

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

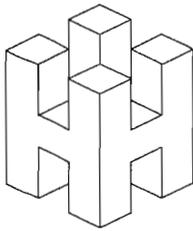
INDEPENDENT AUDITORS' REPORT

JUNE 30, 2007 AND 2006

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HENJES, CONNER &
WILLIAMS, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

800 FRANCES BUILDING
505 FIFTH STREET
P.O. BOX 1528
SIOUX CITY, IOWA 51102

PH. (712) 277-3931
(800) 274-3931
FAX (712) 233-3431

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Capstone Behavioral Healthcare, Inc.
Newton, Iowa

We have audited the accompanying statements of financial position of CAPSTONE BEHAVIORAL HEALTHCARE, INC. (a nonprofit organization) as of June 30, 2007 and 2006, and the related statements of activities, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Capstone Behavioral Healthcare, Inc. as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information on page 13 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Henjes, Conner, & Williams, PC
Certified Public Accountants

Sioux City, Iowa
September 25, 2007

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2007 AND 2006

ASSETS

	<u>2007</u>	<u>2006</u>
<u>CURRENT ASSETS</u>		
Cash and Cash Equivalents	\$ 109,201	\$ 277,305
Accounts Receivable - Trade (Net of Allowances of \$300,056 and \$133,764, for 2007 and 2006 Respectively)	290,958	258,440
Accounts Receivable - Related Party - Note 2 ..	886	-
Prepaid Expenses	<u>400</u>	<u>-</u>
Total Current Assets	\$ <u>401,445</u>	\$ <u>535,745</u>
Total Assets	\$ <u>401,445</u>	\$ <u>535,745</u>

LIABILITIES AND NET ASSETS

<u>CURRENT LIABILITIES</u>		
Accounts Payable - Trade	\$ 12,633	\$ 3,146
Accounts Payable - Adult Rehab Option Adjustment..	16,162	77,169
Accrued Vacation Payable	50,248	48,732
Accrued Wages	43,314	60,363
Payroll Taxes Payable	630	-
Other Payable	<u>6,168</u>	<u>-</u>
Total Current Liabilities	\$ 129,155	\$ 189,410
<u>LONG-TERM LIABILITIES</u>		
Due to Related Party - Note 2	<u>195,000</u>	<u>-</u>
Total Liabilities	\$ 324,155	-
<u>NET ASSETS</u>		
Unrestricted	\$ <u>77,290</u>	\$ <u>346,335</u>
Total Liabilities and Net Assets	\$ <u>401,445</u>	\$ <u>535,745</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

<u>PUBLIC SUPPORT, FEES, AND OTHER REVENUE</u>	<u>2007</u> <u>Unrestricted</u>	<u>2006</u> <u>Unrestricted</u>
Public Support:		
Capstone Community Foundation - Note 2	\$ 9,321	\$ 26,170
Fees from Governmental Agencies:		
County Revenue:		
Chemical Dependency	23,252	33,695
Mental Health	228,695	286,581
Community Based Services	98,924	76,790
Residential	52,063	41,840
Contracted Support Service	2,771	-
Adult Rehab Option Revenue	339,017	445,863
Iowa Department of Public Health	389,079	333,224
Community Support Program - Adult	16,273	15,407
Community Support Program - Children	16,566	16,484
School Contracts	42,467	43,190
Patient Fees	1,150,409	1,242,348
Adjustment for Managed Care and Charity Care ..	(353,466)	(455,803)
Other Revenue:		
Interest Income	-	1,848
Dividend Income	-	928
Miscellaneous Revenue	46,462	60,121
Total Public Support, Fees, and Other Revenue	\$ 2,061,833	\$ 2,168,686
 <u>EXPENSES</u>		
Program Services:		
Chemical Dependency	\$ 460,096	\$ 441,551
Mental Health	876,083	855,661
Substance Abuse Prevention	101,756	97,332
Community Based Services	263,227	269,946
Residential	312,776	336,017
Total Program Services	\$ 2,013,938	\$ 2,000,507
Supporting Services:		
Management and General	316,940	309,945
Total Expenses	\$ 2,330,878	\$ 2,310,452
(Decrease) in Net Assets	\$(269,045)	\$(141,766)
Net Assets at Beginning of Year	346,335	488,101
Net Assets at End of Year	\$ 77,290	\$ 346,335

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2007

	<u>Rehabilitation Program Services</u>			
	<u>Chemical</u>	<u>Mental</u>	<u>Substance</u>	<u>Community</u>
	<u>Dependency</u>	<u>Health</u>	<u>Abuse</u>	<u>Based</u>
			<u>Prevention</u>	<u>Services</u>
<u>SALARIES AND BENEFITS</u>				
Salaries	\$ 281,085	\$ 551,255	\$ 63,550	\$ 175,886
Payroll Taxes and Insurance	27,728	40,274	6,798	18,517
Group Benefits	24,370	29,578	10,034	22,953
Retirement Benefits	8,271	16,933	3,252	4,951
Medical Services	<u>2,854</u>	<u>151</u>	<u> </u>	<u>35</u>
 Total Salaries and Benefits	 \$ 344,308	 \$ 638,191	 \$ 83,634	 \$ 222,342
<u>OTHER EXPENSES</u>				
Professional Fees	\$ 4,280	\$ 4,902	\$ 412	\$ 1,014
Contract Service Payments .	4,469	10,189	1,261	2,604
Office Supplies and Expenses	7,870	11,575	1,278	4,401
Medical Supplies and Other Costs	1,268	597	2,650	903
Food Supplies				
Telephone	4,098	5,797	575	6,538
Postage and Shipping	1,543	2,472	499	971
Space Rent - Note 3	6,509	10,348	2,792	5,502
Building and Grounds	3,625	5,950	1,515	2,821
Utilities	1,205	1,978	541	1,000
Property and Liability Insurance	1,908	5,729	730	2,001
Mileage	3,327	3,926	2,723	5,602
Staff Development, Training and Recruitment	6,401	6,589	385	1,393
Meetings and Conferences .	26	3	15	3
Subscriptions and Publications	44	185	9	17
Membership Dues	777	3,799	284	183
Equipment Rent - Note 3 ..	6,506	11,499	2,268	5,228
Public Relations	989	1,412	181	695
Bank Fees	17	28	4	9
Bad Debts	60,662	150,944		
Miscellaneous	<u>264</u>	<u>(30)</u>	<u> </u>	<u> </u>
 Total Other Expenses	 \$ 115,788	 \$ 237,892	 \$ 18,122	 \$ 40,885
 Total Expenses ...	 \$ <u>460,096</u>	 \$ <u>876,083</u>	 \$ <u>101,756</u>	 \$ <u>263,227</u>

<u>Residential Program</u>	<u>Supporting Services Management and General</u>	<u>Total Expenses</u>
\$ 226,507	\$ 209,691	\$ 1,507,974
21,184	17,976	132,477
21,472	18,265	126,672
5,278	9,221	47,906
<u>161</u>	<u>2</u>	<u>3,203</u>
\$ 274,602	\$ 255,155	\$ 1,818,232
\$ 1,383	\$ 1,168	\$ 13,159
533	4,132	23,188
931	9,810	35,865
1,838	126	7,382
11,689		11,689
4,122	3,150	24,280
92	1,660	7,237
4,012	9,293	38,456
623	5,952	20,486
156	1,760	6,640
1,867	7,571	19,806
5,398	1,911	22,887
1,200	1,253	17,221
22	811	880
66	465	786
96	550	5,689
2,411	6,695	34,607
500	3,553	7,330
12	29	99
		211,606
<u>1,223</u>	<u>1,896</u>	<u>3,353</u>
\$ <u>38,174</u>	\$ <u>61,785</u>	\$ <u>512,646</u>
\$ <u>312,776</u>	\$ <u>316,940</u>	\$ <u>2,330,878</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2006

	<u>Rehabilitation Program Services</u>			
	<u>Chemical</u>	<u>Mental</u>	<u>Substance</u>	<u>Community</u>
	<u>Dependency</u>	<u>Health</u>	<u>Abuse</u>	<u>Based</u>
			<u>Prevention</u>	<u>Services</u>
<u>SALARIES AND BENEFITS</u>				
Salaries	\$ 244,214	\$ 421,606	\$ 60,641	\$ 186,700
Payroll Taxes and Insurance	25,358	43,371	6,377	18,372
Group Benefits	20,231	29,873	8,486	21,593
Retirement Benefits	7,540	8,469	2,927	6,786
Medical Services	<u>3,331</u>	<u>130,719</u>	<u> </u>	<u> </u>
Total Salaries and Benefits	\$ 300,674	\$ 634,038	\$ 78,431	\$ 233,451
<u>OTHER EXPENSES</u>				
Professional Fees	\$ 3,408	\$ 4,707	\$ 642	\$ 1,275
Contract Service Payments .	1,769	10,172	895	1,616
Office Supplies and Expenses	7,621	13,858	1,589	4,999
Medical Supplies and Other Costs	1,396	2,816	2,513	303
Food Supplies				
Telephone	3,518	4,850	484	5,708
Postage and Shipping	1,571	2,673	443	873
Space Rent - Note 3	5,810	10,829	2,792	5,403
Building and Grounds	3,925	7,566	2,058	3,700
Utilities	1,062	2,049	549	982
Property and Liability Insurance	2,255	12,148	718	1,962
Mileage	3,226	4,171	2,998	4,175
Staff Development, Training and Recruitment	1,042	20,834	419	418
Meetings and Conferences .	57	39	23	
Subscriptions and Publications	84	178	12	29
Membership Dues	894	485	230	
Equipment Rent - Note 3 ..	4,696	10,180	2,180	4,390
Public Relations	934	1,058	248	408
Bank Fees	371	768	108	254
Bad Debts	97,162	112,242		
Miscellaneous	<u>76</u>	<u> </u>	<u> </u>	<u> </u>
Total Other Expenses	\$ 140,877	\$ 221,623	\$ 18,901	\$ 36,495
Total Expenses ...	\$ <u>441,551</u>	\$ <u>855,661</u>	\$ <u>97,332</u>	\$ <u>269,946</u>

<u>Residential Program</u>	<u>Supporting Services Management and General</u>	<u>Total Expenses</u>
\$ 249,205	\$ 202,196	\$ 1,364,562
24,512	17,477	135,467
22,878	12,916	115,977
4,836	8,275	38,833
<u>116</u>	<u>25</u>	<u>134,191</u>
\$ 301,547	\$ 240,889	\$ 1,789,030
\$ 1,776	\$ 2,865	\$ 14,673
262	3,391	18,105
1,121	12,180	41,368
1,841	78	8,947
11,825		11,825
4,186	2,503	21,249
425	1,542	7,527
3,553	10,016	38,403
837	7,310	25,396
108	1,856	6,606
1,789	7,760	26,632
4,843	1,519	20,932
226	3,565	26,504
	406	525
48	327	678
	390	1,999
1,004	5,933	28,383
249	7,084	9,981
358	40	1,899
		209,404
<u>19</u>	<u>291</u>	<u>386</u>
\$ <u>34,470</u>	\$ <u>69,056</u>	\$ <u>521,422</u>
\$ <u>336,017</u>	\$ <u>309,945</u>	\$ <u>2,310,452</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

	<u>2007</u>	<u>2006</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Cash Received from Public Support	\$ 9,321	\$ 26,170
Cash Received from Operations	1,683,471	1,882,485
Cash Paid to Employees and Suppliers	(2,102,358)	(2,136,591)
Dividend Income	-	928
Interest Received	-	1,848
Miscellaneous Receipts	<u>46,462</u>	<u>60,121</u>
Net Cash (Used) by Operating Activities	\$(363,104)	\$(165,039)
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
Increase in Due to Related Party	\$ <u>195,000</u>	-
Net Cash Provided by Financing Activities	\$ <u>195,000</u>	-
Net (Decrease) in Cash and Cash Equivalents	\$(168,104)	\$(165,039)
Cash and Cash Equivalents at Beginning of Year ...	<u>277,305</u>	<u>442,344</u>
Cash and Cash Equivalents at End of Year	\$ <u>109,201</u>	\$ <u>277,305</u>
<u>RECONCILIATION OF CHANGE IN NET ASSETS</u>		
<u>TO NET CASH (USED) BY OPERATING ACTIVITIES:</u>		
Change in Net Assets	\$(269,045)	\$(141,766)
Adjustments to Reconcile Change in Net Assets to Net Cash (Used) by Operating Activities:		
Bad Debt Expense	\$ 211,606	\$ 209,404
(Increase) in Accounts Receivable	(244,124)	(278,365)
(Increase) Decrease in Accounts Receivable - Related Party	(886)	4,062
(Increase) in Prepaid Expenses	(400)	-
Increase (Decrease) in Accounts Payable - Trade	9,487	(12,511)
Increase (Decrease) in Accounts Payable - Adult Rehab Option Adjustment	(61,007)	77,169
Increase in Accrued Vacation Payable ..	1,516	64
(Decrease) in Accrued Wages	(17,049)	(11,751)
Increase (Decrease) in Payroll Taxes Payable	630	(10,345)
(Decrease) in Related Party Payable ...	-	(1,000)
Increase in Other Payable	<u>6,168</u>	-
Total Adjustments	\$(<u>94,059</u>)	\$(<u>23,273</u>)
Net Cash (Used) by Operating Activities	\$(<u>363,104</u>)	\$(<u>165,039</u>)

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

Note 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Capstone Behavioral Healthcare, Inc., a non-profit organization with offices in Newton, Pella, and Knoxville, Iowa, provides services to educate, evaluate, and treat persons who are in need of mental health care or substance abuse treatment and provides services to promote the prevention of mental illness and substance abuse.

Financial Statement Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Organization is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets) based upon the existence or absence of donor-imposed restrictions. The Organization only has unrestricted net assets.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Organization considers all highly liquid debt instruments with a maturity of three months or less to be cash equivalents.

Accounts Receivable and Allowances

The Organization's receivables are trade receivables due primarily from individuals, government agencies and Medicaid payors. The receivables are uncollateralized and are due in normal 30 to 60 day billing cycles. No interest or finance charges are collected on trade receivables. Management has included allowances for doubtful accounts and managed care contract adjustments in the calculation of the allowance. The allowance account is maintained at a balance which, in the opinion of management, is adequate to reflect accounts receivable at their net realizable value.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered. Charity care is provided on a sliding fee scale based on the patient's financial need.

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

Note 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(Cont.)

Tax Status

Capstone Behavioral Healthcare, Inc. has been granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. The Organization is exempt from the payment of Federal and state income taxes, as well as Federal unemployment taxes. The State of Iowa has determined that the Organization is exempt from Iowa corporate income tax and Iowa sales and use taxes.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Comparability of Statements

Certain items from prior year have been reclassified to enhance comparability with current year information.

Note 2 - RELATED PARTIES

Capstone Community Foundation is a separate non-profit corporation. It leases property and equipment and contributes funding to the Organization. Following, is a summary of transaction balances at June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Contributions from Capstone Community Foundation	\$ <u>9,321</u>	\$ <u>26,170</u>
Rents Paid for Property and Equipment	\$ <u>56,860</u>	\$ <u>51,646</u>
Due to Capstone Community Foundation .	\$ <u>195,000</u>	<u>-----</u>

Beacon Housing Corporation, a separate non-profit corporation, was incorporated November 12, 1991. It provides residential housing for individuals with disabilities through a HUD program. The two corporations are related by some common officers and trustees and operate toward a common cause. However, the members do not comprise a majority of either non-profit's board. Following is a summary of transaction balances at June 30, 2007 and 2006:

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

Note 2 - RELATED PARTIES
(Cont.)

	<u>2007</u>	<u>2006</u>
Management Fee Receivable from Beacon Housing Corporation	\$ <u>886</u>	<u>-</u>
Management Fee Revenue from Beacon Housing Corporation	\$ <u>6,805</u>	\$ <u>6,405</u>
Rents Paid to Beacon Housing Corporation	\$ <u>3,500</u>	\$ <u>3,000</u>

Management fee income is included in Miscellaneous Revenue on the Statements of Activities.

Note 3 - LEASES

Capstone Behavioral Healthcare, Inc. leases certain property and equipment from Capstone Community Foundation for use in its operations. The leases are classified as operating leases and have one-year terms renewable at the end of each year. The annual lease rate is based on Capstone Community Foundation's actual costs.

The Organization also leases an apartment from Beacon Housing Corporation (a related party) for use as an office; the lease is renewed annually. The Organization also has leases which are properly classified as operating leases for office space and equipment with unrelated third parties.

Lease expense amounted to \$73,063 and \$66,786 at June 30, 2007 and 2006, respectively. These amounts are included in the statements of functional expenses in space rent and equipment rent.

Note 4 - OFF-BALANCE SHEET RISK

At June 30, 2007 and 2006, and at times during the years, the Organization had total bank balances greater than \$100,000 per bank. The banks have FDIC insurance that insures depositor's accounts up to \$100,000. The Organization has exposure on any amount that exceeds \$100,000, should any of these financial institutions fail.

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

Note 5 - ECONOMIC DEPENDENCY

The Organization receives substantially all of its revenue from contracts with Jasper and Marion Counties and the Iowa Department of Public Health. The Organization's ability to continue operating in the absence of those contracts has not been determined.

Note 6 - RETIREMENT PLAN

The Organization established a 403(B) Plan for all full-time employees. The Organization matches 100% of the first 5% of salary deferred by the participant. The Organization contributed \$47,906 and \$38,833 to the Plan in the years ended June 30, 2007 and 2006, respectively.

SUPPLEMENTARY INFORMATION

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

SCHEDULE I - ANALYSIS OF COUNTY REVENUE

FOR THE YEAR ENDED JUNE 30, 2007

	<u>Jasper County</u>	<u>Marion County</u>	<u>Other Counties</u>	<u>Total</u>
Chemical Dependency		\$ 23,252		\$ 23,252
Mental Health	\$ 193,812	34,883		228,695
Community Based Services	78,760	13,224	\$ 6,940	98,924
Residential	31,895		20,168	52,063
Contracted Support Service		<u>2,771</u>		<u>2,771</u>
Total County Revenue	\$ <u>304,467</u>	\$ <u>74,130</u>	\$ <u>27,108</u>	\$ <u>405,705</u>

FOR THE YEAR ENDED JUNE 30, 2006

	<u>Jasper County</u>	<u>Marion County</u>	<u>Other Counties</u>	<u>Total</u>
Chemical Dependency	\$ 10,695	\$ 23,000		\$ 33,695
Mental Health	245,276	41,305		286,581
Community Based Services	58,848	11,338	\$ 6,604	76,790
Residential	<u>26,996</u>		<u>14,844</u>	<u>41,840</u>
Total County Revenue	\$ <u>341,815</u>	\$ <u>75,643</u>	\$ <u>21,448</u>	\$ <u>438,906</u>