CENTERSTONE OF KENTUCKY, INC.

Consolidated Financial Statements and Supplemental Schedules

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

LBMC MAKE A GOOD BUSINESS BETTER

CENTERSTONE OF KENTUCKY, INC.

Table of Contents

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Centerstone of America, Inc.:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Centerstone of Kentucky, Inc. and its subsidiaries (the "Corporation"), which comprise the consolidated statement of financial position as of June 30, 2017, the related consolidated statement of activities and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 of 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 auditors' 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 Corporation'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 Corporation'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 financial position of Centerstone of Kentucky, Inc. as of June 30, 2017, and the changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As explained in Note 2(b) to the consolidated financial statements, the Corporation is part of an affiliated group of entities. The Corporation is included in the reporting entity, Centerstone of America, Inc., and these consolidated financial statements include only the financial position, changes in net assets and cash flows of the Corporation. Our opinion is not modified with respect to this matter.

Report on Supplementary Consolidating Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental consolidating schedules listed in the table of contents are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, which insofar as it relates to the financial statements audited by other auditors is based on the reports of the other auditors, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Prior Period Financial Statements

The consolidated financial statements of the Corporation as of and for the year ended June 30, 2016 as well as the consolidating supplementary information included on pages 24 through 26, were audited by other auditors whose report dated November 11, 2016, expressed an unmodified opinion on those statements and supplementary information.

LBMC, PC

Brentwood, Tennessee
November 30, 2017

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Financial Position

June 30, 2017 and 2016

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	$ 2,804,896	$ 626,508
Investments	5,993,959	4,693,992
Accounts receivable, net	6,377,233	9,006,631
Other receivables	1,228,401	2,747,115
Prepaid expenses and other current assets	1,197,984	1,381,329
Total current assets	17,602,473	18,455,575
Property and equipment, net	12,633,162	13,632,741
Other assets, net	2,044,289	2,208,328
Total assets	$ 32,279,924	$ 34,296,644
Liabilities and Net Assets		
Current liabilities:		
Current portion of long term debt	$ 679,892	$ 386,902
Accounts payable and accrued expenses	4,662,823	5,365,490
Due to affiliated entities	1,172,650	-
Accrued payroll, benefits and taxes	3,447,402	3,076,296
Total current liabilities	9,962,767	8,828,688
Long-term debt, net of current portion	2,867,439	3,549,265
Total liabilities	12,830,206	12,377,953
Net assets:		
Unrestricted	16,964,935	19,192,685
Temporarily restricted	2,484,783	2,726,006
Total net assets	19,449,718	21,918,691
Total liabilities and net assets	$ 32,279,924	$ 34,296,644

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Activities and Changes in Net Assets

Years ended June 30, 2017 and 2016

	2017	2016
Revenue and other support:		
Net client service revenue	$ 59,862,697	$ 65,398,607
Provision for bad debts	(7,776,581)	(5,376,701)
Net client service revenue less provision for bad debts	52,086,116	60,021,906
Public support	36,649,134	37,216,140
Rental income	153,362	178,191
Other operating revenue	1,600,285	1,818,224
Total revenue and other support	90,488,897	99,234,461
Expenses:		
Salary and fringe benefits	69,420,352	68,386,149
Telephone	941,256	886,972
Travel	1,158,120	984,625
Drugs and supplies	2,464,334	2,155,134
Printing and postage	109,680	84,564
Contracted services	1,726,059	9,739,076
Purchased services	4,850,348	7,462,668
Utilities	853,503	1,097,167
Repairs and maintenance	475,211	527,541
Affiliated management fees	7,365,654	-
Rents and leases	2,306,602	2,082,512
Depreciation and amortization	1,530,753	2,242,382
Insurance	56,927	64,885
Interest	92,887	104,247
Miscellaneous	2,147,218	3,173,239
Total expenses	95,498,904	98,991,161
Operating gain (loss)	(5,010,007)	243,300
Nonoperating revenues (expenses):		
Gain (loss) on disposal of assets	2,040,782	(60,938)
Investment income and other	134,713	123,219
Total nonoperating revenues	2,175,495	62,281
Excess of revenue over (under) expenses	(2,834,512)	305,581
Other changes in unrestricted net assets - net assets released from restrictions	606,762	377,175
Change in unrestricted net assets	(2,227,750)	682,756
Change in temporarily restricted net assets:		
Restricted grant revenue	246,409	366,703
Contributed rent revenue	119,130	11,815
Net assets released from restriction	(606,762)	(377,175)
Change in temporarily restricted net assets	(241,223)	1,343
Change in net assets	(2,468,973)	684,099
Net assets at beginning of year	21,918,691	21,234,592
Net assets at end of year	$ 19,449,718	$ 21,918,691

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

	2017	2016
Operating activities:		
Change in net assets	$ (2,468,973)	$ 684,099
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
(Gain) loss on disposal of assets	(2,040,782)	60,938
Depreciation and amortization	1,530,753	2,285,940
Affiliated management fees related to property and equipment	328,106	-
Provision for bad debts	7,776,581	5,376,701
Investment income	(23,939)	24,811
Donation of capital asset	-	(280,000)
Debt assumed in related to donation of capital asset	-	100,220
Changes in operating assets and liabilities		
Accounts receivable, net	(5,147,183)	(5,246,045)
Due to/from affiliates	1,172,650	-
Other receivables	1,518,714	253,704
Prepaid expenses and other current assets	347,384	(126,449)
Accounts payable and accrued expenses	(702,667)	(4,849,184)
Accrued payroll, benefits and taxes	371,106	(1,061,163)
Net cash provided (used) by operating activities	2,661,750	(2,776,428)
Investing activities:		
Purchase of property and equipment	(1,585,171)	(1,158,254)
Proceeds from the sale of property and equipment	2,766,673	-
Proceeds from the sale or maturity of investments	2,300,457	1,545,526
Purchases of investments	(3,576,485)	(1,592,474)
Net cash used by investing activities	(94,526)	(1,205,202)
Financing activities:		
Proceeds from long-term debt	3,435,000	-
Principal payments on long term debt	(3,823,836)	(574,159)
Net cash used by financing activities	(388,836)	(574,159)
Increase (decrease) in cash and cash equivalents	2,178,388	(4,555,789)
Cash and cash equivalents at beginning of year	626,508	5,182,297
Cash and cash equivalents at end of year	$ 2,804,896	$ 626,508
Supplemental cash flows information		
Cash paid for interest	$ 87,361	$ 104,247

See accompanying notes to consolidated financial statements

(1) Nature of operations

(a) Organization

On November 1, 2016, Seven Counties Services, Inc. changed its name to Centerstone of Kentucky, Inc. Centerstone of Kentucky, Inc. and its affiliated entities (the Corporation) is a community mental health-developmental disabilities organization which provides planning, coordination and direct delivery of mental health, substance abuse and developmental disability services. These services are provided at various centers located throughout various counties in the Commonwealth of Kentucky, with the main administrative offices located in Louisville, Kentucky.

(b) Affiliation

Effective November 1, 2016, Centerstone of America, Inc. assumed control of Seven Counties Services, Inc. and SCS Learning, Inc. through sole corporate membership to help further its mission. Centerstone of America, Inc. and its affiliates are private, non-profit corporations that provide multi-funded, locally directed mental health and addiction services to people of all ages. Centerstone of America, Inc. and its affiliates maintain clinics in multiple Tennessee, Illinois, Kentucky, Florida and Indiana counties, with its main administrative offices located in Nashville, Tennessee. No consideration was paid as a result of the change in control.

(2) Summary of significant accounting policies

(a) Principles of consolidation

The consolidated financial statements include Centerstone of Kentucky, Inc. and Centerstone Learning, Inc. (formerly doing business as SCS Learning, Inc.). Centerstone of Kentucky, Inc. controls and appoints the Board of Directors of Centerstone Learning, Inc. as well as provides other support and services. All intercompany balances and transactions have been eliminated in consolidation.

Centerstone of Kentucky, Inc. is the sole member of Centerstone Learning, Inc. Centerstone Learning, Inc. provides cognitive training to children and others with academic difficulties and utilizes a program through LearningRx Franchise Corporation under a franchise agreement.

Centerstone of Kentucky, Inc. is the sole member of Personnel Best, LLC, a limited liability company. Personnel Best, LLC serves as a pass-through entity to receive benefit payments and process the corresponding payroll to providers for Kentucky Medicaid recipients who receive benefits under the Kentucky Consumer Directed Options program.

(b) Affiliated entities and related parties

The Corporation is part of an affiliated group of entities. The Corporation is included in the reporting entity, Centerstone of America, Inc. ("Parent"), and these consolidated financial statements include only the financial position, changes in net assets and cash flows of the Corporation and its subsidiaries.

The Parent is the holding company and sole corporate member of the Corporation. Centerstone of America, Inc. has the following additional entities under common control: Centerstone Military Services, Inc., Centerstone of Tennessee, Inc., Centerstone of Illinois, Inc., Centerstone Research Institute, Inc., Centerstone of Florida, Inc. and Centerstone of Indiana, Inc.

(c) Basis of presentation

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

Unrestricted net assets - Unrestricted net assets are resources available to support operations. The only limits on the use of unrestricted net assets are the broad limits resulting from the nature of the Corporation, the environment in which it operates, the purposes specified in its corporate documents and its application for tax-exempt status, and any limits resulting from contractual agreements with creditors and others that are entered into in the course of its operations.

Temporarily restricted net assets - Net assets subject to donor-imposed restrictions that may or will be met either by action of the Corporation and/or the passage of time. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities and changes in net assets as net assets released from restrictions.

Permanently restricted net assets - Net assets subject to donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Corporation. Included in this classification are endowment funds, which are subject to the restrictions of gift instruments requiring that the principal be maintained in perpetuity, and invested for the purpose of producing present and future income. The Corporation had no permanently restricted net assets at June 30, 2017 or 2016.

(d) Cash and cash equivalents

For purposes of reporting cash flows, the Corporation considers all liquid investments with an original maturity of three months or less to be cash equivalents. The Corporation maintains these deposits with banks. At times, these deposits may exceed federally insured limits. The Corporation believes it is not exposed to any significant credit risk on cash and cash equivalents.

(e) Certificates of deposit

Certificates of deposit (regardless of original maturity) are recorded at cost. Interest income is accounted for in accordance with donor restrictions (temporarily or permanently restricted) or, in the absence of specific donor restrictions, as unrestricted.

(f) Accounts receivable

The accounts receivable balance represents the unpaid amounts billed to clients and third-party payors. Contractual adjustments, discounts and an allowance for doubtful accounts are recorded to report receivables for client care services at net realizable value.

Client accounts receivable are reduced by an allowance for doubtful accounts based on the Corporation's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to its service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to clients who have third-party coverage, the Corporation analyzes contractually due amounts and provides an allowance for contractual adjustments and a provision for bad debts, if necessary. For receivables associated with self-pay payments, which includes both clients without insurance and clients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Corporation records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many clients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Corporation's allowances for doubtful accounts as of June 30, 2017 and 2016 were $5,258,454 and $3,753,526, respectively.

(g) Other receivables

The Corporation has recorded receivables from federal and state agencies related to grants under contract. The Corporation expects full collection of these receivables.

(h) Property and equipment and depreciation

Property and equipment are stated at cost. Depreciation is provided over the assets' estimated useful lives using the straight-line method as follows:

Buildings and improvements	10 – 30 years
Furnishings, equipment and vehicles	3 – 10 years

Expenditures for maintenance and repairs are expensed when incurred. Expenditures for renewals or betterments are capitalized. When property is retired or sold, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded as a change in net assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over (under) expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained; expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(i) Contributed rent receivable

The Corporation has a donated lease with Centerstone Addictions Recovery Center ("CARC"), formerly known as Jefferson Alcohol and Drug Abuse Center ("JADAC"), from Louisville Metro Government. Future contributed rent under this lease is valued at $2,102,500 and $2,247,500 at June 30, 2017 and 2016, respectively, and is being amortized over the life of the lease which matures December 31, 2031. Contributed rent receivable is included in other assets on the consolidating statements of financial position.

(j) Bond costs

Bond costs are amortized by the effective interest method over the terms of the bonds.

(k) Net client service revenue

The Corporation recognizes net client service revenues on the accrual basis of accounting in the reporting period in which services are performed based on the current gross charge structure, less actual adjustments and estimated discounts for contractual allowances, principally for clients covered by Medicare, Medicaid, and managed care and other health plans. Gross client service revenue is recorded in the accounting records using the established rates for the type of service provided to the client. The Corporation recognizes an estimated contractual allowance to reduce gross client charges to the estimated net realizable amount for services rendered based upon previously agreed to rates with a payor. The Corporation utilizes the client billing system to calculate contractual allowances on a payor-by-payor basis based on the rates in effect for each primary third-party payor. The management of the Corporation continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms that result from contract renegotiations and renewals.

Payors include federal and state agencies, including Medicare and Medicaid, managed care health plans, commercial insurance companies, and employers. These third-party payors provide payments to the Corporation at amounts different from its established rates based on negotiated reimbursement agreements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Given the current regulatory and reimbursement environment, there can be no assurances that adequate reimbursement levels will continue to be available for the services provided by the Corporation. Significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on the Corporation's liquidity, financial condition, results of operations and cash flows.

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.

(l) Charity care

The Corporation provides care to clients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The charity care amounts are not reported as net client service revenue as the Corporation does not pursue collection. Amounts for forgone charges related to charity care are approximately $6,280,000 and $6,441,000 for June 30, 2017 and 2016, respectively.

Of the Corporation's total unrestricted operating expense reported pertaining to the entities providing client care, an estimated $3,377,000 and $3,464,000 arose from providing services to charity clients during the years ended June 30, 2017 and 2016, respectively.

The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity clients. The ratio of cost to charges is calculated based on the Corporation's total expenses divided by gross client service revenue.

(m) Public support

The Corporation receives federal, state, and county grants for providing services in specific program areas. Receipt of these funds is subject to the fulfillment of certain obligations by the Corporation as prescribed by these programs and funds may be subject to repayment upon a determination of noncompliance made by a funding agency.

The Corporation has contracts with the State of Kentucky to provide community mental health services. During 2017 and 2016, the Corporation was paid by the State based upon applicable contractually agreed to stipulations.

The Corporation derives a significant portion of its revenue from third-party payors and federal, state and county funding programs. The receipt of future revenues by the Corporation is subject to among other factors, federal, state, and county policies affecting the health care industry, economic conditions that may include an inability to control expenses in periods of inflation, increased competition, market pressures on premium rates and other conditions which are impossible to predict.

(n) Contributions

Contributions received and unconditional promises to give are recorded as unrestricted, temporarily restricted or permanently restricted revenue depending on the existence of donor restrictions, if they exist.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities and changes in net assets as net assets released from restriction.

If a restriction is fulfilled in the same accounting period in which the contribution is received, the contribution is reported as unrestricted.

In-kind contributions are recorded based on their estimated fair value at the date of donation.

(o) Advertising costs

The Corporation uses advertising to promote its programs and services among the general public. The advertising costs are expensed as incurred. Advertising costs for the Corporation totaled $173,000 and $100,000 for 2017 and 2016, respectively.

(p) Income taxes

The Corporation and its subsidiaries are principally organized as not-for-profit corporations under section 501(c)(3) of the United States Internal Revenue Code ("IRC"). The exemption is on all income except unrelated business income as noted under Section 511 of the IRC. IRC Section 513(a) defines an unrelated trade or business of an exempt organization as any trade or business which is not substantially related to the exercise or performance of its exempt purpose. As such, these organizations are generally exempt from income taxes and are required to file Federal Form 990-Return of Organization Exempt from Income Tax, which is an informational return only. Personnel Best, LLC is a disregarded entity for tax purposes, and its activity is included with Centerstone of Kentucky, Inc. for tax reporting.

Accounting principles generally accepted in the United States of America ("GAAP") require management to evaluate tax positions taken and recognize a tax liability if it is more likely than not that an uncertain tax position would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken and has concluded that as of June 30, 2017 and 2016, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

The Corporation and its subsidiaries filed their federal and state income tax returns for periods through June 30, 2016.

(q) Performance indicator and operating indicator

The consolidated statements of activities and changes in net assets include a performance indicator, excess of revenues over expenses. Changes in unrestricted net assets which would be excluded from the performance indicator, consistent with industry practice, include net assets released for long-lived assets and contributions to supported entities. The consolidated statements of activities and changes in net assets also include an operating indicator, operating gain (loss). Certain non-operating items are excluded from the operating indicator, including investment income, gain (loss) on investments and derivatives, interest and dividend income, contributions from donors and related parties, other non-operating income, gains (losses) on disposal of equipment and gains (losses) on disposal of intangible assets.

(r) Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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.

(s) Reclassifications

Certain information from 2016 has been reclassified to conform to the 2017 presentation. There is no effect on the consolidated change in net assets as a result of these reclassifications.

(t) Events occurring after reporting date

The Corporation has evaluated events and transactions that occurred between June 30, 2017 and November 30, 2017, which is the date that the consolidated financial statements were available to be issued, for possible recognition or disclosure in the consolidated financial statements.

(3) Concentrations of credit risk

The mix of the accounts receivable and revenue is as follows:

	Receivables		Revenue	
	2017	2016	2017	2016
Medicare	7 %	2 %	3 %	2 %
Medicaid	86 %	94 %	92 %	94 %
Self-pay	1 %	1 %	1 %	1 %
Other third-party payors	6 %	3 %	4 %	3 %
	100 %	100 %	100 %	100 %

(4) Property and equipment

A summary of property and equipment as of June 30, 2017 and 2016 is as follows:

	2017	2016
Land	$ 1,434,900	$ 1,807,050
Buildings and improvements	16,277,892	18,452,610
Furnishings, equipment and vehicles	26,103,189	25,098,177
Construction in progress	115,113	-
	43,931,094	45,357,837
Accumulated depreciation and amortization	(31,297,932)	(31,725,096)
	$ 12,633,162	$ 13,632,741

Construction in progress consist of various renovation work at a facility. Total costs to be incurred are anticipated to approximate $40,000, and management estimates that the renovations will be completed in 2017.

(5) Long-term debt

A summary of long-term debt as of June 30, 2017 and 2016 is as follows:

	2017	2016
Note payable to Republic Bank in monthly installments of $63,113 including interest at 3.85% through October 3, 2021.	$ 3,014,617	$ -
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2020, refinanced with Republic Bank note payable (see below).	-	1,400,000
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2021, refinanced with Republic Bank note payable (see below).	-	2,035,000

Note payable, payable to landlord in monthly installments of $4,494 including interest at 7.00% through July 1, 2029.	437,011	461,292
Other note payable.	95,703	100,220
	3,547,331	3,996,512
Bond costs, net of amortization of $165,557 in 2016	-	(60,345)
Total long-term debt	3,547,331	3,936,167
Less current portion	679,892	386,902
Long-term debt, excluding current portion	$ 2,867,439	$ 3,549,265

In December 2005, Louisville/Jefferson County Metro Government issued the proceeds from $3,500,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to the Corporation. The bonds were backed by a letter of credit from Fifth Third Bank. The letter of credit was scheduled to expire on December 15, 2016. The bonds were to be repaid in annual installments with the final payment due December 1, 2020. The bonds were issued for the purpose of financing costs of acquiring, constructing, and equipping a new community mental health facility in Louisville, Kentucky, improvements to or acquisition of an adolescent residential treatment facility in Louisville, a new community mental health facility for Oldham, Henry and Trimble Counties and expansion to an existing Bullitt County facility. In October 2016, the bonds were fully redeemed and refinanced under a note payable to Republic Bank. The bond costs were also written off in conjunction with the refinancing of the bonds.

In December 2011, Louisville/Jefferson County Metro Government issued the proceeds from $2,600,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to the Corporation. The bonds were backed by a letter of credit from Fifth Third Bank. The letter of credit was scheduled to expire on December 15, 2016. The bonds were to be repaid in annual installments with the final payment due on December 21, 2021. The bonds were issued for the purpose of financing the Electronic Enterprise Solution software system. Collateral consisted of all accounts receivable, equipment, and general intangibles. In October 2016, the bonds were fully redeemed and refinanced under a note payable to Republic Bank. The bond costs were also written off in conjunction with the refinancing of the bonds.

In June 2014, the Corporation entered into a debt agreement with the landlord of a leased facility. The debt acquired was for $500,000 used to finance the construction of leasehold improvements with the debt being repaid to the landlord over the life of the lease. This note payable is unsecured.

In October 2016, the Corporation entered into a debt agreement with Republic Bank to refinance the industrial bonds. The debt acquired was for $3,435,000. The debt will be repaid in monthly installments including principal and interest of $63,113 over a period of five years. Final installment is due in October 2021. The loan is secured by certain real and personal property.

Aggregate annual maturities of long-term debt as of June 30, 2017 is as follows:

Year	Amount
2018	$ 679,892
2019	707,430
2020	736,111
2021	766,255
2022	286,866
2023 and later years	370,777
	$ 3,547,331

(6) Net assets

The temporarily restricted net assets are available for the following purposes as of June 30, 2017 and 2016:

	2017	2016
Contributed rent	$ 2,131,667	$ 2,361,203
Other	353,116	364,803
	$ 2,484,783	$ 2,726,006

(7) Net service revenue

The Corporation has agreements with third-party payors including Medicare, Medicaid and the State of Kentucky and other commercial insurance carriers that provide for payments to the Corporation at amounts different from its established rates. The following is a schedule of gross service charges by category, charity care, subsidized and contractual adjustments incurred during 2017 and 2016:

	2017	2016
Gross client service revenue	$ 100,086,041	$ 116,262,068
Less deductions		
Contractuals	(40,223,344)	(50,863,461)
Net client service revenue	59,862,697	65,398,607
Less provision for bad debt	(7,776,581)	(5,376,701)
Net client service revenue less provision for bad debt	$ 52,086,116	$ 60,021,906

In accordance with its grant requirements and state regulations, the Corporation provides services to patients and charges them based on their ability to pay according to a co-pay schedule. The Corporation also adjusts charges based on contractual agreements with third-party payors. The Corporation maintains records to identify and monitor the level of charges foregone for services furnished under charity care policy and contractual adjustments.

(8) Public support

The composition of public support during 2017 and 2016 is set forth in the following table.

	2017	2016
Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities	$ 16,206,854	$ 16,548,873
Louisville Metro Government	942,578	747,954
Other state funds	18,659,131	18,845,987
Federal funds	623,375	662,665
Other public support	217,196	410,661
	$ 36,649,134	$ 37,216,140

(9) Defined contribution plan

The Corporation has a 403(b) defined contribution plan (the "Plan"). Contributions are made to employees who meet the eligibility requirements. The Corporation matches up to 4% of the participating employees' compensation. Employer contributions to the Plan were approximately $1,440,000 and $1,109,000 for 2017 and 2016, respectively.

(10) Affiliated entities and related party transactions

The Corporation entered into certain working capital, administrative and general transactions with its Parent as are disclosed in Note 2(b). The Corporation has recorded a net related party payable in current liabilities as of June 30, 2017. For the year ended June 30, 2017, the Corporation incurred affiliated management fees for services provided by its Parent.

(11) Commitments and contingencies

Operating Leases

The Corporation has several non-cancelable operating leases for facilities and equipment through 2029. Total rent expense was approximately $2,305,000 and $2,108,000 for the years ended June 30, 2017 and 2016, respectively, which includes the fair market value of the donated lease of CARC from Louisville Metro Government of $597,706 and $588,835 for the years ended June 30, 2017 and 2016, respectively.

A summary of approximate future minimum payments under these leases as of June 30, 2017 is as follows:

2018	$ 1,740,000
2019	1,534,000
2020	998,000
2021	842,000
2022	821,000
2023 and later years	6,049,000
Total minimum lease payments	$ 11,984,000

Insurance

The Corporation participates in a multi-provider insurance program which provides professional and general liability insurance to cover medical malpractice claims. Insurance coverages are $1,000,000 individually and $3,000,000 in the aggregate annually. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to clients.

The Corporation is self-insured for certain costs related to employee health, dental and accident benefit programs. Expenses resulting from claims experience are recorded as incurred including an estimate of claims incurred but not reported. The accrued liability for such covered medical claims was approximately $368,000 and $306,000 at June 30, 2017 and 2016, respectively, and is included in accrued expenses in the consolidating statements of financial position.

The Corporation has purchased insurance, which limits its exposure on a per individual basis to $200,000 annually with a maximum of approximately $7,000,000 in total for all participants during the year.

Litigation

The Corporation is involved in certain litigation arising in the ordinary course of business and has made provisions for any known estimable settlements. The Corporation is also involved in other litigation for which the outcome is unknown. After consultation with legal counsel, it is management's opinion that these matters will be resolved without material adverse effect on the Corporation's financial position, results of operations, and cash flows.

Healthcare industry

The delivery of personal health care services entails an inherent risk of liability. Participants in the health care services industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant exposure and defense costs. The Corporation is insured with respect to medical malpractice risk on a claims-made basis. The Corporation also maintains insurance for general liability, director and officer liability and property. Certain policies are subject to deductibles. In addition to the insurance coverage provided, the Corporation indemnifies certain officers and directors for actions taken on behalf of the Corporation. Management is not aware of any claims against the Corporation which would have a material financial impact.

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

Healthcare reform

The health care industry in the United States is subject to fundamental changes due to ongoing health care reform efforts and related political, economic and regulatory influences. Notably, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the "Affordable Care Act") resulted in expanded health care coverage to millions of previously uninsured people beginning in 2014 and has resulted in significant changes to the U.S. health care system. To help fund this expansion, the Affordable Care Act outlines certain reductions in Medicare reimbursements for various health care providers as well as certain other changes to Medicare payment methodologies. This comprehensive health care legislation has resulted and will continue to result in extensive rulemaking by regulatory authorities, and also may be altered, amended, repealed, or replaced.

It is difficult to predict the full impact of the Affordable Care Act due to the complexity of the law and implementing regulations, as well the Corporation's inability to foresee how CMS and other participants in the health care industry will respond to the choices available to them under the law. The Corporation also cannot accurately predict whether any new or pending legislative proposals will be adopted or, if adopted, what effect, if any, these proposals would have on the Corporation's business. Similarly, while the Corporation can anticipate that some of the rulemaking that will be promulgated by regulatory authorities will affect the Corporation's business and the manner in which the Corporation is reimbursed by the federal health care programs, the Corporation cannot accurately predict today the impact of those regulations on the Corporation's business. The provisions of the legislation and other regulations implementing the provisions of the Affordable Care Act or any amended or replacement legislation may increase costs, decrease revenues, expose the Corporation to expanded liability or require the Corporation to revise the ways in which it conducts business.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Financial Position

June 30, 2017

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Assets:				
Current assets:				
Cash and cash equivalents	$ 2,782,445	$ 22,451	$ -	$ 2,804,896
Investments	5,993,959	-	-	5,993,959
Accounts receivable, net	6,377,233	-	-	6,377,233
Other receivables	1,531,642	28,292	(331,533)	1,228,401
Prepaid expenses and other current assets	1,197,984	-	-	1,197,984
Total current assets	17,883,263	50,743	(331,533)	17,602,473
Property and equipment, net	12,631,529	1,633	-	12,633,162
Other assets, net	2,037,500	6,789	-	2,044,289
Total assets	$ 32,552,292	$ 59,165	$ (331,533)	$ 32,279,924
Liabilities and net assets:				
Current liabilities:				
Current portion of long term debt	$ 679,892	$ -	$ -	$ 679,892
Accounts payable and accrued expenses	4,546,154	448,202	(331,533)	4,662,823
Due to affiliated entities	1,172,650	-	-	1,172,650
Accrued payroll, benefits and taxes	3,444,560	2,842	-	3,447,402
Total current liabilities	9,843,256	451,044	(331,533)	9,962,767
Long-term debt, net of current portion	2,867,439	-	-	2,867,439
Total liabilities	12,710,695	451,044	(331,533)	12,830,206
Net assets:				
Unrestricted	17,356,814	(391,879)	-	16,964,935
Temporarily restricted	2,484,783	-	-	2,484,783
Total net assets	19,841,597	(391,879)	-	19,449,718
Total liabilities and net assets	$ 32,552,292	$ 59,165	$ (331,533)	$ 32,279,924

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Activities and Changes in Net Assets

Year ended June 30, 2017

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Revenue and other support:				
Net client service revenue	$ 59,496,944	$ 365,753	$ -	$ 59,862,697
Provision for bad debts	(7,776,581)	-	-	(7,776,581)
Net client service revenue less provision for bad debts	51,720,363	365,753	-	52,086,116
Public support	36,649,134	-	-	36,649,134
Rental income	153,362	-	-	153,362
Other operating revenue	1,600,285	-	-	1,600,285
Total revenue and other support	90,123,144	365,753	-	90,488,897
Expenses:				
Salary and fringe benefits	69,220,175	200,177	-	69,420,352
Telephone	938,664	2,592	-	941,256
Travel	1,154,148	3,972	-	1,158,120
Drugs and supplies	2,437,358	26,976	-	2,464,334
Printing and postage	109,680	-	-	109,680
Contracted services	1,726,059	-	-	1,726,059
Purchased services	4,835,273	15,075	-	4,850,348
Utilities	849,438	4,065	-	853,503
Repairs and maintenance	475,211	-	-	475,211
Affiliated management fees	7,365,654	-	-	7,365,654
Rents and leases	2,277,017	29,585	-	2,306,602
Depreciation and amortization	1,526,497	4,256	-	1,530,753
Insurance	54,486	2,441	-	56,927
Interest	92,887	-	-	92,887
Miscellaneous	2,003,119	144,099	-	2,147,218
Total expenses	95,065,666	433,238	-	95,498,904
Operating gain (loss)	(4,942,522)	(67,485)	-	(5,010,007)
Nonoperating revenues (expenses):				
Gain on disposal of assets	2,040,782	-	-	2,040,782
Investment income and other	134,713	-	-	134,713
Total nonoperating revenues and expenses	2,175,495	-	-	2,175,495
Excess of revenues over (under) expenses	(2,767,027)	(67,485)	-	(2,834,512)
Other changes in unrestricted net assets - net assets released from restrictions	606,762	-	-	606,762
Change in unrestricted net assets	(2,160,265)	(67,485)	-	(2,227,750)
Change in temporarily restricted net assets:				
Restricted grant revenue	246,409	-	-	246,409
Contributed rent revenue	119,130	-	-	119,130
Net assets released from restriction	(606,762)	-	-	(606,762)
Change in temporarily restricted net assets	(241,223)	-	-	(241,223)
Change in net assets	(2,401,488)	(67,485)	-	(2,468,973)
Net assets at beginning of year	22,243,085	(324,394)	-	21,918,691
Net assets at end of year	$ 19,841,597	$ (391,879)	$ -	$ 19,449,718

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Functional Expenses

Year ended June 30, 2017

	Mental Health	Developmental Disabilities	Substance Abuse	Trust and Agency	Centerstone Learning, Inc.	Total Program	Management and General	Fund-Raising	Total
Salaries	$ 31,618,286	$ 5,284,024	$ 6,087,261	$ 11,100,047	$ 177,920	$ 54,267,538	$ 3,508,402	$ 101,233	$ 57,877,173
Payroll taxes	2,326,562	399,311	447,960	820,648	14,740	4,009,221	248,072	7,428	4,264,721
Benefits	3,997,190	718,036	903,022	1,371,352	7,517	6,997,117	265,675	15,666	7,278,458
Contracted services	1,621,156	-	104,903	-	-	1,726,059	-	-	1,726,059
Purchased services	971,887	2,449,000	193,854	27,780	15,075	3,657,596	1,191,054	1,698	4,850,348
Building rentals, maintenance and utilities	2,729,229	217,410	1,222,792	-	38,684	4,208,115	419,805	5,579	4,633,499
Drugs and supplies	595,885	327,611	1,487,665	-	26,977	2,438,138	24,459	1,737	2,464,334
Travel	759,501	213,056	115,551	1,916	3,972	1,093,996	62,612	1,512	1,158,120
Software licenses and maintenance	39,262	58	10,338	-	-	49,658	355,520	-	405,178
Training	124,337	15,811	65,130	31,167	249	236,694	95,270	1,141	333,105
Office supplies	167,110	41,422	54,053	-	-	262,585	23,126	218	285,929
General and administrative expenses	299,309	142,602	157,141	10,041	143,847	752,940	475,137	4,609	1,232,686
Affiliated management fees	-	-	-	-	-	-	7,365,654	-	7,365,654
Interest expense	40,965	8,778	9,510	-	-	59,253	33,634	-	92,887
Depreciation and amortization	488,468	116,151	128,202	-	4,256	737,077	793,138	538	1,530,753
Total expenses	$ 45,779,147	$ 9,933,270	$ 10,987,382	$ 13,362,951	$ 433,237	$ 80,495,987	$ 14,861,558	$ 141,359	$ 95,498,904

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Financial Position

June 30, 2016

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Assets:				
Current assets:				
Cash and cash equivalents	$ 620,061	$ 6,447	$ -	$ 626,508
Investments	4,693,992	-	-	4,693,992
Accounts receivable, net	9,006,631	-	-	9,006,631
Other receivables	2,996,383	(249,268)	-	2,747,115
Prepaid expenses and other current assets	1,379,121	2,208	-	1,381,329
Total current assets	18,696,188	(240,613)	-	18,455,575
Property and equipment, net	13,626,852	5,889	-	13,632,741
Other assets, net	2,199,583	8,745	-	2,208,328
Total assets	$ 34,522,623	$ (225,979)	$ -	$ 34,296,644
Liabilities and net assets:				
Current liabilities:				
Current portion of long term debt	$ 386,902	$ -	$ -	$ 386,902
Accounts payable and accrued expenses	5,269,819	95,671	-	5,365,490
Accrued payroll, benefits and taxes	3,073,552	2,744	-	3,076,296
Total current liabilities	8,730,273	98,415	-	8,828,688
Long-term debt, net of current portion	3,549,265	-	-	3,549,265
Total liabilities	12,279,538	98,415	-	12,377,953
Net assets:				
Unrestricted	19,517,079	(324,394)	-	19,192,685
Temporarily restricted	2,726,006	-	-	2,726,006
Total net assets	22,243,085	(324,394)	-	21,918,691
Total liabilities and net assets	$ 34,522,623	$ (225,979)	$ -	$ 34,296,644

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Activities and Changes in Net Assets

Year ended June 30, 2016

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Revenue and other support:				
Net client service revenue	$ 64,895,925	$ 502,682	$ -	$ 65,398,607
Provision for bad debts	(5,376,701)	-	-	(5,376,701)
Net client service revenue less provision for bad debts	59,519,224	502,682	-	60,021,906
Public support	37,216,140	-	-	37,216,140
Rental income	178,191	-	-	178,191
Other operating revenue	1,818,224	-	-	1,818,224
Total revenue and other support	98,731,779	502,682	-	99,234,461
Expenses:				
Salary and fringe benefits	68,123,706	262,443	-	68,386,149
Telephone	884,150	2,822	-	886,972
Travel	982,983	1,642	-	984,625
Drugs and supplies	2,113,670	41,464	-	2,155,134
Printing and postage	84,564	-	-	84,564
Contracted services	9,739,076	-	-	9,739,076
Purchased services	7,440,385	22,283	-	7,462,668
Utilities	1,091,970	5,197	-	1,097,167
Repairs and maintenance	518,522	9,019	-	527,541
Rents and leases	2,028,568	53,944	-	2,082,512
Depreciation and amortization	2,218,475	23,907	-	2,242,382
Insurance	58,012	6,873	-	64,885
Interest	104,247	-	-	104,247
Miscellaneous	3,037,384	135,855	-	3,173,239
Total expenses	98,425,712	565,449	-	98,991,161
Operating gain (loss)	306,067	(62,767)	-	243,300
Nonoperating revenues (expenses):				
Gain (loss) on disposal of assets	2,120	(63,058)	-	(60,938)
Investment income and other	123,219	-	-	123,219
Total nonoperating revenues and expenses	125,339	(63,058)	-	62,281
Excess of revenues over (under) expenses	431,406	(125,825)	-	305,581
Other changes in unrestricted net assets - net assets released from restrictions	377,175			377,175
Change in unrestricted net assets	808,581	(125,825)	-	682,756
Change in temporarily restricted net assets:				
Restricted grant revenue	366,703	-	-	366,703
Contributed rent revenue	11,815	-	-	11,815
Net assets released from restriction	(377,175)	-	-	(377,175)
Change in temporarily restricted net assets	1,343	-	-	1,343
Change in net assets	809,924	(125,825)	-	684,099
Net assets at beginning of year	21,433,161	(198,569)	-	21,234,592
Net assets at end of year	$ 22,243,085	$ (324,394)	$ -	$ 21,918,691

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Functional Expenses

Year ended June 30, 2016

	Mental Health	Developmental Disabilities	Substance Abuse	Trust and Agency	Centerstone Learning, Inc.	Total Program	Management and General	Fund-Raising	Total
Salaries	$ 29,174,124	$ 5,223,853	$ 4,313,736	$ 11,790,563	$ 238,198	$ 50,740,474	$ 5,691,373	$ 66,921	$ 56,498,768
Payroll taxes	2,030,658	378,309	296,850	823,282	21,442	3,550,541	357,049	5,545	3,913,135
Benefits	4,362,222	834,352	664,839	1,664,928	2,803	7,529,144	430,581	14,521	7,974,246
Contracted services	8,779,868	-	1,174,628	-	-	9,954,496	(215,420)	-	9,739,076
Purchased services	956,582	2,320,287	338,942	2,778	22,283	3,640,872	3,821,664	132	7,462,668
Building rentals, maintenance and utilities	2,817,520	183,446	897,348	10	77,855	3,976,179	680,709	2,189	4,659,077
Drugs and supplies	638,243	354,715	1,015,920	-	41,464	2,050,342	8,559	96,233	2,155,134
Travel	645,082	209,100	60,134	1,760	1,642	917,718	66,430	477	984,625
Software licenses and maintenance	10,468	452	395	(50)	-	11,265	1,118,122	-	1,129,387
Training	76,365	17,302	50,022	26,119	-	169,808	111,280	2,684	283,772
Office supplies	202,189	78,015	33,826	-	-	314,030	40,219	202	354,451
General and administrative expenses	370,203	142,705	116,342	10,760	135,855	775,865	709,324	5,004	1,490,193
Interest expense	22,394	4,479	4,106	-	-	30,979	73,268	-	104,247
Depreciation and amortization	554,034	122,675	112,704	-	23,907	813,320	1,428,524	538	2,242,382
Total expenses	$ 50,639,952	$ 9,869,690	$ 9,079,792	$ 14,320,150	$ 565,449	$ 84,475,033	$ 14,321,682	$ 194,446	$ 98,991,161

See accompanying independent auditors' report.