit agreement and a $2,000,000 equipment purchase line agreement, as of December 31, 2019 and 2018. The line of credit agreement expires July 30, 2020, and the equipment purchase line expires August 4, 2020. Interest on the line of credit and equipment purchase line varies with the bank's prime rate. At December 31, 2019, the interest rate was 3.25% and 3.75% on the line of credit and the equipment purchase line, respectively. At December 31, 2019 and 2018, there was nothing drawn on the equipment purchase line or the line of credit.

The Hospital has a $2,000,000 convertible line of credit expiring on September 30, 2020. At December 31, 2019, there was nothing drawn on the convertible line of credit. The convertible line of credit is collateralized by certain equipment detailed within the security agreement. Interest varies with the Daily LIBOR rate plus 1.50%, which was 3.28% at December 31, 2019.

Note 8: Long-Term Obligations

	2019	2018
Capital lease obligations (A)	$ 422,871	$ 747,609
Capital lease obligations (B)	43,979	109,242
Capital lease obligations (C)	727,637	957,416
Capital lease obligations (D)	214,695	280,755
Note payable to bank (E)	107,831	292,686
Note payable to bank (F)	1,920,391	2,053,750
Note payable to bank (G)	204,233	259,933
Note payable to bank (H)	330,400	-
Total long-term obligations	3,972,037	4,701,391
Less current maturities	1,066,969	2,980,157
	$ 2,905,068	$ 1,721,234

(A) Capital lease obligation payable in monthly installments of $28,880 with an interest rate of 3.64%. The lease is governed by a master lease agreement from a leasing company and is secured by the leased equipment. The lease was amended on March 30, 2016 and is scheduled to expire in 2021.

(B) Capital lease obligation payable in monthly installments of $5,524 with an interest rate of 1.28%. The lease is governed by a master lease agreement from a leasing company and is secured by the leased equipment. The lease is scheduled to expire in 2020.

(C) Capital lease obligation payable in monthly installments of $19,148. The lease is governed by an equipment lease and purchase option agreement and is secured by the leased equipment. In conjunction with leasing the equipment, the Hospital agreed to an annual minimum purchase commitment of $4,226,722 for supplies to be used in operating the equipment. The lease is scheduled to expire in 2023.

(D) Capital lease obligation payable in monthly installments of $5,505. The lease is governed by a master lease agreement from a leasing company is secured by the leased equipment. In conjunction with leasing the equipment, the Hospital agreed to a quarterly minimum purchase commitment of $39,518 for supplies to be used in operating the equipment. The lease is scheduled to expire in 2023.

(E) A promissory note payable in 60 monthly installments of $15,404 plus variable rate interest of prime, less one percent. At December 31, 2019, this rate was 3.75%. The loan is secured by the Hospital’s assets. The loan was originally a draw on the Hospital’s equipment purchase line in early 2015, and converted into a promissory note in August 2015. The promissory note matures in August 2020.

(F) During 2019, the Hospital refinanced its outstanding promissory note. The amended and restated promissory note in the name of NNS, LLC is payable in monthly installments of $11,064 and matures in May 2029. Interest is payable monthly at a rate of LIBOR plus 1.25%. At December 31, 2019, this rate was 3.03%. The loan is secured by certain real estate.

(G) A promissory note payable in 60 monthly installments of $4,642 plus variable rate interest of prime, less one percent. At December 31, 2019, this rate was 3.75%. The loan is secured by the Hospital's assets. The loan was originally a draw on the Hospital's equipment purchase line in early 2018 and converted into a promissory note in August 2018. The promissory note matures in August 2023.

(H) A promissory note payable in 60 monthly installments of $5,900 plus variable rate interest of prime, less one percent. At December 31, 2019, this rate was 3.75%. The loan is secured by the Hospital's assets. The loan was originally a draw on the Hospital's equipment purchase line in early 2019 and converted into a promissory note in August 2019. The promissory note matures in August 2024.

Property and equipment include the following property under capital lease arrangements:

	2019	2018
Equipment	$ 2,976,070	$ 3,382,168
Less accumulated depreciation	2,566,073	1,347,572
	$ 409,997	$ 2,034,596

Aggregate annual payments on capital lease obligations and long-term debt at December 31, 2019, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2020	$ 368,303	$ 708,687
2021	260,472	426,577
2022	260,472	382,393
2023	241,905	54,812
2024	181,172	-
Thereafter	1,250,531	-
	$ 2,562,855	1,572,469
Less amount representing interest		163,287
Present value of future minimum lease payments		1,409,182
Less current maturities		698,666
Noncurrent portion		$ 710,516

Note 9: Operating Leases

Noncancellable operating leases for the primary Hospital facility, several other facilities in the greater Indianapolis area and certain diagnostic equipment expire through 2026. The facility leases generally contain renewal options for periods ranging from five to ten years and require the Hospital to pay all executory costs (property taxes, maintenance and insurance). The leases are secured by certain assets, as defined in the lease agreements.

Future minimum lease payments at December 31, 2019, were:

2020	$ 6,546,006
2021	6,493,554
2022	6,614,535
2023	6,404,079
2024	5,924,160
Later years	9,358,837
Future minimum lease payments	$ 41,341,171

Total lease expense was $8,119,719 and $7,955,103 for the years ended December 31, 2019 and 2018, respectively.

Note 10: Related Party Transactions

The Hospital and Orthopaedics-Indianapolis, Inc. (OI) are related parties through OI's ownership of the Hospital. OI provides certain management, administrative and payroll related services for the Hospital. Amounts paid to OI for these services were $4,673,513 and $4,659,259 for the years ended December 31, 2019 and 2018, respectively. Reimbursed expenses from OI amounted to $2,889,123 and $6,144,459 for the years ended December 31, 2019 and 2018. Amounts due from and to OI, are reported in the accompanying consolidated balance sheets as other current assets or liabilities. Amounts due to OI was $675,000 and $600,391 at December 31, 2019 and 2018, respectively.

OrthoIndy Enterprises, LLC (OE) is a related party through common ownership. The Hospital entered into a management service agreement with OE to provide management services, including certain management, administrative and payroll related services for an initial period of five years, renewing automatically for one-year terms unless terminated by either party. Amounts paid to OE for these services were $10,409,404 and $9,897,721 for the years ended December 31, 2019 and 2018, respectively. Reimbursed expenses from OE amounted to $489,630 for the year ended December 31, 2019. Amounts due from and to OE are reported in the accompanying consolidated balance sheets as other current assets or liabilities.

The Hospital subleases certain facilities from OI on the west and south sides of Indianapolis. The west and south side leases expire in 2023 and 2025, respectively, and provide annual rental payments of approximately $2,550,000. Lease expense recognized in 2019 and 2018 approximated $2,600,000 and $2,550,000, respectively. Future minimum lease payments to OI are included at Note 9.

NNS, LLC, a consolidated entity of the Hospital, owns certain property the Hospital rents for its use. The intercompany rent has been eliminated in the consolidated financial statements.

Note 11: Pension Plan

In March 2007, the Hospital joined the retirement benefit plan of OI. The plan provides for a matching component for up to 6% of the employees' salary and also allows a discretionary profit-sharing contribution from the Hospital. Substantially all of the Hospital's full-time employees are covered by the plan. Pension expense in 2019 and 2018 was $1,690,207 and $1,518,547, respectively.

Note 12: Commitments and Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Self-Insurance of Employee Health Claims

The Hospital pools its share of health insurance claims with OI, a related party. Any such accrual is included in the related party accrual described in Note 10.

Put Option

As described in Note 5, the Class C member has a right to put its ownership to the Company at fair market value, in accordance with terms outlined in the operating agreement.

Note 13: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Variable Consideration

Estimates of variable consideration in determining the transaction price for patient care service revenue are described in Notes 1 and 3.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 6.

Admitting Physicians

The Hospital is served by a group of admitting and surgical physicians that comprise nearly 100% of the Hospital's net patient service revenue. The physician group is a related party of the Hospital through ownership as described in Note 10.

Note 14: Future Changes in Accounting Principles

Accounting for Leases

The Financial Accounting Standards Board amended its standard related to the accounting for leases. Under the new standard, lessees will now be required to recognize substantially all leases on the balance sheet as both a right-of-use asset and a liability. The standard has two types of leases for income statement recognition purposes: operating leases and finance leases. Operating leases will result in the recognition of a single lease expense on a straight-line basis over the lease term similar to the treatment for operating leases under existing standards. Finance leases will result in an accelerated expense similar to the accounting for capital leases under existing standards. The determination of lease classification as operating or finance will be done in a manner similar to existing standards. The new standard also contains amended guidance regarding the identification of embedded leases in service contracts and the identification of lease and nonlease components in an arrangement. The new standard is effective for annual periods beginning after December 15, 2020, and any interim periods within annual reporting periods that begin after December 15, 2020. The Hospital is evaluating the impact the standard will have on the consolidated financial statements; however, the standard is expected to have a material impact on the consolidated financial statements due to the recognition of additional assets and liabilities for operating leases.

Note 15: Subsequent Events

On January 15, 2020, a wholly owned subsidiary of the Hospital, 1260 IP Med, LLC, acquired certain real estate at the Hospital's South Campus for approximately $54,000,000. This real estate was being leased by the Hospital through this point of acquisition. Simultaneous with the real estate acquisition, the Hospital entered into a Membership Interest Purchase and Sale Agreement whereby the Hospital's interest in 1260 IP Med, LLC was sold to HP III Indianapolis, LLC; the Hospital owns a 25% interest in HP III, LLC. Funding for the series of transactions was provided, in part, by a $36,800,000 loan which is guaranteed by the Hospital, as well as equity contributions from its owners. The loan is due June 30, 2020 and is expected to be refinanced before its due date.

In connection with the real estate transactions described above, the Hospital entered into a Master Lease Agreement with 1260 IP Med, LLC requiring annual payments of $2,921,715 for 240 months beginning with the commencement of the lease in January 2020. The lease provides for annual inflation rent adjustments and provisions for future expansion funded by the landlord. Management has determined this lease is a capital lease arrangement.

The Hospital also entered into a sublease with OI with an initial monthly rental of $113,731, which can be adjusted based upon square footage utilized by OI. The term of the sublease coincides with the Master Lease Agreement described above.

Subsequent events have been evaluated through March 9, 2020, which is the date the consolidated financial statements were available to be issued.