

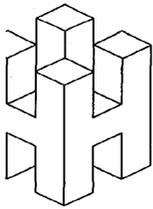
CAPSTONE BEHAVIORAL HEALTHCARE, INC.

INDEPENDENT AUDITORS' REPORT

JUNE 30, 2010 AND 2009

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**HENJES, CONNER &
WILLIAMS, P.C.**

CERTIFIED PUBLIC ACCOUNTANTS

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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, 2010 and 2009, 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, 2010 and 2009, 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.

The accompanying financial statements have been prepared assuming that the Organization will continue as a going concern. As discussed in Note 9 to the financial statements, the Organization has suffered recurring losses from operations and has a net deficit that raises substantial doubt about its ability to continue as a going concern. Management's plan in regard to these matters are also described in Note 9. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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 14 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 26, 2010

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2010 AND 2009

ASSETS

	<u>2010</u>	<u>2009</u>
<u>CURRENT ASSETS</u>		
Cash and Cash Equivalents	\$ 64,454	\$ 32,281
Accounts Receivable - Trade (Net of Allowances of \$91,900 and \$198,149, for 2010 and 2009 Respectively)	463,160	608,094
Accounts Receivable - Related Party - Note 2	-	560
Prepaid Expenses	<u>20,019</u>	<u>26,561</u>
Total Current Assets	\$ <u>547,633</u>	\$ <u>667,496</u>
Total Assets	\$ <u>547,633</u>	\$ <u>667,496</u>

LIABILITIES AND NET ASSETS

<u>CURRENT LIABILITIES</u>		
Accounts Payable - Trade	\$ 47,891	\$ 107,236
Due to Related Party - Note 2	7,741	6,291
Accrued Vacation Payable	59,317	56,809
Accrued Wages	73,167	10,142
Accrued Interest	774	-
Payroll Taxes Payable	19,467	15,433
Current Maturities of Notes Payable - Note 3	<u>114,720</u>	<u>-</u>
Total Current Liabilities	\$ 323,077	\$ 195,911
<u>LONG-TERM LIABILITIES</u>		
Due to Related Party - Note 2	\$ 375,744	\$ 295,744
Notes Payable - Net of Current Maturities - Note 3	<u>113,088</u>	<u>-</u>
Total Long-Term Liabilities	\$ <u>488,832</u>	\$ <u>295,744</u>
Total Liabilities	\$ 811,909	\$ 491,655
<u>NET ASSETS (DEFICIT)</u>		
Unrestricted	(<u>264,276</u>)	<u>175,841</u>
Total Liabilities and Net Assets	\$ <u>547,633</u>	\$ <u>667,496</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

	2010	2009
<u>PUBLIC SUPPORT, FEES, AND OTHER REVENUE</u>	<u>Unrestricted</u>	<u>Unrestricted</u>
Public Support:		
Capstone Community Foundation - Note 2	\$ 34,698	-
Fees from Governmental Agencies:		
County Revenue:		
Substance Abuse Prevention	-	\$ 38,860
Chemical Dependency	25,020	38,171
Mental Health	293,288	222,571
Community Based Services	113,501	85,955
Residential	-	5,373
Adult Rehab Option Revenue	-	525,434
Iowa Department of Public Health	193,652	338,290
Community Support Program - Children	-	736
School Contracts	2,141	4,669
Patient Fees	1,819,067	1,346,102
Prior Year Patient Fees Revenue - Note 8	-	445,384
Adjustment for Managed Care and Charity Care	(562,222)	(417,337)
Other Revenue:		
Miscellaneous Revenue	<u>31,565</u>	<u>27,937</u>
Total Public Support, Fees, and Other Revenue	\$ 1,950,710	\$ 2,662,145
 <u>EXPENSES</u>		
Program Services:		
Chemical Dependency	\$ 542,619	\$ 380,672
Mental Health	779,545	926,693
Substance Abuse Prevention	110,375	103,584
Community Based Services	250,330	226,965
Residential	<u>314,153</u>	<u>292,857</u>
Total Program Services	\$ 1,997,022	\$ 1,930,771
Supporting Services:		
Management and General	<u>393,805</u>	<u>305,492</u>
Total Expenses	\$ 2,390,827	\$ 2,236,263
Increase (Decrease) in Net Assets	\$(440,117)	\$ 425,882
Net Assets at Beginning of Year	<u>175,841</u>	(<u>250,041</u>)
Net Assets at End of Year	\$(<u>264,276</u>)	\$ <u>175,841</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2010

	<u>Rehabilitation Program Services</u>			
	<u>Chemical Dependency</u>	<u>Mental Health</u>	<u>Substance Abuse Prevention</u>	<u>Community Based Services</u>
<u>SALARIES AND BENEFITS</u>				
Salaries	\$ 255,717	\$ 541,291	\$ 75,140	\$ 168,946
Payroll Taxes and Insurance	31,872	48,237	8,302	18,397
Group Benefits	71,030	21,408	6,417	15,813
Retirement Benefits	18,401	4,984	1,662	4,097
Medical Services	<hr/>	<hr/>	<hr/>	<hr/>
Total Salaries and Benefits ..	\$ 377,020	\$ 615,920	\$ 91,521	\$ 207,253
<u>OTHER EXPENSES</u>				
Professional Fees				
Contract Service Payments	\$ 7,557	\$ 33,392	\$ 1,048	\$ 1,678
Office Supplies and Expenses	43,531	12,739	3,943	11,081
Medical Supplies and Other Costs ...	156	996	1,923	
Food Supplies				
Telephone	9,618	3,496	764	2,500
Postage and Shipping	3,936	2,131	535	1,615
Space Rent - Note 4	22,223	9,161	1,618	4,396
Building and Grounds	12,025	4,667	911	3,384
Utilities	3,673	995	332	818
Property and Liability Insurance	13,758	4,738	1,243	3,063
Mileage	1,165	1,882	1,764	8,825
Staff Development, Training and Recruitment	371	47,842		185
Meetings and Conferences		5,790		
Subscriptions and Publications		639		
Membership Dues	4,288	1,234	50	37
Equipment Rent - Note 4	17,815	4,825	1,609	3,966
Interest Expense			2,159	
Public Relations	11,673	2,495	955	1,529
Bank Fees		5		
Bad Debts	13,810	26,598		
Miscellaneous	<hr/>	<hr/>	<hr/>	<hr/>
Total Other Expenses	\$ 165,599	\$ 163,625	\$ 18,854	\$ 43,077
Total Expenses	\$ 542,619	\$ 779,545	\$ 110,375	\$ 250,330

<u>Residential Program</u>	<u>Supporting Services Management and General</u>	<u>Total Expenses</u>
\$ 197,119	\$ 272,954	\$ 1,511,167
21,638	27,529	155,975
20,882	21,417	156,967
5,410	3,839	38,393
12		12
\$ 245,061	\$ 325,739	\$ 1,862,514
\$ 2,216	\$ 22,636	\$ 22,636
13,347	7,073	52,964
1,708	10,009	94,650
14,802	1,136	5,919
4,302		14,802
1,606	1,765	22,445
9,467	666	10,489
2,891	3,738	50,603
1,080	2,042	25,920
4,044	766	7,664
6,053	2,871	29,717
	1,953	21,642
	1,138	49,536
	270	6,060
116	661	1,416
37	4,203	9,849
5,237	3,717	37,169
		2,159
2,186	1,392	20,230
	1,949	1,954
		40,408
	81	81
\$ 69,092	\$ 68,066	\$ 528,313
\$ 314,153	\$ 393,805	\$ 2,390,827

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2009

	<u>Rehabilitation Program Services</u>			
	<u>Chemical Dependency</u>	<u>Mental Health</u>	<u>Substance Abuse Prevention</u>	<u>Community Based Services</u>
<u>SALARIES AND BENEFITS</u>				
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	<u>6,018</u>	<u>83</u>	<u> </u>	<u> </u>
Total Salaries and Benefits ..	\$ 265,804	\$ 715,338	\$ 90,048	\$ 190,826
<u>OTHER EXPENSES</u>				
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 4	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 4	9,756	13,744	1,016	4,285
Public Relations	449	417		60
Bad Debts	60,857	92,817		
Miscellaneous	<u> </u>	(<u>1,515</u>)	<u> </u>	<u>375</u>
Total Other Expenses	\$ <u>114,868</u>	\$ <u>211,355</u>	\$ <u>13,536</u>	\$ <u>36,139</u>
Total Expenses	\$ <u>380,672</u>	\$ <u>926,693</u>	\$ <u>103,584</u>	\$ <u>226,965</u>

<u>Residential Program</u>	<u>Supporting Services Management and General</u>	<u>Total Expenses</u>
\$ 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
<u>95</u>	<u>126</u>	<u>6,322</u>
\$ 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
	<u>372</u>	(<u>768</u>)
\$ <u>57,308</u>	\$ <u>84,413</u>	\$ <u>517,619</u>
\$ <u>292,857</u>	\$ <u>305,492</u>	\$ <u>2,236,263</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

	<u>2010</u>	<u>2009</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Cash Received from Public Support	\$ 34,698	-
Cash Received from Operations	1,996,075	\$ 2,121,287
Cash Paid to Employees and Suppliers	(2,336,588)	(2,074,429)
Interest Paid	(1,385)	-
Miscellaneous Receipts	<u>31,565</u>	<u>27,937</u>
Net Cash Provided (Used) by Operating Activities	\$(275,635)	\$ 74,795
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
Increase (Decrease) in Due to Related Party	\$ 80,000	\$(80,500)
Proceeds from Issuance of Notes Payable	230,000	-
Payments on Notes Payable	(<u>2,192</u>)	<u> </u>
Net Cash Provided (Used) by Financing Activities	\$ <u>307,808</u>	\$(<u>80,500</u>)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 32,173	\$(5,705)
Cash and Cash Equivalents at Beginning of Year	<u>32,281</u>	<u>37,986</u>
Cash and Cash Equivalents at End of Year	\$ <u>64,454</u>	\$ <u>32,281</u>
<u>RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:</u>		
Change in Net Assets	\$(440,117)	\$ 425,882
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Bad-Debt Expense	\$ 40,408	\$ 153,674
(Increase) Decrease in Accounts Receivable	104,526	(493,318)
(Increase) Decrease in Accounts Receivable - Related Party	560	(560)
(Increase) Decrease in Prepaid Expenses	6,542	(19,043)
Increase (Decrease) in Accounts Payable - Trade	(59,345)	35,766
Increase in Due to Related Party	1,450	5,940
Increase in Accrued Vacation Payable	2,508	522
Increase (Decrease) in Accrued Wages	63,025	(49,501)
Increase in Accrued Interest	774	-
Increase in Payroll Taxes Payable	<u>4,034</u>	<u>15,433</u>
Total Adjustments	\$ <u>164,482</u>	\$(<u>351,087</u>)
Net Cash Provided (Used) by Operating Activities	\$(<u>275,635</u>)	\$ <u>74,795</u>

See Accompanying Notes to Financial Statements

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009

Jote 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.

Basis of Presentation

The Organization follows accounting standards set by the Financial Accounting Standards Board, commonly referred to as the FASB. The FASB sets generally accepted accounting principles (GAAP) that the Organization follows to ensure we consistently report our financial condition, and results of operations. References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC.

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.

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009

Note 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Cont.) Tax Status (Continued)

The Organization reports accrued interest related to unrecognized tax benefits as interest expense and penalties as income tax expense. There are no material uncertain tax positions reported on the Project's financial statements. The Organization is no longer subject to examination by the Internal Revenue Service for fiscal years ending prior to June 30, 2007.

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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Contributions from Capstone Community Foundation	\$ <u>34,698</u>	<u>-</u>
Rents Paid for Property and Equipment	\$ <u>61,502</u>	\$ <u>58,580</u>
Due to Capstone Community Foundation	\$ <u>383,485</u>	\$ <u>302,035</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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Management Fee Receivable from Beacon Housing Corporation	<u>-</u>	\$ <u>560</u>
Management Fee Revenue from Beacon Housing Corporation	\$ <u>6,949</u>	\$ <u>6,692</u>
Rents Paid to Beacon Housing Corporation	\$ <u>4,200</u>	\$ <u>4,200</u>

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

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009

Note 3 - NOTES PAYABLE

During the year ended June 30, 2010, the Organization issued notes payable as follows to fund the Organization's operating deficits:

	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Current</u>	<u>Long Term</u>	<u>Total</u>
First Newton National Bank	3.78 %	October 2010	\$ 90,000	-	\$ 90,000
First Newton National Bank	6.25 %	May 2015	<u>24,720</u>	<u>\$ 113,088</u>	<u>137,808</u>
			<u>\$ 114,720</u>	<u>\$ 113,088</u>	<u>\$ 227,808</u>

The notes are secured by CD's and real estate of the Capstone Community Foundation, and have also been guaranteed by the Foundation.

The aggregate maturities of the long-term debt, outstanding at June 30, 2010, is as follows:

Years Ending

June 30, 2011	\$ 114,720
June 30, 2012	26,310
June 30, 2013	28,002
June 30, 2014	29,804
June 30, 2015	28,972
June 30, 2016 and Thereafter	-
	<u>\$ 227,808</u>

Note 4 - 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 \$87,772 and \$88,837 at June 30, 2010 and 2009, respectively. These amounts are included in the statements of functional expenses in space rent and equipment rent.

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009

Note 5 - 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 6 - ECONOMIC DEPENDENCY

The Organization has received a significant portion of its revenue from contracts with Jasper and Marion Counties and the Iowa Department of Public Health (IDPH). During the year ended June 30, 2010, the Organization did not renew its substance abuse treatment contract with the IDPH. The Organization's ability to continue operating in the absence of those contracts has not been determined.

Note 7 - 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 \$38,393 and \$30,489 to the Plan in the years ended June 30, 2010 and 2009, respectively.

Note 8 - PRIOR YEAR PATIENT FEES 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	.....		<u>219,940</u>
Total Prior year Patient Fees Revenue	.....	\$	<u>445,384</u>

Recognizing these payments in the year services were rendered would have had the following impact on the 2009 financial statements:

			<u>2009</u>
Total Revenue	.....	\$	<u>2,216,761</u>
Change in Net Assets	.....	\$	<u>(19,502)</u>

CAPSTONE BEHAVIORAL HEALTHCARE, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009

Note 9 - GOING CONCERN

As shown in the accompanying financial statements, the Organization has incurred recurring losses from operations and as of June 30, 2010, the Organization's total liabilities exceeded its total assets by \$264,276. These factors raise substantial doubt about the Organization's ability to continue as a going concern. Management has instituted a cost reduction program which included a reduction in labor and fringe costs and a modification of the contracted services it provides. In addition, the Organization has made changes to its staffing policies and has instituted more efficient management techniques. Management believes these factors will contribute towards achieving profitability. The financial statements do not include any adjustments that might be necessary if the Organization is unable to continue as a going concern.

Note 10 - SUBSEQUENT EVENTS

Subsequent to year-end the Organization received a payment of \$133,935 from a third party payor for a reconciliation payment related to services provided during the year ended June 30, 2009. This amount had been included in the balance of Accounts Receivable - Trade at June 30, 2010 and 2009.

In preparing the financial statements, the Organization has evaluated all subsequent events, for potential recognition or disclosure, through October 26, 2010, the date the financial statements were available to be issued.

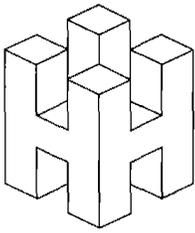
CAPSTONE BEHAVIORAL HEALTHCARE, INC.
SCHEDULE I - ANALYSIS OF COUNTY REVENUE

FOR THE YEAR ENDED JUNE 30, 2010

	<u>Jasper County</u>	<u>Marion County</u>	<u>Other Counties</u>	<u>Total</u>
Chemical Dependency		\$ 25,020		\$ 25,020
Mental Health	\$ 157,202	86,750	\$ 49,336	293,288
Community Based Services	<u>93,528</u>	<u>13,531</u>	<u>6,442</u>	<u>113,501</u>
Total County Revenue	\$ <u>250,730</u>	\$ <u>125,301</u>	\$ <u>55,778</u>	\$ <u>431,809</u>

FOR THE YEAR ENDED JUNE 30, 2009

	<u>Jasper County</u>	<u>Marion County</u>	<u>Other Counties</u>	<u>Total</u>
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	<u>2,800</u>	<u>618</u>	<u>1,955</u>	<u>5,373</u>
Total County Revenue	\$ <u>218,785</u>	\$ <u>139,975</u>	\$ <u>32,170</u>	\$ <u>390,930</u>



**HENJES, CONNER &
WILLIAMS, P.C.**

CERTIFIED PUBLIC ACCOUNTANTS

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

We have audited the financial statements of CAPSTONE BEHAVIORAL HEALTH CARE, INC. for the year ended June 30, 2010, and have issued our report thereon dated October 26, 2010. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards as well as certain information related to the planned scope and timing of our audit. We communicated such information in our engagement letter to you dated June 16, 2010. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Capstone Behavioral Health Care, Inc. are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2010. We noted no transactions entered into by the Organization during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Management's estimate of allowance for uncollectable receivables are based on management's knowledge of patient receivables and the likelihood payment will be received. We evaluated the key factors and assumptions used to develop the above estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. We have evaluated the disclosures in the financial statements and they are neutral, consistent, and clear in relation to the financial statements taken as a whole. The most sensitive disclosures affecting the financial statements were:

The disclosure of related party transactions in Note 2 to the financial statements due to the significance of the transactions with the related party.

The disclosure of economic dependency in Note 6 to the financial statements due to the potential impact on the Organization's operations.

The disclosure of prior year patient fees revenue in Note 8 to the financial statements due to the significance of those revenues on the Organization's operations during fiscal year 2009.

The disclosure regarding going concern in Note 9 to the financial statements due to the significance of the financial challenges facing the Organization.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. A schedule that summarizes the corrected misstatements of the financial statements is available upon request.

The following material misstatements detected as a result of audit procedures were corrected by management:

- Adjustment to allocate administrative costs to various cost centers in accordance with the Organization's cost allocation policy.
- Adjustment to balances of prepaid expenses at June 30, 2010.
- Adjustment for proper reporting of prior period Magellan rate adjustment.
- Adjustment to record accrued wages payable at year end.
- Adjustment to correct balances of accounts receivable and allowance accounts.
- Adjustment to adjust accounts payable balance for FY09 Magellan settlement.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 26, 2010.

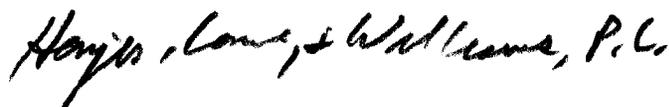
Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Organization's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Organization's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Directors and management of Capstone Behavioral Health Care, Inc. and is not intended to be and should not be used by anyone other than these specified parties.



Certified Public Accountants

Sioux City, Iowa
October 26, 2010