Seven Counties Services, Inc.
and SCS Learning, Inc.

Consolidated Financial Statements

Years Ended June 30, 2016 and 2015

Seven Counties Services, Inc. and SCS Learning, Inc.

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June 30, 2016 and 2015

Independent Auditor's Report

To the Board of Directors
Seven Counties Services, Inc. and SCS Learning, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Seven Counties Services, Inc., and SCS Learning, Inc. (nonprofit organizations), which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, 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 and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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.

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Independent Auditor's Report (Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Seven Counties Services, Inc. and SCS Learning, Inc. as of June 30, 2016 and 2015, and the results of their operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental consolidating information is presented for purposes of additional analysis and is 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 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, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Mountjoy Chilton Medley LLP

Louisville, Kentucky
November 11, 2016

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidated Statements of Financial Position
June 30, 2016 and 2015

	2016	2015
Assets		
Current Assets		
Cash	$ 626,508	$ 5,182,297
Investments	4,693,992	4,671,855
Accounts and grants receivable, less allowance for doubtful accounts of $4,556,000 in 2016 and $4,016,000 in 2015	11,753,746	11,884,402
Contributed rent receivable, current	241,620	256,203
Prepaid expenses and other current assets	1,139,709	1,013,260
Total Current Assets	18,455,575	23,008,017
Property, Plant and Equipment		
Land	1,807,050	1,807,050
Buildings and improvements	13,940,964	13,762,287
Leasehold improvements	4,511,646	4,388,959
Equipment and vehicles	25,098,177	21,978,678
Construction in progress	-	2,458,322
	45,357,837	44,395,296
Less: accumulated depreciation	31,725,096	29,526,035
Property, Plant and Equipment, net	13,632,741	14,869,261
Other Assets		
Contributed rent receivable, less current	2,119,583	2,358,704
Franchise fees, net of amortization of $10,755 in 2016 and $14,214 in 2015	8,745	40,086
Long-term investments	80,000	80,000
Total Other Assets	2,208,328	2,478,790
Total Assets	$ 34,296,644	$ 40,356,068

	2016	2015
Liabilities and Net Assets		
Current Liabilities		
Current maturities of bonds and notes payable, net bond costs	$ 386,902	$ 430,838
Accounts payable	2,666,925	7,335,713
Accrued payroll and vacation	3,445,697	4,506,860
Accrued expenses and other current liabilities	2,154,404	1,239,410
Deferred revenue	174,760	1,641,604
Total Current Liabilities	8,828,688	15,154,425
Bonds and Notes Payable, less current maturities	3,549,265	3,967,051
Total Liabilities	12,377,953	19,121,476
Net Assets, temporarily restricted	2,726,006	2,724,663
Net Assets, unrestricted	19,192,685	18,509,929
Total Net Assets	21,918,691	21,234,592
Total Liabilities and Net Assets	$ 34,296,644	$ 40,356,068

See accompanying notes.

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2016 and 2015

	2016	2015
Changes in Unrestricted Net Assets:		
Revenues:		
Reimbursements under Kentucky Department for Behavioral Health, Developmental & Intellectual Disabilities	$ 15,601,434	$ 15,686,468
Net reimbursements under Medicaid	61,636,021	55,454,192
Net reimbursements under Medicare	1,015,992	963,721
Federal, state and local grants	21,614,706	22,882,608
Private pay and commercial insurance	2,746,594	1,956,854
Other revenues	1,996,415	1,582,813
Provision for bad debts	(5,376,701)	(3,023,082)
Assets released from restrictions	377,175	270,786
Total Revenues	99,611,636	95,774,360
Expenses:		
Salaries and fringe benefits	68,386,149	57,001,016
Subcontract services	9,739,076	12,649,475
Purchased services	7,462,668	12,313,482
Building rentals, maintenance and utilities	4,652,204	4,232,466
Program supplies	2,155,134	2,978,419
Transportation and travel	984,625	954,095
Depreciation and amortization	2,242,382	2,226,973
Interest expense	104,247	105,044
General and administrative expenses	3,264,676	3,298,567
Total Expenses	98,991,161	95,759,537
Operating Income	620,475	14,823
Nonoperating Income (loss):		
Investment income and other	123,219	1,206,255
Loss on disposal of property and equipment	(31,553)	(82,511)
Other expense	(29,385)	-
Total Nonoperating Income	62,281	1,123,744
Increase in Unrestricted Net Assets Before Reorganization Items	682,756	1,138,567
Reorganization Items	-	383,783
Increase in Unrestricted Net Assets	682,756	754,784
Changes in Temporarily Restricted Net Assets:		
Restricted grant revenue	366,703	109,756
Contributed rent	11,815	-
Assets released from restrictions	(377,175)	(270,786)
Increase (Decrease) in Temporarily Restricted Net Assets	1,343	(161,030)
Increase in Total Net Assets	684,099	593,754
Net Assets at Beginning of Year,	21,234,592	20,640,838
Net Assets at End of Year	$ 21,918,691	$ 21,234,592

See accompanying notes.

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidated Statements of Cash Flows
Years Ended June 30, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities		
Cash received for services	$ 96,268,561	$ 91,738,175
Cash paid to suppliers and employees	(100,905,407)	(89,425,608)
Interest income received	148,030	1,222,742
Interest paid	(104,247)	(105,044)
Other revenues received	1,816,635	1,582,813
Net Cash (Used) Provided by Operating Activities	(2,776,428)	5,013,078
Cash Flows from Investing Activities		
Purchases of property and equipment	(1,158,254)	(3,294,136)
Purchases of investments	(1,592,474)	(1,649,692)
Maturities of investments	1,545,526	1,583,000
Proceeds from sale of assets	-	10,850
Net Cash Used by Investing Activities	(1,205,202)	(3,349,978)
Cash Flows from Financing Activities		
Payments for reorganization items	-	(383,783)
Principal payments on bonds and note payable	(574,159)	(327,972)
Net Cash Used by Financing Activities	(574,159)	(711,755)
Net (Decrease) Increase in Cash and Cash Equivalents	(4,555,789)	951,345
Cash and Cash Equivalents at Beginning of Year	5,182,297	4,230,952
Cash and Cash Equivalents at End of Year	$ 626,508	$ 5,182,297

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidated Statements of Cash Flows (Continued)
Years Ended June 30, 2016 and 2015

	2016	2015
Reconciliation of Net Increase in Total Net Assets to Net Cash (Used) Provided by Operating Activities		
Change in Net Assets	$ 684,099	$ 593,754
Adjustments to reconcile net increase in total net assets to net cash (used) provided by operating activities:		
Contributed rent received	(11,815)	-
Contributed rent expensed	265,519	270,786
Depreciation and amortization	2,242,382	2,226,973
Amortization of bond issuance costs and franchise fees	43,558	16,493
Cash flows used by reorganization items	-	383,783
Bad debt expense	5,376,701	3,023,082
Change in investment interest receivable	3,962	8,283
Unrealized loss on investments	20,849	8,204
Loss on disposal of property and equipment	31,553	82,511
Donation of capital asset	(280,000)	-
Debt assumed in relation to donation of capital asset	100,220	-
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(5,246,045)	(5,836,749)
Prepaid expenses and other current assets	(126,449)	(79,976)
Increase (decrease) in:		
Accounts payable	(4,267,949)	4,706,906
Accrued payroll and vacation	(1,061,163)	325,131
Accrued expenses and other current liabilities	914,994	(1,237,428)
Deferred revenue	(1,466,844)	521,325
Total Adjustments	(3,460,527)	4,419,324
Net Cash (Used) Provided by Operating Activities	$ (2,776,428)	$ 5,013,078
Supplemental Schedule Noncash Investing and Financing Activities:		
Accounts payable incurred to acquire equipment	$ 11,887	$ 412,726

See accompanying notes.

Note A - Nature of Organization and Operations

Seven Counties Services, Inc. (SCS) is a community mental health - developmental disabilities organization which provides planning, coordination and direct delivery of mental health, substance abuse and developmental disability services, primarily on an outpatient basis, to residents of Jefferson County and six adjoining counties in the Commonwealth of Kentucky. These services are provided at various centers located within the seven county area. SCS also has contracts with other health care and social agencies for the provision of additional mental health, substance abuse and developmental disability services.

SCS is the sole member of Personnel Best, LLC, a limited liability company. Personnel Best, LLC performs 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.

SCS Learning, Inc. provides cognitive training to children and others with academic difficulties and utilizes a program through LearningRx Franchise Corporation under a franchise agreement. During the year, SCS Learning, Inc. operated in two locations with the rights to open an additional site within the appointed area. One of the SCS Learning, Inc. locations was closed during 2016.

On August 25, 2016, the SCS Board of Directors approved a plan to Affiliate with Centerstone of America, Inc. (an Indiana nonprofit organization) during fiscal year 2017. The Affiliation will become effective on November 1, 2016.

Note B - Summary of Significant Accounting Policies

This summary of significant accounting policies is presented to assist in understanding the Organization's consolidated financial statements. The consolidated financial statements and notes are representations of the Organizations' management who is responsible for the integrity and objectivity of the consolidated financial statements. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the consolidated financial statements.

1. Principles of Consolidation: The consolidated financial statements include the accounts of Seven Counties Services, Inc. and SCS Learning, Inc. SCS controls and appoints the Board of Directors of SCS Learning, Inc. as well as providing other support services. SCS and SCS Learning, Inc. are collectively "the Organization." All intercompany balances and transactions have been eliminated in consolidation.

2. Revenue Recognition: Revenues from services to clients covered under Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities contracts are recognized at SCS' established billing rates, subject to annual contract limitations.

   Revenues from services to clients covered under Medicaid, including Managed Care Organizations (MCOs), and Medicare are recognized at SCS' established billing rates less contractual adjustments. Contractual adjustments represent the differences between established billing rates and the amounts estimated to be reimbursable under the Medicaid, MCOs and Medicare programs.

   Revenues from federal, state and local grants are recognized when the qualifying expenditures are made.

   The Organization recognizes revenues earned from private payers by assessment of a fee based upon the client's ability to pay for services. Revenues earned from payers covered by commercial insurance are recognized based upon the Organization's established billing rates.

Note B - Summary of Significant Accounting Policies (Continued)

3. Accounts Receivable: The valuation of accounts receivable is based upon a detailed analysis of past due accounts and the history of uncollectible accounts. Estimated uncollectible accounts increase the allowance for doubtful accounts and when the accounts receivable are written off, the allowance for doubtful accounts is decreased. The Organization reviews the net accounts receivable with subsequent collections to determine the accuracy of the allowance for doubtful accounts. Included in accounts receivable is $8,884,188 and $9,897,235 due from the Kentucky Medicaid program, including Medicaid MCOs, for the years ended June 30, 2016 and 2015, respectively.

4. Investments: The Organization records all investments at fair market value. See Note D for discussion of fair market value measurements.

   Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of the investment securities will occur in the near term and that such changes could materially affect the financial condition of the Organization. Though the market value of investments is subject to fluctuations on a year-to-year basis, management believes the investment policy is prudent for the long-term welfare of the Organization.

5. Cash and Cash Equivalents: For purposes of the statement of cash flows, the Organization considers unrestricted cash and investments with original maturities of three months or less, excluding those amounts held as part of an investment fund, to be cash and cash equivalents.

6. Income Taxes: Seven Counties Services, Inc. and SCS Learning, Inc. are exempt from federal, state and local income taxes as a not-for-profit corporation as described under Internal Revenue Code Section 501(c)(3). The Organizations file an informational tax return in the U.S. federal jurisdiction and with the Kentucky Office of the Attorney General. Personnel Best, LLC is a disregarded entity for tax purposes, and its activity is included with SCS for tax reporting. However, income from certain activities not directly related to the Organizations' tax-exempt purpose may be subject to taxation as unrelated business income.

   As of June 30, 2016 and 2015, the Organization did not have any accrued interest or penalties related to income tax liabilities, and no interest or penalties have been charged to operations for the years then ended.

7. Property and Equipment: Property and equipment are stated at cost, if purchased, or at fair market value as of the date of donation, if donated. The Organization's policy is to capitalize asset purchases exceeding $1,000 for equipment and $5,000 for leasehold improvements and building and improvements. Depreciation of property and equipment is computed by the straight-line method. The following estimated useful lives were used:

	Years
Buildings and improvements	10 - 30
Equipment and vehicles	3 - 10

   Amortization of leasehold improvements is provided using the straight-line method over the lease term or estimated lives of the improvements, whichever is less.

   Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

Note B - Summary of Significant Accounting Policies (Continued)

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

9. Deferred Revenue: Deferred revenue represents amounts received in advance under various cost reimbursement grants for which the expenditures have not yet been incurred as of the consolidated statement of financial position date.

   Deferred revenue also represents fees paid in advance to SCS Learning, Inc. for classes extending past the consolidated statement of financial position date.

10. Compensated Absences: Employees of the Organization are entitled to paid leave (including vacation, holiday and sick) and short-term disability, depending on job classification, length of service, and other factors. It is impractical to estimate the amount of compensation for future sick pay and short-term disability and, accordingly, no liability has been recorded in the accompanying consolidated financial statements. The Organization's policy is to recognize the costs of sick time and short-term disability absences when actually paid to employees.

11. Donated Services and Materials: Donated services which require specific expertise and would normally have been purchased, and donated services which create or enhance nonfinancial assets, are required to be reflected in the consolidated financial statements. The Organization has received services from a substantial number of unpaid volunteers who donated significant amounts of time to the services provided by the Organization. However, only donated services that meet the criteria for recognition are recorded on the consolidated financial statements. The estimated value of volunteer services which did not meet the criteria for recognition totaled approximately $27,000 and $24,000 during the years ended 2016 and 2015, respectively. The estimated value of services received which were recognized as other revenue and expenses were approximately $75,000 and $30,000 during the years ended 2016 and 2015, respectively. Also, approximately $23,000 and $161,000 of donated pharmaceuticals were recorded as other revenues and expenses during the years ended 2016 and 2015, respectively.

12. Contributions: Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when the stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements. Donations of long-lived assets with explicit restrictions that specify how the assets are to be used and donations 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-lived assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. There were temporarily restricted net assets of $2,361,203 and $2,614,907 for contributed rent receivable at June 30, 2016 and 2015, respectively. In addition there were other temporarily restricted net assets for $364,803 and $109,756 included in temporarily restricted net assets at June 30, 2016 and 2015, respectively. There were no permanently restricted net assets as of June 30, 2016 and 2015.

13. Subcontract Services: Certain services covered under Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities contracts are subcontracted to other health care and social agencies. The consolidated financial statements recognize the revenues and expenses for these program services, and the related amounts paid to subcontractors.

Note B - Summary of Significant Accounting Policies (Continued)

14. Charity Care: Services are provided to clients with a demonstrated inability to pay based on certain criteria under the Organization's charity care policies without charge or at amounts less than their established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as net revenue. The Organization maintains records to identify and monitor the level of charity care it provides. The total cost incurred based on the Organization's overall cost to charge ratio to provide charity care was approximately \$2,496,000 and \$1,832,000, for the years ended June 30, 2016 and 2015, respectively. Charges forgone, based on established rates, was approximately \$6,441,000 and \$2,577,000 for the years ended 2016 and 2015, respectively.

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

16. Recently Issued Accounting Standard Updates: In 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU No. 2015-03 includes amendments that require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Organization is required to retrospectively adopt the guidance in ASU No. 2015-03 for years beginning after December 15, 2015. The Organization adopted ASU No. 2015-03 during 2016 and has retrospectively classified its debt costs as a reduction of the carrying amount of the debt.

    In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)* (ASU 2016-02), to improve financial reporting with respect to leasing transactions. ASU 2016-02 will require lessees to recognize a lease liability and a right-of-use asset with respect to all leases with terms of greater than twelve months. The lease liability will represent the lessee's obligation to make lease payments measured on a discounted basis, while the right-of-use asset will represent the lessee's right to use, or control use of, the underlying asset for the lease term. For leases with a term of twelve months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets or lease liabilities. The provisions of ASU 2016-02 are effective for the year ending June 30, 2021. Early adoption is permitted.

    In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14). ASU 2016-14 changes presentation and disclosure requirements for not-for-profit organizations to provide more relevant information about their resources (and the changes in those resources) to donors, grantors, creditors, and other users of the financial statements. This standard includes qualitative and quantitative requirements in the following areas: 1) net asset classes, 2) investment return, 3) expenses, 4) liquidity and the availability of resources, and 5) presentation of operating cash flows. The provisions of ASU 2016-14 are effective for the year ending June 30, 2019. Early adoption is permitted.

    The Organization is currently evaluating these two accounting standards updates and the related impact thereof on the Organization's financial statements.

17. Subsequent Events: Subsequent events for the Organization have been considered through the date of the Independent Auditor's Report which represents the date the consolidated financial statements were available to be issued. (See also Notes F and G)

Note B - Summary of Significant Accounting Policies (Continued)

18. Reclassifications: Certain amounts for 2015 have been reclassified to conform with the 2016 presentation. These reclassifications had no effect on the previously reported 2015 change in net assets or net assets as of June 30, 2015.

Note C - Business and Revenue Concentrations and Vulnerability

SCS provides services without obtaining payment from many of its clients, most of whom are insured under third-party agreements or covered by Medicaid or under contracts with the Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities (DBHDID) or Central State Hospital. The percentage of revenues obtained from major revenue contracts was as follows:

	2016	2015
Medicaid and Medicaid MCOs	62%	58%
DBHDID	16%	16%
Central State Hospital	13%	13%

The Organization's operations are concentrated in the health care industry. In the health care industry, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Compliance with health care industry laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Note D - Investments and Fair Value Measurements

Accounting principles generally accepted in the United States of America establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

Level 2 - Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active or inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Note D - Investments and Fair Value Measurements (Continued)

All assets have been valued using a market approach. Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies used at June 30, 2016 and 2015.

Cash equivalents - the carrying amounts approximate fair value because of the short maturity of these financial instruments.

Certificates of deposit - valued at the closing price reported on the active market.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair value of investments as of June 30, 2016 and 2015 is summarized below:

	2016	2015
Level 1 investments:		
Cash equivalents	$ 1,063,388	$ 978,503
Certificates of deposit	3,630,604	3,693,352
	$ 4,693,992	$ 4,671,855

All certificates of deposit are held at various financial institutions and are fully insured by the Federal Deposit Insurance Corporation (FDIC).

Note E - Long-term Investment

SCS owns approximately 5% of the outstanding common stock of Mental Health Risk Retention Group (MHRRG). MHRRG provides professional liability insurance to mental health care providers and an organization must have "ownership" to participate. SCS does not maintain control over the operations of MHRRG. The investment of $80,000 by SCS in MHRRG is recorded on the cost method.

Note F - Bonds and Notes Payable

In December 2005, Louisville/Jefferson County Metro Government issued the proceeds from $3,500,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to SCS. The bonds are backed by a letter of credit from Fifth Third Bank. The letter of credit is scheduled to expire on December 15, 2016. The bonds will be repaid in annual installments with the final payment due December 1, 2020. The 2005 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. Collateral consists of the facilities constructed with the proceeds of the bonds with a net book value of approximately $2,981,000 and $3,179,000 as of June 30, 2016 and 2015, respectively.

Note F - Bonds and Notes Payable (Continued)

In December 2011, Louisville/Jefferson County Metro Government issued the proceeds from $2,600,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to SCS. The bonds are backed by a letter of credit from Fifth Third Bank. The letter of credit is scheduled to expire on December 15, 2016. The bonds will be repaid in annual installments with the final payment due December 1, 2021. The bonds were issued for the purpose of financing the Electronic Enterprise Solution software system. Collateral consists of all accounts receivable, equipment, and general intangibles with a net book value of approximately $16,750,000 and $15,106,000 as of June 30, 2016 and 2015, respectively.

In June 2014, SCS 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 February 2016, SCS assumed a note payable to Kentucky Housing Corporation (KHC)) associated with the receipt property serving as collateral for the note payable. The note payable assumed had a principle balance of $100,220 and with annual payments of principle and interest starting on August 1, 2016. The note is secured by property received with a net book value of approximately $275,000 as of June 30, 2016.

Outstanding principal and future maturities of the above bonds payable are as follows:

	2016	2015
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2020 (interest rate of .54% at June 30, 2016).	$ 1,400,000	$ 1,650,000
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2021 (interest rate of .52% at June 30, 2016).	2,035,000	2,340,000
Note payable, payable to Landlord in monthly installments of $4,494 including interest at 7.00% through July 1, 2029.	461,292	480,451
Note payable, payable to KHC in monthly installments of $5,519 including interest at 1.00% through August 1, 2035.	100,220	-
	3,996,512	4,470,451
Bond costs, net of amortization of $165,557 in 2016 and $153,340 in 2015	(60,345)	(72,562)
	3,936,167	4,397,889
Less current maturities, net	386,902	503,400
	$ 3,549,265	$ 3,894,489

Note F - Bonds and Notes Payable (Continued)

Future Maturities:

June 30,	
2017	$ 447,247
2018	679,753
2019	707,410
2020	736,091
2021	766,233
2022-2035	659,778
	$ 3,996,512

In accordance with the trust indentures, SCS must comply with certain financial covenants relating to the above bonds. Management is not aware of any violations of covenants as of June 30, 2016.

On October 3, 2016 the above Industrial Revenue Bonds were refinanced under a term note payable to Republic Bank. The term note is payable in monthly installments of $63,113 including principle and interest through October 3, 2021. The term note bears interest at 3.85% and is secured by a mortgage on certain facilities owned by SCS. The impact of this refinancing is reflected in the future maturities schedule above.

Note G - Lease Commitments

The Organization leases administrative and clinical space at several locations as well as several vehicles under noncancelable operating leases with initial terms of at least one year. The Organization leases other equipment on a month-to-month basis. Total rental expense for all leases was approximately $2,108,000 and $1,981,000 for the years ended June 30, 2016 and 2015 respectively, which includes $588,835 and $587,073 for the years ended June 30, 2016 and 2015, respectively, for the fair market value of the donated lease of the Jefferson Alcohol and Drug Abuse Center (JADAC) from Louisville Metro Government. Future contributed rent under this lease is valued at $2,247,500 and $2,392,500 at June 30, 2016 and 2015, respectively, and is being amortized over the life of the lease which matures December 31, 2031. In addition the Company received donated rent from a landlord for the use of three additional facilities during 2016 and 2015 of which $111,203 and $125,787, respectively, is included in the above rental expense and the remaining contributed receivable of $113,703 and $222,407, respectively, is treated as a temporarily restricted assets receivable in the months specified in the related agreements.

At June 30, 2016, the minimum annual lease commitments under agreements having initial terms of more than one year were as follows:

2017	$ 1,237,477
2018	1,038,795
2019	907,743
2020	367,913
2021	201,500
2022-2029	1,528,958
	$ 5,282,386

Note G - Lease Commitments (Continued)

In September 2016 SCS entered into a lease agreement for a new office location. The lease will have a commencement date of the sooner of March 1, 2017 or the date of occupancy and a term of 150 months with the first six months of rent abated. Rent under this operating lease will be based on the square footage rented by SCS during the term. The future commitment under this lease is not reflected in the above schedule.

Note H - Retirement Plan

The Organization has a 403(b) plan (Plan) for its employees that meet the Plan's eligibility requirements. SCS matches amounts up to four percent of the participating employees' compensation. Retirement plan contribution expense for the years ended June 30, 2016 and 2015 totals approximately $1,109,000 and $903,000, respectively.

Note I - Medical Malpractice Insurance

The Organization participates in a multi-provider insurance program which provides coverage on a claims-made basis for medical malpractice liabilities. Insurance coverages are $1,000,000 individually and $3,000,000 in the aggregate annually. Management intends to maintain such coverages in the future and is of the opinion that insurance coverages are adequate to cover any potential losses on asserted claims. Liabilities for incurred but not reported losses, if any, as of June 30, 2016 and 2015 are not determinable and no provision for such losses has been made in the financial statements. Management is unaware of any incidents which would ultimately result in a loss in excess of its insurance coverages (see Note O).

Note J - Functional Classification of Expenses

Expenses by functional classification are as follows:

	2016	2015
Program Services:		
Mental health	$ 50,222,533	$ 50,672,764
Developmental disabilities	9,787,703	12,031,050
Chemical dependency	9,004,446	6,244,254
Trust and agency programs	14,320,149	13,438,212
SCS Learning, Inc.	565,449	711,815
Total Program Services	83,900,280	83,098,095
Management and general	14,897,559	12,570,221
Fundraising	193,322	91,221
	$ 98,991,161	$ 95,759,537

Note K - Concentration of Credit Risk

The Organization maintains its cash accounts at various banks located in Kentucky. Accounts at each bank are guaranteed by the FDIC up to $250,000. The Organization requires funds in the operating account to be maintained in a Commercial Overnight Repurchase Sweep Account with funds collateralized by U.S. government securities. At June 30, 2016, the Organization's uncollateralized cash balances totaled approximately $25,000.

Note L - Self-insured Health Plan

The Organization participates in a self-insurance program for its employees' health care costs. The Organization is liable for claims of $200,000 per employee annually with a maximum of approximately $6,300,000 in total for all plan participants for the year. The Organization has third-party insurance coverage for any losses in excess of such amounts. The accrued liability for such covered medical claims at June 30, 2016 and 2015 is approximately, $306,000 and $207,000, respectively, and is included in accrued expenses on the consolidated statement of financial position.

Note M - Construction in Progress

During 2014, the Organization started to implement a new electronic medical records and financial and human resources software included in construction in progress at June 30, 2015 at a total cost of approximately $2,436,000. The electronic medical records and financial and human resources software was completed and placed in service during 2016.

Note N - Bankruptcy - Description of Petition

On April 4, 2013, the Organization filed a petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Western District of Kentucky, Louisville Division. On April 5, 2013, the Organization filed a motion to terminate participation in Kentucky Employee Retirement Systems (KERS). Under Chapter 11, certain claims against the Organization in existence prior to the filing of the petitions for relief under the federal bankruptcy laws are stayed while the Organization continues business operations as Debtor-in-possession. These claims were reflected in the June 30, 2014 balance sheet as "liabilities subject to compromise." Additional claims (liabilities subject to compromise) may arise subsequent to the filing date resulting from rejection of executory contracts, including leases, and from the determination by the court (or agreed to by the parties in interest) of allowed claims for contingencies and other disputed amounts. Claims secured against the Organization's assets ("secured claims") also are stayed, although the holders of such claims have the right to move the court for relief from the stay. Secured claims are secured primarily by liens on the Organization's property, plant and equipment. The Organization received approval from the Bankruptcy Court to pay or otherwise honor certain of its prepetition obligations, including employee wages.

The Organization was granted exclusive authority by the Bankruptcy court to propose a plan of reorganization any time prior to October 6, 2014, and it is the opinion of the Management, Board of Directors and legal counsel of the Organization that absent the alleged liability to KERS, the Organization is financially sound, and would not likely need to reorganize under Chapter 11. In May of 2014 the Bankruptcy Court ruled that the Organization had legal standing to seek relief in Chapter 11 and withdraw from KERS. The Organization officially emerged from Chapter 11 bankruptcy effective February 6, 2015.

The Organization has not contributed to the KERS plan for its employees since April 7, 2013. KERS did not present a formal request for payment for these amounts, or any other amount, to the Bankruptcy Court within the allowed time. Various motions have been filed related to the April 4, 2013 and April 5, 2013 filings, and the court has ruled, following an evidentiary hearing, that KERS is not entitled to injunctive relief to compel the Organization to continue making reports and employer and employee contributions into the KERS plan. Therefore, there has been no liability recorded on the consolidated statement of financial position for the estimated contributions based on eligible employees' wages subsequent to April 7, 2013. KERS is currently appealing the court's ruling allowing SCS relief under Chapter 11, the appeal is in the United States 6th Circuit Court of Appeals.

Note N - Bankruptcy - Description of Petition (Continued)

At June 30, 2015 reorganization items were comprised of:

	2015
Legal fees	$ 223,783
Trustee fees	80,000
Other fees	80,000
	$ 383,783

Note O - Other Commitments and Contingencies

SCS filed a lawsuit on January 16, 2014, against a software vendor due to significant problems and challenges with implementation of software provided by the vendor. In May 2013, the software vendor had filed a proof of claim against SCS and in July 2013, the Bankruptcy Court (see Note N) granted SCS's unopposed motion to reject its contract with the software vendor, thus this amount has not been recorded as a liability on the statement of financial position. The vendor's proof of claim against SCS was withdrawn during 2014. The parties settled the dispute in October 2014, awarding SCS a settlement, which is included in other revenue on the consolidated statement of operations.

The Organization is a party to various legal and/or administrative proceedings arising out of the operation of facilities and programs and arising in the ordinary course of business. Management believes that, generally, these claims are without merit. Management does not believe the results of these proceedings or claims, individually or in the aggregate, will have a material adverse effect on the financial condition, results of operations or liquidity.

Supplementary Information

Seven Counties Services, Inc. and SCS Learning, Inc.

Consolidating Statements of Financial Position

June 30, 2016 and 2015

	2016				2015			
Assets	Seven Counties Services	SCS Learning	Eliminations	Consolidated	Seven Counties Services	SCS Learning	Eliminations	Consolidated
Current Assets								
Cash	$ 620,061	$ 6,447	$ -	$ 626,508	$ 5,161,372	$ 20,925	$ -	$ 5,182,297
Investments	4,693,992	-	-	4,693,992	4,671,855	-	-	4,671,855
Accounts and grants receivable, less allowance for doubtful accounts	12,003,014	25,070	(274,338)	11,753,746	12,037,609	64,617	(217,824)	11,884,402
Contributed rent receivable, current	241,620	-	-	241,620	256,203	-	-	256,203
Prepaid expenses and other current assets	1,137,501	2,208	-	1,139,709	1,008,004	5,256	-	1,013,260
Total Current Assets	18,696,188	33,725	(274,338)	18,455,575	23,135,043	90,798	(217,824)	23,008,017
Property, Plant and Equipment								
Land	1,807,050	-	-	1,807,050	1,807,050	-	-	1,807,050
Buildings and improvements	13,940,964	-	-	13,940,964	13,762,287	-	-	13,762,287
Leasehold improvements	4,449,777	61,869	-	4,511,646	4,252,262	136,697	-	4,388,959
Equipment and vehicles	25,071,679	26,498	-	25,098,177	21,952,180	26,498	-	21,978,678
Construction in progress	-	-	-	-	2,458,322	-	-	2,458,322
	45,269,470	88,367	-	45,357,837	44,232,101	163,195	-	44,395,296
Less: accumulated depreciation	31,642,618	82,478	-	31,725,096	29,426,311	99,724	-	29,526,035
	13,626,852	5,889	-	13,632,741	14,805,790	63,471	-	14,869,261
Other Assets								
Contributed rent receivable, less current	2,119,583	-	-	2,119,583	2,358,704	-	-	2,358,704
Franchise fees, net of amortization	-	8,745	-	8,745	-	40,086	-	40,086
Long-term investments	80,000	-	-	80,000	80,000	-	-	80,000
Total Other Assets	2,199,583	8,745	-	2,208,328	2,438,704	40,086	-	2,478,790
Total Assets	$ 34,522,623	$ 48,359	$ (274,338)	$ 34,296,644	$ 40,379,537	$ 194,355	$ (217,824)	$ 40,356,068

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidating Statements of Financial Position (Continued)
June 30, 2016 and 2015

	2016				**2015**			
Liabilities and Net Assets	Seven Counties Services	SCS Learning	Eliminations	Consolidated	Seven Counties Services	SCS Learning	Eliminations	Consolidated
Current Liabilities								
Current maturities of bonds and notes payable, net bond costs	$ 386,902	$ -	$ -	$ 386,902	$ 430,838	$ -	$ -	$ 430,838
Accounts payable	2,663,771	277,492	(274,338)	2,666,925	7,335,713	217,824	(217,824)	7,335,713
Accrued payroll and vacation	3,442,953	2,744	-	3,445,697	4,503,889	2,971	-	4,506,860
Accrued expenses and other current liabilities	2,149,593	4,811	-	2,154,404	1,232,876	6,534	-	1,239,410
Deferred revenue	87,054	87,706	-	174,760	1,476,009	165,595	-	1,641,604
Total Current Liabilities	8,730,273	372,753	(274,338)	8,828,688	14,979,325	392,924	(217,824)	15,154,425
Bonds and Notes Payable, less current maturities	3,549,265	-	-	3,549,265	3,967,051	-	-	3,967,051
Total Liabilities	12,279,538	372,753	(274,338)	12,377,953	18,946,376	392,924	(217,824)	19,121,476
Net Assets, temporarily restricted	2,726,006	-	-	2,726,006	2,724,663	-	-	2,724,663
Net Assets (Deficit), unrestricted	19,517,079	(324,394)	-	19,192,685	18,708,498	(198,569)	-	18,509,929
Total Net Assets (Deficit)	22,243,085	(324,394)	-	21,918,691	21,433,161	(198,569)	-	21,234,592
Total Liabilities and Net Assets	$ 34,522,623	$ 48,359	$ (274,338)	$ 34,296,644	$ 40,379,537	$ 194,355	$ (217,824)	$ 40,356,068

See accompanying independent auditor's report.

Seven Counties Services, Inc. and SCS Learning, Inc.
Consolidating Statements of Operations and Changes in Net Assets (Deficit)
Years Ended June 30, 2016 and 2015

	2016				2015			
	Seven Counties Services	SCS Learning	Eliminations	Consolidated	Seven Counties Services	SCS Learning	Eliminations	Consolidated
Changes in Net Assets (Deficit):								
Revenues:								
Reimbursements under Kentucky Department for Behavioral Health, Developmental & Intellectual Disabilities	$ 15,601,434	$ -	$ -	$ 15,601,434	$ 15,686,468	$ -	$ -	$ 15,686,468
Net reimbursements under Medicaid	61,636,021	-	-	61,636,021	55,454,192	-	-	55,454,192
Net reimbursements under Medicare	1,015,992	-	-	1,015,992	963,721	-	-	963,721
Federal, state and local grants	21,981,409	-	-	21,981,409	22,992,364	-	-	22,992,364
Private pay and commercial insurance	2,243,912	502,682	-	2,746,594	1,397,957	624,550	(65,653)	1,956,854
Other revenues	2,008,230	-	-	2,008,230	1,582,813	-	-	1,582,813
Provision for bad debts	(5,376,701)	-	-	(5,376,701)	(3,023,082)	-	-	(3,023,082)
Total Revenues	99,110,297	502,682	-	99,612,979	95,054,433	624,550	(65,653)	95,613,330
Expenses:								
Salaries and fringe benefits	68,123,706	262,443	-	68,386,149	56,669,031	331,985	-	57,001,016
Subcontract services	9,739,076	-	-	9,739,076	12,649,475	-	-	12,649,475
Purchased services	7,440,385	22,283	-	7,462,668	12,289,222	24,260	-	12,313,482
Building rentals, maintenance and utilities	4,581,222	70,982	-	4,652,204	4,157,225	75,241	-	4,232,466
Program supplies	2,113,670	41,464	-	2,155,134	2,977,046	67,026	(65,653)	2,978,419
Transportation and travel	982,983	1,642	-	984,625	951,054	3,041	-	954,095
Depreciation and amortization	2,218,475	23,907	-	2,242,382	2,194,335	32,638	-	2,226,973
Interest expense	104,247	-	-	104,247	105,044	-	-	105,044
General and administrative expenses	3,121,948	142,728	-	3,264,676	3,120,942	177,625	-	3,298,567
Total Expenses	98,425,712	565,449	-	98,991,161	95,113,374	711,816	(65,653)	95,759,537
Operating Income (loss)	684,585	(62,767)	-	621,818	(58,941)	(87,266)	-	(146,207)
Nonoperating Income (loss):								
Investment income and other	123,219	-	-	123,219	1,206,255	-	-	1,206,255
(Loss) gain on disposal of property and equipment	2,120	(33,673)	-	(31,553)	(82,511)	-	-	(82,511)
Other expense	-	(29,385)	-	(29,385)	-	-	-	-
Total Nonoperating Income (Loss)	125,339	(63,058)	-	62,281	1,123,744	-	-	1,123,744
Increase (Decrease) in total net assets before reorganization items	809,924	(125,825)	-	684,099	1,064,803	(87,266)	-	977,537
Reorganization items	-	-	-	-	383,783	-	-	383,783
Increase (Decrease) in total net assets	809,924	(125,825)	-	684,099	681,020	(87,266)	-	593,754
Total Net Assets (Deficit) at Beginning of Year	21,433,161	(198,569)	-	21,234,592	20,752,141	(111,303)	-	20,640,838
Total Net Assets (Deficit) at End of Year	$ 22,243,085	$ (324,394)	$ -	$ 21,918,691	$ 21,433,161	$ (198,569)	$ -	$ 21,234,592

See accompanying independent auditor's report.