CENTERSTONE OF KENTUCKY, INC.

Consolidated Financial Statements

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

LBMC MAKE A GOOD BUSINESS BETTER

CENTERSTONE OF KENTUCKY, INC.

Table of Contents

INDEPENDENT AUDITORS' REPORT

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

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Centerstone of Kentucky, Inc. and its subsidiaries (the "Corporation"), which comprise the consolidated statements of financial position as of June 30, 2019 and 2018, the related consolidated statements of activities and changes in net assets, cash flows and functional expenses 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 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 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, 2019 and 2018, and the changes in their net assets, their cash flows and their functional expenses 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, cash flows and functional expenses of the Corporation. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report (as part of Centerstone of America, Inc.'s Consolidated Single Audit report) dated December 11, 2019 on our consideration of Centerstone of America, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Centerstone of America, Inc.'s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Centerstone of America, Inc.'s internal control over financial reporting and compliance.

LBMC, PC

Brentwood, Tennessee
December 11, 2019

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Financial Position

June 30, 2019 and 2018

	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	$ 2,996,024	$ 1,664,815
Investments	4,119,993	5,043,522
Accounts receivable, net	3,928,356	5,615,288
Other receivables	4,368,355	1,663,750
Prepaid expenses and other current assets	1,059,176	1,153,539
Total current assets	16,471,904	15,140,914
Property and equipment, net	9,158,130	11,268,501
Other assets, net	1,747,500	1,897,333
Total assets	$ 27,377,534	$ 28,306,748
Liabilities and Net Assets		
Current liabilities:		
Current portion of long-term debt	$ 736,252	$ 707,561
Accounts payable and accrued expenses	4,825,577	4,730,825
Due to affiliated entities	1,296,366	1,243,568
Accrued payroll, benefits and taxes	5,802,061	3,815,983
Total current liabilities	12,660,256	10,497,937
Long-term debt, net of current portion	1,423,627	2,159,879
Total liabilities	14,083,883	12,657,816
Net assets:		
Without donor restrictions	11,211,712	13,327,977
With donor restrictions	2,081,939	2,320,955
Total net assets	13,293,651	15,648,932
Total liabilities and net assets	$ 27,377,534	$ 28,306,748

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, 2019 and 2018

	2019	2018
Revenue and other support:		
Net client service revenue	$ 59,526,378	$ 60,419,473
Provision for bad debts	(896,676)	(3,877,480)
Net client service revenue less provision for bad debts	58,629,702	56,541,993
Public support	41,525,760	39,056,133
Rental income	341,935	222,262
Other operating revenue	1,132,151	1,788,069
Total revenue and other support	101,629,548	97,608,457
Expenses:		
Salary and fringe benefits	71,981,992	71,188,215
Professional fees	4,076,519	3,716,320
Facilities	4,464,688	4,020,999
Equipment	652,968	471,267
Depreciation and amortization	1,159,213	1,428,212
Travel and transportation	1,194,704	1,263,808
Supplies	1,144,448	1,225,946
Communications	725,006	906,785
Affiliated management fees	14,513,068	12,980,015
Interest	104,336	134,781
Miscellaneous	4,259,104	4,544,189
Total expenses	104,276,046	101,880,537
Operating loss	(2,646,498)	(4,272,080)
Nonoperating revenues:		
Gain on disposal of assets	38,850	51,833
Investment income and other	216,795	208,679
Total nonoperating revenues	255,645	260,512
Excess of expenses over revenues	(2,390,853)	(4,011,568)
Other changes in net assets without donor restrictions -		
net assets released from restrictions	274,588	374,610
Change in net assets without donor restrictions	(2,116,265)	(3,636,958)
Change in net assets with donor restrictions:		
Restricted grant revenue	35,572	188,426
Contributed rent revenue	-	22,356
Net assets released from restriction	(274,588)	(374,610)
Change in net assets with donor restrictions	(239,016)	(163,828)
Change in net assets	(2,355,281)	(3,800,786)
Net assets at beginning of year	15,648,932	19,449,718
Net assets at end of year	$ 13,293,651	$ 15,648,932

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statements of Cash Flows

Years ended June 30, 2019 and 2018

	2019	2018
Operating activities:		
Change in net assets	$ (2,355,281)	$ (3,800,786)
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Gain on disposal of assets	(38,850)	(51,833)
Depreciation and amortization	1,159,213	1,428,212
Affiliated management fees related to property and equipment	1,251,989	486,709
Provision for bad debts	896,676	3,877,480
Investment income	(76,471)	(50,241)
Changes in operating assets and liabilities		
Accounts receivable, net	790,256	(3,115,535)
Due to/from affiliates	52,798	70,918
Other receivables	(2,704,605)	(435,349)
Prepaid expenses and other assets	244,196	191,401
Accounts payable and accrued expenses	94,752	68,002
Accrued payroll, benefits and taxes	1,986,078	368,581
Net cash provided (used) by operating activities	1,300,751	(962,441)
Investing activities:		
Purchase of property and equipment	(301,981)	(570,330)
Proceeds from the sale of property and equipment	40,000	71,903
Proceeds from the sale or maturity of investments	1,500,000	1,000,678
Purchases of investments	(500,000)	-
Net cash provided by investing activities	738,019	502,251
Financing activities:		
Proceeds from line of credit	750,000	-
Repayments on line of credit	(750,000)	-
Principal payments on long-term debt	(707,561)	(679,891)
Net cash used by financing activities	(707,561)	(679,891)
Increase (decrease) in cash and cash equivalents	1,331,209	(1,140,081)
Cash and cash equivalents at beginning of year	1,664,815	2,804,896
Cash and cash equivalents at end of year	$ 2,996,024	$ 1,664,815
Supplemental cash flows information		
Cash paid for interest	$ 118,957	$ 136,912

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statement of Functional Expenses

Year ended June 30, 2019

	Mental Health	Developmental Disabilities	Substance Abuse	Trust and Agency	Centerstone Learning, Inc.	Total Program Services	Management and General	Fund-Raising	Total
Salary and fringe benefits	$ 41,552,866	$ 6,931,230	$ 8,496,436	$ 13,754,938	$ 161,829	$ 70,897,299	$ 1,064,303	$ 20,390	$ 71,981,992
Professional fees	969,310	2,040,063	514,620	20,835	1,138	3,545,966	530,553	-	4,076,519
Facilities	2,438,496	95,620	1,540,068	-	30,100	4,104,284	360,404	-	4,464,688
Equipment	383,018	73,671	128,007	(341)	-	584,355	68,613	-	652,968
Depreciation and amortization	688,532	118,349	237,318	-	4,833	1,049,032	109,958	223	1,159,213
Travel and transportation	701,749	242,631	197,309	2,523	4,723	1,148,935	45,769	-	1,194,704
Supplies	366,362	39,135	700,336	22	19,742	1,125,597	18,829	22	1,144,448
Communications	455,833	93,687	108,265	53	3,588	661,426	63,580	-	725,006
Affiliated management fees	-	-	-	-	-	-	14,124,276	388,792	14,513,068
Interest	41,240	4,906	9,388	-	-	55,534	48,802	-	104,336
Computer Hardware and Software	55,018	794	4,093	-	-	59,905	7,685	-	67,590
Miscellaneous	571,661	404,488	2,309,806	73,466	88,017	3,447,438	742,554	1,522	4,191,514
Total expenses	$ 48,224,085	$ 10,044,574	$ 14,245,646	$ 13,851,496	$ 313,970	$ 86,679,771	$ 17,185,326	$ 410,949	$ 104,276,046

See accompanying notes to the consolidated financial statements.

CENTERSTONE OF KENTUCKY, INC.

Consolidated Statement of Functional Expenses

Year ended June 30, 2018

	Mental Health	Developmental Disabilities	Substance Abuse	Trust and Agency	Centerstone Learning, Inc.	Total Program Services	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 notes to the consolidated financial statements.

(1) Nature of operations

(a) Organization

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. (collectively "Seven Counties Services") 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.

On October 31, 2019, the Corporation entered into an agreement to disaffiliate from Centerstone of America, Inc. by June 30, 2020. The Corporation will pay residual costs related to the disaffiliation to Centerstone of America, Inc. beginning on July 1, 2020. Management of the Corporation and Centerstone of America, Inc. are still determining the amount of those residual costs.

(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.

Effective June 2019, Centerstone of Kentucky, Inc. sold Centerstone Learning, Inc. Centerstone of Kentucky, Inc. was the sole member of Centerstone Learning, Inc. Centerstone Learning, Inc. provided cognitive training to children and others with academic difficulties and utilized 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:

Net assets without donor restrictions - Net assets that are not restricted by donor-imposed restrictions and available to support operations. The only limits on the use of net assets without donor restrictions 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.

Net assets with donor restrictions - Net assets resulting from contributions and other inflows of net assets whose use by the Corporation is limited by donor-imposed restrictions. These include net assets with donor restrictions, some of which may or will be met either by action of the Corporation and/or passage of time. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of activities and changes in net assets as net assets released from restrictions. These also include net assets with donor restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Corporation. Net assets with donor restrictions at June 30, 2019 and 2018 represent pledges receivable, donor-restricted funds designated for various programs offered by the Corporation, and contributed rent.

(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) Investments

Investments include certificates of deposits and cash and cash equivalents. Certificates of deposit (regardless of original maturity) are recorded at fair value in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 820, *Fair Value Measurement*. Interest income is accounted for in accordance with donor restrictions or, in the absence of specific donor restrictions, as without donor restrictions.

Fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, fair value accounting standards establish a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity including quoted market prices in active markets for identical assets (Level 1), or significant other observable inputs (Level 2) and the reporting entity's own assumptions about market participant assumptions (Level 3). As of June 30, 2019 and 2018, the Corporation has approximately $2,002,000 and $2,739,000, respectively, in certificates of deposit which would be classified as Level 2 under the hierarchy above. The Corporation does not have any fair value measurements using significant unobservable inputs (Level 3) as of June 30, 2019 or 2018. The Corporation also has approximately $1,929,000 and $2,107,000 as of June 30, 2019 and 2018, respectively, in a bank deposit program, and $189,000 and $198,000 as of June 30, 2019 and 2018, respectively, in outside foundations that are not included in the fair value hierarchy.

(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, 2019 and 2018 were $538,670 and $813,596, 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 without donor restrictions, 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 with donor restrictions. 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 $1,812,500 and $1,957,500 at June 30, 2019 and 2018, 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 $4,562,000 and $4,407,000 for the years ended June 30, 2019 and 2018, respectively.

Of the Corporation's total unrestricted operating expense reported pertaining to the entities providing client care, an estimated $3,051,000 and $3,360,000 arose from providing services to charity clients during the years ended June 30, 2019 and 2018, 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 2019 and 2018, 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 revenue without donor restrictions or revenue with donor restrictions 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, net assets with donor restrictions are reclassified to net assets without donor restrictions 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 support without donor restrictions.

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 $117,000 and $152,000 for 2019 and 2018, 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, 2019 and 2018, 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, 2018.

(p) Performance indicator and operating indicator

The consolidated statements of activities and changes in net assets include a performance indicator, excess of expenses over revenues. Changes in net assets without restrictions 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) Recently adopted accounting pronouncement

In August 2016, the FASB issued Accounting Standards Update ("ASU") 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities,* to improve the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance and cash flows. The Corporation adopted this ASU for the fiscal year ended June 30, 2019 and has applied the provisions retrospectively.

(r) New accounting pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), which will eliminate the transaction and industry-specific revenue recognition guidance under current GAAP and replace it with a principles-based approach. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principle of the guidance in ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The five step model defined by ASU 2014-09 requires the entity to: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The FASB has also issued several ASUs to provide entities further clarity on the application of ASU 2014-09. ASU 2014-09 additionally enhances the required disclosures surrounding the nature, amount, timing and uncertainty of revenues and the associated cash flows. ASU 2014-09 may be applied retrospectively to each period (full retrospective) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective). ASU 2014-09, as amended, is effective beginning July 1, 2019 and management of the Corporation is currently evaluating the impact adoption will have on its financial statements and disclosures.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* ("ASU 2018-08"). ASU 2018-08 is intended to clarify (1) when transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of contribution accounting guidance, or as exchange (reciprocal) transactions subject to other guidance, and (2) determining whether a contribution is conditional. ASU 2018-08 is effective beginning July 1, 2019 and management of the Corporation is currently evaluating the impact adoption will have on its financial statements and disclosures.

(s) 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.

(t) Reclassifications

Certain information from 2018 has been reclassified to conform to the 2019 presentation. There is no effect on the consolidated change in net assets as a result of these reclassifications.

(v) Functional expenses

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Corporation. Therefore, expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include salaries and fringe benefits, professional fees, facilities, equipment, depreciation and amortization, travel and transportation, supplies, communications, interest, and miscellaneous expenses. Other than depreciation and amortization, these costs are allocated based on management's estimates of time and effort involved for each program or supporting function. Depreciation and amortization expense is allocated based on management's assessment of administrative square footage used as a percent of the total facility's square footage.

(u) Events occurring after reporting date

The Corporation has evaluated events and transactions that occurred between June 30, 2019 and December 11, 2019 which is the date that the consolidated financial statements were available to be issued, for possible recognition or disclosure in the consolidated financial statements. See footnote 1(b).

(3) Concentrations of credit risk

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

	Receivables		Revenue	
	2019	2018	2019	2018
Medicare	2 %	2 %	2 %	2 %
Medicaid	89 %	87 %	95 %	93 %
Self-pay	5 %	6 %	2 %	2 %
Other third-party payors	4 %	5 %	1 %	3 %
	100 %	100 %	100 %	100 %

(4) Property and equipment

A summary of property and equipment as of June 30, 2019 and 2018 is as follows:

	2019	2018
Land	$ 1,434,900	$ 1,434,900
Buildings and improvements	11,520,973	16,582,617
Furnishings, equipment and vehicles	5,324,263	26,449,753
Construction in progress	45,000	-
	18,325,136	44,467,270
Accumulated depreciation and amortization	(9,167,006)	(33,198,769)
	$ 9,158,130	$ 11,268,501

As of June 30, 2019, the Corporation has commitments for various property and equipment renovations that approximate $75,000 and are expected to be completed in 2020.

(5) Liquidity and availability

The Corporation regularly monitors liquidity required to meet its operating needs and other commitments, while also striving to maximize the investment of its available funds. As part of the Corporation's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due.

Financial assets available for general expenditures within one year of the statement of financial position are as follows:

Cash and cash equivalents	$ 2,996,024
Investments	3,930,847
Accounts receivable, net	3,928,356
Other receivables	2,873,552
	$ 13,728,779

None of the above assets are subject to donor or other restrictions. Investments excludes approximately $189,000 related to investment in outside foundations. Other receivables excludes approximately $1,494,000 which are related to certain grants received by the Corporation. The Corporation also has a $2,000,000 line of credit that could be utilized. The line of credit matures November 19, 2019 (see Note 6).

(6) Long-term debt

A summary of long-term debt as of June 30, 2019 and 2018 is as follows:

	2019	2018
Note payable to Republic Bank in monthly installments of $63,113 including interest at 3.85% through October 3, 2021	$ 1,686,262	$ 2,363,400
Note payable to landlord in monthly installments of $4,494 including interest at 7.00% through July 1, 2029	387,064	412,909
Other note payable	86,553	91,131
Total long-term debt	2,159,879	2,867,440
Less current portion	736,252	707,561
Long-term debt, excluding current portion	$ 1,423,627	$ 2,159,879

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 with the final installment due in October 2021. The loan is secured by certain real and personal property.

In November 2018, the Corporation entered into a revolving line-of-credit in the amount of $2,000,000, secured by substantially all assets. The line-of-credit matures in November 2019. There were no borrowings outstanding as of June 30, 2019.

Aggregate annual maturities of long-term debt as of June 30, 2019 is as follows:

Year	Amount
2020	$ 736,252
2021	766,255
2022	286,866
2023	38,786
2024	41,286
2025 and later years	290,434
	$ 2,159,879

(7) Net assets

The net assets with donor restrictions are available for the following purposes as of June 30, 2019 and 2018:

	2019	2018
Contributed rent	$ 1,812,500	$ 1,957,500
Other	269,439	363,455
	$ 2,081,939	$ 2,320,955

The contributed rent is subject to time restrictions. For the years ended June 30, 2019 and 2018, $145,000 and $196,523, respectively, was released from restrictions related to contributed rent. Other net assets with donor restrictions are subject to specific purpose and for the years ended June 30, 2019 and 2018, $129,588 and $178,087, respectively, was released from restrictions.

(8) 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 2019 and 2018:

	2019	2018
Gross client service revenue	$ 148,617,887	$ 117,155,560
Less deductions		
Contractuals	(89,091,509)	(56,736,087)
Net client service revenue	59,526,378	60,419,473
Less provision for bad debt	(896,676)	(3,877,480)
Net client service revenue less provision for bad debt	$ 58,629,702	$ 56,541,993

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.

(9) Public support

The composition of public support during 2019 and 2018 is set forth in the following table.

	2019	2018
Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities	$ 17,362,339	$ 17,224,071
Louisville Metro Government	1,277,717	979,770
Other state funds	21,091,835	20,052,884
Federal funds	1,575,410	703,366
Other public support	218,459	96,042
	$ 41,525,760	$ 39,056,133

(10) Defined contribution plan

The Corporation has a 403(b) defined contribution plan (the "Plan"). Contributions are made to employees who meet the eligibility requirements. Prior to January 1, 2019, the Corporation matched up to 4% of the participating employees' compensation. Effective January 1, 2019, the Corporation matches up to 3% of the participating employees' compensation Employer contributions to the Plan were approximately $1,700,000 and $1,474,000 for 2019 and 2018, respectively.

(11) 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, 2019 and 2018. For the years ended June 30, 2019 and 2018, the Corporation incurred affiliated management fees for services provided by its Parent which include finance, payroll, human resources, marketing, executive support, and other supporting services.

The Corporation entered into a management services agreement and employee leasing agreement (the "agreements") with a nonprofit corporation effective July 1, 2018 and January 1, 2019, respectively. The Corporation received a management fee of $500 each month which is included in other revenue on the consolidated statement of activities and changes in net assets. As of June 30, 2019, the Corporation has approximately $164,000 due from the nonprofit corporation which is included in other receivables on the consolidated statement of financial position. The Corporation is reimbursed for direct expense incurred related to salaries and benefits per the agreements. These expenses and reimbursements are reported at net on the consolidated statements of activities and changes in net assets. The agreements terminated on July 1, 2019.

(12) Commitments and contingencies

Operating Leases

The Corporation has several non-cancelable operating leases for facilities and equipment through 2029. Total rent expense was approximately $2,834,000 and $2,861,000 for the years ended June 30, 2019 and 2018, respectively, which includes the fair market value of the donated lease of CARC from Louisville Metro Government of $312,072 and $609,215 for the years ended June 30, 2019 and 2018, respectively.

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

2020	$ 2,254,000
2021	1,767,000
2022	1,755,000
2023	1,613,000
2024	1,378,000
2025 and later years	4,404,000
Total minimum lease payments	$ 13,171,000

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 $571,000 and $261,000 at June 30, 2019 and 2018, 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 and no annual aggregate.

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.

Litigation - Kentucky Employee Retirement System

On April 4, 2013, Seven Counties Services filed a petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court and filed a motion to terminate participation in Kentucky Employee Retirement System ("KERS"). Seven Counties Services' liability to KERS, which was in existence prior to filing for bankruptcy under Chapter 11 was stayed while the Seven Counties Services continued business operations.

In May of 2014, the Court ruled that Seven Counties Services had legal standing to seek relief under Chapter 11 and withdraw from KERS, and Seven Counties Services officially emerged from bankruptcy in February of 2015.

Various motions were filed related to the April 4, 2013 and April 5, 2013 filings, and the court ruled, following an evidentiary hearing, that KERS was not entitled to injunctive relief to compel Seven Counties Services to continue making reports and employer and employee contributions into the KERS plan. KERS appealed the court's ruling allowing relief under Chapter 11 to the United States Sixth Circuit Court of Appeals.

Following briefing and argument, the Court of Appeals affirmed that Seven Counties Services was eligible to seek relief under Chapter 11 of the Bankruptcy Code. It certified to the Kentucky Supreme Court the question of whether Seven Counties Services' participation in, and contributions to, KERS were based on a statutory obligation. On August 29, 2019, the Kentucky Supreme Court issued an opinion stating that Seven Counties Services' participation in KERS was statutory in nature.

The case has now returned to the United States Court of Appeals for the Sixth Circuit, which asked for supplemental briefing on the effect of the Kentucky Supreme Court’s decision on KERS’s pending appeal and Seven Counties’ pending cross-appeal. The Sixth Circuit has not made a final ruling and proceedings are ongoing.

Seven Counties Services has and continues to take the position that it owes KERS nothing and believes it has meritorious claims and arguments to support this position. However, at this time it cannot be determined how this matter will be resolved.

Health care 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.

Health care 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 as 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.