CAPSTONE BEHAVIORAL HEALTHCARE, INC.

INDEPENDENT AUDITORS' REPORT

JUNE 30, 2009 AND 2008

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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 corporation) as of June 30, 2009 and 2008, 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, 2009 and 2008, 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 12 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, P.C.
Certified Public Accountants

Sioux City, Iowa
October 6, 2009

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2009 AND 2008

ASSETS

	2009	2008
CURRENT ASSETS		
Cash and Cash Equivalents	$ 32,281	$ 37,986
Accounts Receivable - Trade (Net of Allowances of $198,149 and $257,780, for 2009 and 2008 Respectively)	608,094	268,450
Accounts Receivable - Related Party - Note 2	560	-
Prepaid Expenses	26,561	7,518
Total Current Assets	$ 667,496	$ 313,954
Total Assets	$ 667,496	$ 313,954

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES		
Accounts Payable - Trade	$ 107,236	$ 71,470
Due to Related Party - Note 2	6,291	351
Accrued Vacation Payable	56,809	56,287
Accrued Wages	10,142	59,643
Payroll Taxes Payable	15,433	-
Total Current Liabilities	$ 195,911	$ 187,751
LONG-TERM LIABILITIES		
Due to Related Party – Note 2	295,744	376,244
Total Liabilities	$ 491,655	$ 563,995
NET ASSETS		
Unrestricted	175,841	(250,041)
Total Liabilities and Net Assets	$ 667,496	$ 313,954

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

PUBLIC SUPPORT, FEES, AND OTHER REVENUE	2009 Unrestricted	2008 Unrestricted
Public Support:		
Capstone Community Foundation - Note 2	-	$ 1,257
Fees from Governmental Agencies:		
County Revenue:		
Substance Abuse Prevention	$ 38,860	40,000
Chemical Dependency	38,171	32,092
Mental Health	222,571	136,328
Community Based Services	85,955	89,064
Residential	5,373	53,750
Adult Rehab Option Revenue	525,434	391,172
Iowa Department of Public Health	338,290	323,009
Community Support Program - Adult	-	7,237
Community Support Program - Children	736	5,270
School Contracts	4,669	-
Patient Fees	1,346,102	1,027,680
2007 Patient Fees Recognized as Revenue in Current Year - Note 7	225,444	-
2008 Patient Fees Recognized as Revenue in Current Year - Note 7	219,940	-
Adjustment for Managed Care and Charity Care	(417,337)	(304,988)
Other Revenue:		
Miscellaneous Revenue	27,937	54,543
Total Public Support, Fees, and Other Revenue	$ 2,662,145	$ 1,856,414
EXPENSES		
Program Services:		
Chemical Dependency	$ 380,672	$ 402,658
Mental Health	926,693	836,453
Substance Abuse Prevention	103,584	95,450
Community Based Services	226,965	239,759
Residential	292,857	315,740
Total Program Services	$ 1,930,771	$ 1,890,060
Supporting Services:		
Management and General	305,492	293,685
Total Expenses	$ 2,236,263	$ 2,183,745
Increase (Decrease) in Net Assets	$ 425,882	$(327,331)
Net Assets at Beginning of Year	(250,041)	77,290
Net Assets at End of Year	$ 175,841	$(250,041)

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2009

	Rehabilitation Program Services			
	Chemical Dependency	Mental Health	Substance Abuse Prevention	Community Based Services
SALARIES AND BENEFITS				
Salaries	$ 221,082	$ 612,177	$ 68,602	$ 155,257
Payroll Taxes and Insurance	26,167	42,507	8,529	20,420
Group Benefits	10,941	44,330	10,368	11,199
Retirement Benefits	1,596	16,241	2,549	3,950
Medical Services	6,018	83		
Total Salaries and Benefits	$ 265,804	$ 715,338	$ 90,048	$ 190,826
OTHER EXPENSES				
Professional Fees				
Contract Service Payments	$ 822	$ 18,555		$ 218
Office Supplies and Expenses	14,076	26,798	$ 3,207	9,978
Medical Supplies and Other Costs	67	1,872	1,931	609
Food Supplies				
Telephone	3,774	5,850	539	3,103
Postage and Shipping	1,211	2,383	303	815
Space Rent - Note 3	11,892	18,179	1,626	4,750
Building and Grounds	5,983	8,689	719	2,596
Utilities	1,478	1,711	221	591
Property and Liability Insurance	2,966	7,698	637	1,701
Mileage	476	5,290	2,645	6,712
Staff Development, Training and Recruitment	420	7,499	445	
Meetings and Conferences	354	592	135	334
Subscriptions and Publications	12	272	12	12
Membership Dues	275	504	100	
Equipment Rent - Note 3	9,756	13,744	1,016	4,285
Public Relations	449	417		60
Bad Debts	60,857	92,817		
Miscellaneous		(1,515)		375
Total Other Expenses	$ 114,868	$ 211,355	$ 13,536	$ 36,139
Total Expenses	$ 380,672	$ 926,693	$ 103,584	$ 226,965

Residential Program	Supporting Services Management and General	Total Expenses
$ 194,974	$ 166,514	$ 1,418,606
25,424	20,427	143,474
11,917	30,998	119,753
3,139	3,014	30,489
95	126	6,322
$ 235,549	$ 221,079	$ 1,718,644
	$ 20,536	$ 20,536
	15,599	35,194
$ 10,581	10,519	75,159
2,283	61	6,823
13,571		13,571
5,082	3,981	22,329
914	786	6,412
9,108	5,331	50,886
2,502	2,245	22,734
668	2,295	6,964
1,923	1,799	16,724
7,296	2,580	24,999
146	3,544	12,054
73	1,867	3,355
	3,687	3,995
	265	1,144
3,161	5,989	37,951
	2,957	3,883
		153,674
	372	(768)
$ 57,308	$ 84,413	$ 517,619
$ 292,857	$ 305,492	$ 2,236,263

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2008

	Rehabilitation Program Services			
	Chemical Dependency	Mental Health	Substance Abuse Prevention	Community Based Services
SALARIES AND BENEFITS				
Salaries	$ 252,648	$ 588,841	$ 65,372	$ 166,981
Payroll Taxes and Insurance	24,860	55,637	6,271	16,108
Group Benefits	17,619	37,587	7,221	15,526
Retirement Benefits	6,699	11,786	3,105	4,556
Medical Services	9,416	47	-	7
Total Salaries and Benefits	$ 311,242	$ 693,898	$ 81,969	$ 203,178
OTHER EXPENSES				
Professional Fees	$ 2,386	$ 3,735	$ 417	$ 1,114
Contract Service Payments	4,680	17,405	557	1,953
Office Supplies and Expenses	6,381	10,653	587	3,889
Medical Supplies and Other Costs	796	1,354	3,087	(77)
Food Supplies				
Telephone	3,739	5,494	402	5,537
Postage and Shipping	1,231	2,218	271	698
Space Rent – Note 3	7,258	12,973	1,888	4,920
Building and Grounds	4,548	7,389	878	3,507
Utilities	1,162	2,308	330	840
Property and Liability Insurance	2,685	7,417	695	1,856
Mileage	2,297	5,209	2,936	5,689
Staff Development, Training and Recruitment	1,361	7,292	290	2,333
Meetings and Conferences	13		16	
Subscriptions and Publications	105	120		
Membership Dues	1,350	387	100	38
Equipment Rent - Note 3	5,956	9,752	1,027	4,222
Public Relations	448	582		49
Bank Fees	5	5		
Bad Debts	44,719	47,964		
Miscellaneous	296	298		13
Total Other Expenses	$ 91,416	$ 142,555	$ 13,481	$ 36,581
Total Expenses	$ 402,658	$ 836,453	$ 95,450	$ 239,759

Residential Program	Supporting Services Management and General	Total Expenses
$ 222,311	$ 190,906	$ 1,487,059
22,376	26,115	151,367
16,965	18,757	113,675
6,184	8,595	40,925
82		9,552
$ 267,918	$ 244,373	$ 1,802,578
$ 1,260	$ 1,425	$ 10,337
2,001	4,109	30,705
2,537	2,764	26,811
1,166	40	6,366
12,218		12,218
4,959	2,208	22,339
587	867	5,872
7,932	6,366	41,337
1,948	3,269	21,539
823	959	6,422
2,083	6,109	20,845
5,312	2,474	23,917
1,686	8,800	21,762
	772	801
	116	341
38	30	1,943
3,272	3,647	27,876
	2,947	4,026
	31	41
		92,683
	2,379	2,986
$ 47,822	$ 49,312	$ 381,167
$ 315,740	$ 293,685	$ 2,183,745

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Public Support	-	$ 1,257
Cash Received from Operations	$ 2,121,287	1,708,045
Cash Paid to Employees and Suppliers	(2,074,429)	(2,016,304)
Miscellaneous Receipts	27,937	54,543
Net Cash Provided (Used) by Operating Activities	$ 74,795	$(252,459)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (Decrease) in Due to Related Party	$(80,500)	$ 181,244
Net Cash Provided (Used) by Financing Activities	$(80,500)	$ 181,244
Net (Decrease) in Cash and Cash Equivalents	$(5,705)	$(71,215)
Cash and Cash Equivalents at Beginning of Year	37,986	109,201
Cash and Cash Equivalents at End of Year	$ 32,281	$ 37,986
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Change in Net Assets	$ 425,882	$(327,331)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Bad-Debt Expense	$ 153,674	$ 92,683
(Increase) in Accounts Receivable	(493,318)	(70,175)
(Increase) Decrease in Accounts Receivable - Related Party	(560)	886
(Increase) in Prepaid Expenses	(19,043)	(7,118)
Increase in Accounts Payable - Trade	35,766	58,837
(Decrease) in Accounts Payable - Adult Rehab Option Adjustment	-	(16,162)
Increase in Due to Related Party	5,940	351
Increase in Accrued Vacation Payable	522	6,039
Increase (Decrease) in Accrued Wages	(49,501)	16,329
Increase (Decrease) in Payroll Taxes Payable	15,433	(630)
(Decrease) in Other Payable	-	(6,168)
Total Adjustments	$(351,087)	$ 74,872
Net Cash Provided (Used) by Operating Activities	$ 74,795	$(252,459)

See Accompanying Notes to Financial Statements

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.

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.

The Organization has elected to defer the implementation of FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes as allowed in FASB Staff Position FIN 48-3. The Organization has not evaluated uncertain tax positions; therefore there could be additional liabilities for income taxes, penalties and interest which are not recorded in these financial statements. It is the policy of the Organization to include interest paid on taxes in interest expense and penalties are included in operating expenses.

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

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.

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, 2009 and 2008:

	2009	2008
Contributions from Capstone Community Foundation	$ -	$ 1,257
Rents Paid for Property and Equipment	$ 58,580	$ 49,281
Due to Capstone Community Foundation	$ 302,035	$ 376,244

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, 2009 and 2008:

	2009	2008
Management Fee Receivable from Beacon Housing Corporation	$ 560	-
Payable to Beacon Housing Corporation	-	$ 351
Management Fee Revenue from Beacon Housing Corporation	$ 6,692	$ 6,171
Rents Paid to Beacon Housing Corporation	$ 4,200	$ 4,200

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.

Note 3 - LEASES
(Cont.)

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 $88,837 and $69,213 at June 30, 2009 and 2008, respectively. These amounts are included in the statements of functional expenses in space rent and equipment rent.

Note 4 - OFF-BALANCE SHEET RISK

At times throughout the year, the Organization's cash and equivalents balances may exceed amounts insured by the Federal Deposit Insurance Corporation. The Organization does not believe it is exposed to any significant credit risk on cash and equivalents.

Note 5 - ECONOMIC DEPENDENCY

The Organization receives a significant portion 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 has 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 $30,489 and $40,925 to the Plan in the years ended June 30, 2009 and 2008, respectively.

Note 7 - PRIOR YEAR REVENUE

During the year ending June 30, 2009, two payments were received for services rendered in prior years. This revenue was not recorded in the prior years because the amount of revenue could not be estimated and there was no evidence, at the time, the payments would be received. The payments received were as follows:

Patient Fees for Service Rendered During Year Ending June 30, 2007	$ 225,444
Patient Fees for Service Rendered During Year Ending June 30, 2008	$ 219,940

Recognizing these payments in the year services were rendered would have had the following impact on the current year financial statements:

	2009	2008
Total Revenue	$ 2,216,761	$ 2,076,354
Change in Net Assets	$(19,502)	$(107,391)

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

SCHEDULE I – ANALYSIS OF COUNTY REVENUE

FOR THE YEAR ENDED JUNE 30, 2009

	Jasper County	Marion County	Other Counties	Total
Substance Abuse Prevention	$ 38,860			$ 38,860
Chemical Dependency	2,941	$ 35,230		38,171
Mental Health	120,945	82,313	$ 19,313	222,571
Community Based Services	53,239	21,814	10,902	85,955
Residential	2,800	618	1,955	5,373
Total County Revenue	$ 218,785	$ 139,975	$ 32,170	$ 390,930

FOR THE YEAR ENDED JUNE 30, 2008

	Jasper County	Marion County	Other Counties	Total
Substance Abuse Prevention	$ 40,000			$ 40,000
Chemical Dependency		$ 32,092		32,092
Mental Health	82,375	53,953		136,328
Community Based Services	53,480	26,490	$ 9,094	89,064
Residential	34,824	2,098	16,828	53,750
Total County Revenue	$ 210,679	$ 114,633	$ 25,922	$ 351,234