CENTERSTONE OF KENTUCKY, INC.

Consolidated Financial Statements and Supplemental Schedules

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)

LBMC MAKE A GOOD BUSINESS BETTER

CENTERSTONE OF KENTUCKY, INC.

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LBMC MAKE A GOOD BUSINESS BETTER

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 statements of financial position as of June 30, 2018 and 2017, the related consolidated statements of activities 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 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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, 2018 and 2017, and the changes in their net assets and their cash flows for the years 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 audits were 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 audits 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.

LBMC, PC

Brentwood, Tennessee
November 28, 2018

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Financial Position

June 30, 2018 and 2017

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	$ 1,664,815	$ 2,804,896
Investments	5,043,522	5,993,959
Accounts receivable, net	5,615,288	6,377,233
Other receivables	1,663,750	1,228,401
Prepaid expenses and other current assets	1,153,539	1,197,984
Total current assets	15,140,914	17,602,473
Property and equipment, net	11,268,501	12,633,162
Other assets, net	1,897,333	2,044,289
Total assets	$ 28,306,748	$ 32,279,924
Liabilities and Net Assets		
Current liabilities:		
Current portion of long-term debt	$ 707,561	$ 679,892
Accounts payable and accrued expenses	4,730,825	4,662,823
Due to affiliated entities	1,243,568	1,172,650
Accrued payroll, benefits and taxes	3,815,983	3,447,402
Total current liabilities	10,497,937	9,962,767
Long-term debt, net of current portion	2,159,879	2,867,439
Total liabilities	12,657,816	12,830,206
Net assets:		
Unrestricted	13,327,977	16,964,935
Temporarily restricted	2,320,955	2,484,783
Total net assets	15,648,932	19,449,718
Total liabilities and net assets	$ 28,306,748	$ 32,279,924

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, 2018 and 2017

	2018	2017
Revenue and other support:		
Net client service revenue	$ 60,419,473	$ 59,862,697
Provision for bad debts	(3,877,480)	(7,776,581)
Net client service revenue less provision for bad debts	56,541,993	52,086,116
Public support	39,272,545	36,649,134
Rental income	222,262	153,362
Other operating revenue	1,571,657	1,600,285
Total revenue and other support	97,608,457	90,488,897
Expenses:		
Salary and fringe benefits	71,605,344	69,420,352
Telephone	906,785	941,256
Travel	1,263,807	1,158,120
Drugs and supplies	2,796,411	2,464,334
Printing and postage	67,905	109,680
Contracted services	675,432	1,726,059
Purchased services	3,747,661	4,850,348
Utilities	607,932	853,503
Repairs and maintenance	481,906	475,211
Affiliated management fees	12,980,015	7,365,654
Rents and leases	2,867,185	2,306,602
Depreciation and amortization	1,428,212	1,530,753
Insurance	45,635	56,927
Interest	134,781	92,887
Miscellaneous	2,271,526	2,147,218
Total expenses	101,880,537	95,498,904
Operating loss	(4,272,080)	(5,010,007)
Nonoperating revenues:		
Gain on disposal of assets	51,833	2,040,782
Investment income and other	208,679	134,713
Total nonoperating revenues	260,512	2,175,495
Excess of expenses over revenue	(4,011,568)	(2,834,512)
Other changes in unrestricted net assets - net assets released from restrictions	374,610	606,762
Change in unrestricted net assets	(3,636,958)	(2,227,750)
Change in temporarily restricted net assets:		
Restricted grant revenue	188,426	246,409
Contributed rent revenue	22,356	119,130
Net assets released from restriction	(374,610)	(606,762)
Change in temporarily restricted net assets	(163,828)	(241,223)
Change in net assets	(3,800,786)	(2,468,973)
Net assets at beginning of year	19,449,718	21,918,691
Net assets at end of year	$ 15,648,932	$ 19,449,718

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

	2018	2017
Operating activities:		
Change in net assets	$ (3,800,786)	$ (2,468,973)
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Gain on disposal of assets	(51,833)	(2,040,782)
Depreciation and amortization	1,428,212	1,530,753
Affiliated management fees related to property and equipment	486,709	328,106
Provision for bad debts	3,877,480	7,776,581
Investment income	(50,241)	(23,939)
Changes in operating assets and liabilities		
Accounts receivable, net	(3,115,535)	(5,147,183)
Due to/from affiliates	70,918	1,172,650
Other receivables	(435,349)	1,518,714
Prepaid expenses and other current assets	191,401	347,384
Accounts payable and accrued expenses	68,002	(702,667)
Accrued payroll, benefits and taxes	368,581	371,106
Net cash provided (used) by operating activities	(962,441)	2,661,750
Investing activities:		
Purchase of property and equipment	(570,330)	(1,585,171)
Proceeds from the sale of property and equipment	71,903	2,766,673
Proceeds from the sale or maturity of investments	1,000,678	2,300,457
Purchases of investments	-	(3,576,485)
Net cash provided (used) by investing activities	502,251	(94,526)
Financing activities:		
Proceeds from long-term debt	-	3,435,000
Principal payments on long term debt	(679,891)	(3,823,836)
Net cash used by financing activities	(679,891)	(388,836)
Increase (decrease) in cash and cash equivalents	(1,140,081)	2,178,388
Cash and cash equivalents at beginning of year	2,804,896	626,508
Cash and cash equivalents at end of year	$ 1,664,815	$ 2,804,896
Supplemental cash flows information		
Cash paid for interest	$ 136,912	$ 87,361

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, 2018 or 2017.

(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, 2018 and 2017 were $813,596 and $1,765,147, 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 expenses over revenue, 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 $1,957,500 and $2,131,667 at June 30, 2018 and 2017, 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) 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.

(k) 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 $4,407,000 and $6,280,000 for June 30, 2018 and 2017, respectively.

Of the Corporation's total unrestricted operating expense reported pertaining to the entities providing client care, an estimated $3,360,000 and $3,377,000 arose from providing services to charity clients during the years ended June 30, 2018 and 2017, 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.

(l) 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 2018 and 2017, 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.

(m) 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.

(n) 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 $152,000 and $173,000 for 2018 and 2017, respectively.

(o) 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, 2018 and 2017, 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, 2017.

(p) 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 loss. Certain non-operating items are excluded from the operating indicator, including investment income, gain (loss) on investments, interest and dividend income, contributions from donors and related parties, other non-operating income and gains on disposal of equipment.

(q) New accounting pronouncement

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*. The ASU was issued to address certain complexities in current presentation requirements for net assets, resolve deficiencies in the transparency of information regarding an organization's liquidity and inconsistencies in the type of information provided by organizations about expenses. As a result, the primary provisions of ASU 2016-14 include:

- **Reduction in the number of net asset classifications from three to two: net assets with donor restrictions and net assets without donor restrictions. Differences in the nature of donor restrictions will be disclosed in the notes, with an emphasis on how and when the resources can be used.**

- **Organizations will be required to disclose, either on the face of the statements or in notes, the extent to which the statement of financial position comprises financial assets, the extent to which those assets can be converted to cash within one year, and any limitations that would preclude their current use.**

- **In addition to reporting expenses by functional classifications under current requirements, organizations will be required to provide information about expenses by their nature through an analysis demonstrating how the nature of expenses relate to the programs and supporting activities. Additional disclosures about the methods used to allocate costs among program and support functions will also be required.**

The ASU is effective for the Corporation for the year ending June 30, 2019. Management is currently assessing the impact of adopting this standard.

(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) Events occurring after reporting date

The Corporation has evaluated events and transactions that occurred between June 30, 2018 and November 28, 2018, 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 net client service revenue is as follows:

	Receivables		Revenue	
	2018	2017	2018	2017
Medicare	2 %	7 %	2 %	3 %
Medicaid	87 %	86 %	93 %	92 %
Self-pay	6 %	1 %	2 %	1 %
Other third-party payors	5 %	6 %	3 %	4 %
	100 %	100 %	100 %	100 %

(4) Property and equipment

A summary of property and equipment as of June 30, 2018 and 2017 is as follows:

	2018	2017
Land	$ 1,434,900	$ 1,434,900
Buildings and improvements	16,582,617	16,277,892
Furnishings, equipment and vehicles	26,449,753	26,103,189
Construction in progress	-	115,113
	44,467,270	43,931,094
Accumulated depreciation and amortization	(33,198,769)	(31,297,932)
	$ 11,268,501	$ 12,633,162

(5) Long-term debt

A summary of long-term debt as of June 30, 2018 and 2017 is as follows:

	2018	2017
Note payable to Republic Bank in monthly installments of $63,113 including interest at 3.85% through October 3, 2021	$ 2,363,400	$ 3,014,617
Note payable to landlord in monthly installments of $4,494 including interest at 7.00% through July 1, 2029	412,909	437,011
Other note payable	91,131	95,703
Total long-term debt	2,867,440	3,547,331
Less current portion	707,561	679,892
Long-term debt, excluding current portion	$ 2,159,879	$ 2,867,439

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 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, 2018 is as follows:

Year	Amount
2019	$ 707,561
2020	736,111
2021	766,255
2022	286,866
2023	38,786
2024 and later years	331,861
	$ 2,867,440

(6) Net assets

The temporarily restricted net assets are available for the following purposes as of June 30, 2018 and 2017:

	2018	2017
Contributed rent	$ 1,957,500	$ 2,131,667
Other	363,455	353,116
	$ 2,320,955	$ 2,484,783

(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 2018 and 2017:

	2018	2017
Gross client service revenue	$ 117,155,560	$ 100,086,041
Less deductions		
Contractuals	(56,736,087)	(40,223,344)
Net client service revenue	60,419,473	59,862,697
Less provision for bad debt	(3,877,480)	(7,776,581)
Net client service revenue less provision for bad debt	$ 56,541,993	$ 52,086,116

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 2018 and 2017 is set forth in the following table.

	2018	2017
Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities	$ 17,224,071	$ 16,206,854
Louisville Metro Government	1,443,986	942,578
Other state funds	19,805,080	18,659,131
Federal funds	703,366	623,375
Other public support	96,042	217,196
	$ 39,272,545	$ 36,649,134

(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 $1,474,000 and $1,440,000 for 2018 and 2017, 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, 2018 and 2017. For the years ended June 30, 2018 and 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 $2,861,000 and $2,305,000 for the years ended June 30, 2018 and 2017, respectively, which includes the fair market value of the donated lease of CARC from Louisville Metro Government of $609,215 and $597,706 for the years ended June 30, 2018 and 2017, respectively.

A summary of approximate future minimum payments under these leases as of June 30, 2018 is as follows:

2019	$ 1,993,000
2020	1,133,000
2021	1,102,000
2022	1,104,000
2023	959,000
2024 and later years	5,244,000
Total minimum lease payments	$ 11,535,000

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 $261,000 and $368,000 at June 30, 2018 and 2017, 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 $8,400,000 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, 2018

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Assets:				
Current assets:				
Cash and cash equivalents	$ 1,646,459	$ 18,356	$ -	$ 1,664,815
Investments	5,043,522	-	-	5,043,522
Accounts receivable, net	5,615,288	-	-	5,615,288
Other receivables	1,899,810	85,247	(321,307)	1,663,750
Prepaid expenses and other current assets	1,153,539	-	-	1,153,539
Total current assets	15,358,618	103,603	(321,307)	15,140,914
Property and equipment, net	11,268,501	-	-	11,268,501
Other assets, net	1,892,500	4,833	-	1,897,333
Total assets	$ 28,519,619	$ 108,436	$ (321,307)	$ 28,306,748
Liabilities and net assets:				
Current liabilities:				
Current portion of long-term debt	$ 707,561	$ -	$ -	$ 707,561
Accounts payable and accrued expenses	4,499,718	460,064	(228,957)	4,730,825
Due to affiliated entities	1,243,568	92,350	(92,350)	1,243,568
Accrued payroll, benefits and taxes	3,812,848	3,135	-	3,815,983
Total current liabilities	10,263,695	555,549	(321,307)	10,497,937
Long-term debt, net of current portion	2,159,879	-	-	2,159,879
Total liabilities	12,423,574	555,549	(321,307)	12,657,816
Net assets (deficit):				
Unrestricted	13,775,090	(447,113)	-	13,327,977
Temporarily restricted	2,320,955	-	-	2,320,955
Total net assets (deficit)	16,096,045	(447,113)	-	15,648,932
Total liabilities and net assets (deficit)	$ 28,519,619	$ 108,436	$ (321,307)	$ 28,306,748

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Activities and Changes in Net Assets

Year ended June 30, 2018

	Centerstone of Kentucky, Inc.	Centerstone Learning, Inc.	Eliminations	Total
Revenue and other support:				
Net client service revenue	$ 60,104,448	$ 315,025	$ -	$ 60,419,473
Provision for bad debts	(3,877,480)	-	-	(3,877,480)
Net client service revenue less provision for bad debts	56,226,968	315,025	-	56,541,993
Public support	39,272,545	-	-	39,272,545
Rental income	222,262	-	-	222,262
Other operating revenue	1,571,657	-	-	1,571,657
Total revenue and other support	97,293,432	315,025	-	97,608,457
Expenses:				
Salary and fringe benefits	71,410,233	195,111	-	71,605,344
Telephone	902,621	4,164	-	906,785
Travel	1,259,145	4,662	-	1,263,807
Drugs and supplies	2,777,076	19,335	-	2,796,411
Printing and postage	66,545	1,360	-	67,905
Contracted services	675,432	-	-	675,432
Purchased services	3,744,455	3,206	-	3,747,661
Utilities	604,491	3,441	-	607,932
Repairs and maintenance	481,900	6	-	481,906
Affiliated management fees	12,980,015	-	-	12,980,015
Rents and leases	2,838,079	29,106	-	2,867,185
Depreciation and amortization	1,424,623	3,589	-	1,428,212
Insurance	44,213	1,422	-	45,635
Interest	134,781	-	-	134,781
Miscellaneous	2,166,669	104,857	-	2,271,526
Total expenses	101,510,278	370,259	-	101,880,537
Operating loss	(4,216,846)	(55,234)	-	(4,272,080)
Nonoperating revenues:				
Gain on disposal of assets	51,833	-	-	51,833
Investment income and other	208,679	-	-	208,679
Total nonoperating revenues	260,512	-	-	260,512
Excess of expenses over revenue	(3,956,334)	(55,234)	-	(4,011,568)
Other changes in unrestricted net assets - net assets released from restrictions	374,610	-	-	374,610
Change in unrestricted net assets	(3,581,724)	(55,234)	-	(3,636,958)
Change in temporarily restricted net assets:				
Restricted grant revenue	188,426	-	-	188,426
Contributed rent revenue	22,356	-	-	22,356
Net assets released from restriction	(374,610)	-	-	(374,610)
Change in temporarily restricted net assets	(163,828)	-	-	(163,828)
Change in net assets	(3,745,552)	(55,234)	-	(3,800,786)
Net assets (deficit) at beginning of year	19,841,597	(391,879)	-	19,449,718
Net assets (deficit) at end of year	$ 16,096,045	$ (447,113)	$ -	$ 15,648,932

See accompanying independent auditors' report.

CENTERSTONE OF KENTUCKY, INC.

Consolidating Statement of Functional Expenses

Year ended June 30, 2018

	Mental Health	Developmental Disabilities	Substance Abuse	Trust and Agency	Centerstone Learning, Inc.	Total Program	Management and General	Fund-Raising	Total
Salaries	35,059,869	5,581,889	7,025,029	11,083,212	175,221	$ 58,925,220	396,686	-	$ 59,321,906
Payroll taxes	2,484,731	404,221	493,258	776,658	13,232	4,172,100	(83,166)	-	4,088,934
Benefits	4,756,117	818,507	1,126,447	1,436,570	6,658	8,144,299	50,205	-	8,194,504
Contracted services	674,282	-	-	-	-	674,282	1,150	-	675,432
Purchased services	960,567	2,073,713	273,565	30,558	3,206	3,341,609	406,052	-	3,747,661
Building rentals, maintenance and utilities	2,937,846	182,213	1,519,875	85	38,139	4,678,158	231,285	-	4,909,443
Drugs and supplies	562,093	467,529	1,747,302	21	19,335	2,796,280	131	-	2,796,411
Travel	799,101	242,467	175,565	1,743	4,662	1,223,538	40,269	-	1,263,807
Software licenses and maintenance	57,841	54	1,351	-	-	59,246	5,911	-	65,157
Training	80,060	21,521	530,179	12,334	-	644,094	48,308	-	692,402
Office supplies	177,399	29,618	55,438	-	-	262,455	4,533	-	266,988
General and administrative expenses	406,883	143,936	218,777	10,725	106,217	886,538	428,346	-	1,314,884
Affiliated management fees	-	-	-	-	-	-	12,909,652	70,363	12,980,015
Interest expense	49,567	10,193	13,385	-	-	73,145	61,636	-	134,781
Depreciation and amortization	679,299	158,049	210,063	-	3,589	1,051,000	377,212	-	1,428,212
Total expenses	$ 49,685,655	$ 10,133,910	$ 13,390,234	$ 13,351,906	$ 370,259	$ 86,931,964	$ 14,878,210	$ 70,363	$ 101,880,537

See accompanying independent auditors' report.

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 (deficit):				
Unrestricted	17,356,814	(391,879)	-	16,964,935
Temporarily restricted	2,484,783	-	-	2,484,783
Total net assets (deficit)	19,841,597	(391,879)	-	19,449,718
Total liabilities and net assets (deficit)	$ 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 loss	(4,942,522)	(67,485)	-	(5,010,007)
Nonoperating revenues:				
Gain on disposal of assets	2,040,782	-	-	2,040,782
Investment income and other	134,713	-	-	134,713
Total nonoperating revenues	2,175,495	-	-	2,175,495
Excess of expenses over revenue	(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 (deficit) at beginning of year	22,243,085	(324,394)	-	21,918,691
Net assets (deficit) 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.