

**OPEN ARMS CARE CORPORATION INC.,  
AND AFFILIATES**

**Consolidated Financial Statements**

**December 31, 2013 and 2012**

**(With Independent Auditors' Report Thereon)**



**LATTIMORE BLACK MORGAN & CAIN, PC**  
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

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## **INDEPENDENT AUDITORS' REPORT**

**The Board of Directors of  
Open Arms Care Corporation Inc., and Affiliates:**

### **Report on the Financial Statements**

**We have audited the accompanying consolidated balance sheets of Open Arms Care Corporation Inc., and Affiliates (collectively the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.**

### ***Management's Responsibility for the Financial Statements***

**Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.**

### ***Auditors' Responsibility***

**Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.**

**An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity'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 entity'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 Open Arms Care Corporation Inc., and Affiliates as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Report on Consolidating Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 15-17 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations, and cash flows of the individual companies. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Lattimore Black Morgan & Cain, PC*

Brentwood, Tennessee

August 20, 2014

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Consolidated Balance Sheets

December 31, 2013 and 2012

	<u>Assets</u>	
	<u>2013</u>	<u>2012</u>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 2,241,667	\$ 2,773,760
Funds held in custody for others	227,967	225,743
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$89,000 in 2013 and 2012	3,235,963	3,372,624
Prepaid expenses and other current assets	65,368	42,871
Trusteed funds - current portion	<u>1,092,324</u>	<u>1,017,421</u>
<b>Total current assets</b>	<u>6,863,289</u>	<u>7,432,419</u>
<b>Property and equipment:</b>		
Land and land improvements	3,408,743	3,376,360
Buildings and improvements	20,421,917	20,532,693
Furniture and equipment	3,942,706	4,492,711
Vehicles	<u>92,789</u>	<u>156,931</u>
	27,866,155	28,558,695
Accumulated depreciation and amortization	<u>(22,007,838)</u>	<u>(21,834,246)</u>
<b>Property and equipment</b>	<u>5,858,317</u>	<u>6,724,449</u>
<b>Other Assets:</b>		
Trusteed funds	3,740,683	4,750,544
Bond issue costs, less accumulated amortization of approximately \$1,691,000 and \$1,626,000 in 2013 and 2012, respectively	197,786	262,935
Investments and other long-term assets	<u>1,093,683</u>	<u>969,456</u>
<b>Total other assets</b>	<u>5,032,152</u>	<u>5,982,935</u>
<b>Total assets</b>	<u>\$ 17,753,758</u>	<u>\$ 20,139,803</u>

	<u>Liabilities and Net Assets</u>	
<b>Current liabilities:</b>		
Accounts payable	\$ 661,879	\$ 663,512
Funds held in custody for others	227,967	225,743
Accrued salaries and benefits	912,761	1,562,221
Accrued interest	274,909	313,207
Current portion of long-term debt	<u>1,964,992</u>	<u>1,874,992</u>
<b>Total current liabilities</b>	4,042,508	4,639,675
<b>Long-term debt, less current portion</b>	<u>11,726,109</u>	<u>13,685,862</u>
<b>Total liabilities</b>	15,768,617	18,325,537
<b>Net assets</b>	<u>1,985,141</u>	<u>1,814,266</u>
<b>Total liabilities and net assets</b>	<u>\$ 17,753,758</u>	<u>\$ 20,139,803</u>

See accompanying notes to the consolidated financial statements.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Unrestricted revenues:		
Net patient service revenues	\$ 38,566,913	\$ 39,819,475
Investment income	209,565	159,537
Net special events revenue	29,486	22,920
Other revenues	<u>45,851</u>	<u>29,150</u>
Total unrestricted revenues	<u>38,851,815</u>	<u>40,031,082</u>
Expenses:		
Salaries and wages	22,331,999	22,474,632
Employee benefits	4,376,569	4,460,706
Professional services	1,582,793	1,782,578
Supplies and expenses	4,672,551	4,434,791
Maintenance and repairs	494,137	491,083
Utilities	667,133	666,381
Insurance	494,518	522,013
Depreciation and amortization	1,110,673	1,174,031
Interest expense	748,270	840,079
Loss (gain) on disposal of property and equipment	691	(300)
Taxes and licenses	2,185,300	2,260,032
Provision for doubtful accounts	<u>16,306</u>	<u>726</u>
Total expenses	<u>38,680,940</u>	<u>39,106,752</u>
Excess of revenues over expenses	170,875	924,330
Net assets at beginning of year	<u>1,814,266</u>	<u>889,936</u>
Net assets at end of year	<u>\$ 1,985,141</u>	<u>\$ 1,814,266</u>

See accompanying notes to the consolidated financial statements.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Consolidated Statements of Cash Flows

Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Cash flows from operating activities:</b>		
Excess of revenues over expenses	\$ 170,875	\$ 924,330
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Net gains on investments and trusteed funds	(97,928)	(61,566)
Depreciation and amortization	1,110,673	1,174,031
Provision for doubtful accounts	16,306	726
(Gain) loss on disposal of property and equipment	691	(300)
(Increase) decrease in operating assets:		
Patient accounts receivable	120,355	102,474
Prepaid expenses and other current assets	(22,497)	174,183
Other assets	5,000	(30,736)
Increase (decrease) in operating liabilities:		
Accounts payable	(1,633)	(187,878)
Accrued salaries and benefits	(649,460)	37,223
Accrued interest	(38,298)	(35,780)
Net cash provided by operating activities	<u>614,084</u>	<u>2,096,707</u>
<b>Cash flows from investing activities:</b>		
Proceeds from the sale of investments, net	97,665	-
Proceeds from disposal of property and equipment	15,110	300
Purchase of property and equipment	(189,954)	(393,132)
Decrease (increase) in trusteed funds, net	<u>805,994</u>	<u>(478,242)</u>
Net cash provided (used) by investing activities	<u>728,815</u>	<u>(871,074)</u>
<b>Cash flows from financing activities -</b>		
principal payments of long-term debt	<u>(1,874,992)</u>	<u>(1,796,690)</u>
Decrease in cash and cash equivalents	(532,093)	(571,057)
Cash and cash equivalents at beginning of year	<u>2,773,760</u>	<u>3,344,817</u>
Cash and cash equivalents at end of year	<u>\$ 2,241,667</u>	<u>\$ 2,773,760</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	<u>\$ 786,568</u>	<u>\$ 875,859</u>

See accompanying notes to the consolidated financial statements.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

### (1) Organization

The accompanying consolidated financial statements of Open Arms Care Corporation Inc., and Affiliates (collectively the "Company") include the transactions and accounts of Open Arms Care Corporation, Inc., Open Arms Care Foundation ("Foundation"), and Open Arms Health System, LLC ("Clinic").

Open Arms Care Corporation, Inc. owns intermediate care facilities for persons with intellectual and developmental disabilities. The facilities are located in Chattanooga, Knoxville, Memphis, and Nashville, Tennessee. Prior to November 6, 2000, Open Arms Care Corporation, Inc. was known as Rebound Care Corporation d/b/a Open Arms Care Corporation. In 2005, the Foundation was formed to support non-Medicaid allowable expenses and capital projects through charitable donations for the benefit of the Open Arms Care Corporation, Inc.'s clients. In 2013, Open Arms Health System, LLC was formed to provide routine clinic services to the clients and employees of Open Arms Care Corporation, Inc.

### (2) Summary of significant accounting policies

#### (a) Principles of consolidation

These consolidated financial statements include the accounts of Open Arms Care Corporation, Inc., Open Arms Care Foundation, Inc., and Open Arms Care Health Services, LLC. All significant intercompany accounts and transactions have been eliminated.

#### (b) Cash and cash equivalents

The Company considers cash and highly liquid investments having a maturity date at acquisition of 90 days or less, excluding amounts designated under bond indenture agreements and trustee funds designated for operating expenditures, to be cash and cash equivalents.

#### (c) Investments and trustee funds

Investments and trustee funds, which are comprised of cash and cash equivalents, equity and debt securities with readily determinable fair values, are accounted for as trading securities and all investments in such securities are measured at fair value. Investment income or loss (including realized gains and losses on the sale of investments, interest, dividends, and unrealized gains and losses on investments) is included in unrestricted revenues unless the income or loss is restricted by donor or law.

#### (d) Property and equipment

Property and equipment are stated at cost. Depreciation is provided over the assets' estimated useful lives using the straight-line method. Buildings and improvements are generally depreciated over ten to twenty five years, furniture and equipment over three to ten years and vehicles over three to five years.



# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

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 included in operations.

(e) Bond issue costs and discount

Bond issue costs and discount are being amortized using the effective interest method over the life of the debt.

(f) Performance indicator

The excess of revenues over expenses as reflected in the accompanying statements of operations is a performance indicator.

(g) Federal income taxes

Open Arms Care Corporation, Inc. is an organization recognized as exempt from federal income tax under Section 501(c)(3) and as a public charity under Section 509(a)(1) and as a hospital described in Section 170(b)(1)(A)(iii). Open Arms Care Foundation is an organization recognized as exempt from federal income tax under 501(c)(3) and as a public charity under Section 509(a)(1) and as a publicly supported organization under Section 170(b)(1)(A)(vi). The Internal Revenue Service has determined that the Company is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Open Arms Health System, LLC is a single member limited liability company and for tax purposes, is treated as a disregarded entity of Open Arms Care Corporation, Inc.

Under generally accepted accounting principles, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax purposes not meeting the "more likely than not" test, no tax benefit is recorded. The Company has no material uncertain tax positions that qualify for either recognition or disclosure in the financial statements.

As of December 31, 2013, the Company has accrued no interest and no penalties related to uncertain tax positions. It is the Company's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

The Company files Federal Form 990 informational tax returns. The Company is currently open to audit under the statute of limitations for years ended December 31, 2010 through 2013.

(h) Revenue recognition

Net patient service revenue is recognized at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are made on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

(i) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(j) Events occurring after reporting date

The Company has evaluated events and transactions that occurred between December 31, 2013 and August 20, 2014, which is the date that the financial statements were available to be issued, for possible recognition or disclosure in the financial statements.

(3) Credit risk

The Company may maintain cash and cash equivalents on deposit at banks in excess of federally insured amounts. The Company has not experienced any losses in such accounts and management believes the Company is not exposed to any significant credit risk related to cash and cash equivalents.

(4) Medicaid program

Services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Company is reimbursed at a rate determined prospectively based on its filed cost reports. Final determination of amounts to be received is subject to audit by Medicaid.

The State of Tennessee passed legislation, effective July 1, 1994, which imposed a provider tax on Intermediate Care Facilities for persons with intellectual and developmental disabilities at a rate of 6% of gross receipts, as defined. During 2008, this rate was reduced to 5.5%. The statements of operations include approximately \$2,128,000 and \$2,197,000 of Tennessee provider tax expense for 2013 and 2012, respectively. Additionally, net patient service revenues include approximately \$2,128,000 and \$2,197,000 in reimbursement related to per diem rates as a result of the provider tax for 2013 and 2012, respectively.

Substantially all net patient service revenues in 2013 and 2012 relate to services provided to patients covered by the Medicaid program. Laws and regulations governing the Medicaid program are extremely complex and subject to interpretation. The Company believes it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicaid program.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

### (5) Fair value measurements

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). The Company does not have any fair value measurements using significant unobservable inputs (Level 3) as of December 31, 2013 or 2012.

#### *Financial Instruments*

The carrying amount of financial instruments, consisting of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and short-term debt approximate their fair value due to their relatively short maturities. Long-term debt is carried at amortized cost, which approximates fair value.

#### *Non-Financial Assets*

The Company's non-financial assets, which primarily includes property and equipment are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required and the Company is required to evaluate the non-financial instrument for impairment, a resulting asset impairment would require that the non-financial asset be recorded at the fair value. During the years ended December 31, 2013 and 2012, the Company did not measure any non-recurring, non-financial assets at fair value or recognize any changes in net assets related to changes in fair value for non-financial assets.

The following table sets forth by level, within the fair value hierarchy, the Company's investments and trustee funds at fair value as of December 31, 2013 and 2012:

	<u>Fair Value Measurements as of</u> <u>December 31, 2013 using the following inputs</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and equivalents	\$ 1,615,766	\$ -	\$ -	\$ 1,615,766
Marketable equity securities	1,029,614	-	-	1,029,614
Corporate & government debt securities	<u>589,710</u>	<u>2,646,060</u>	<u>-</u>	<u>3,235,770</u>
Total	\$ <u>3,235,090</u>	\$ <u>2,646,060</u>	\$ <u>-</u>	\$ <u>5,881,150</u>

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

### Fair Value Measurements as of December 31, 2012 using the following inputs

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and equivalents	\$ 2,598,343	\$ -	\$ -	\$ 2,598,343
Marketable equity securities	897,579	-	-	897,579
Corporate & government debt securities	<u>636,435</u>	<u>2,554,523</u>	<u>-</u>	<u>3,190,958</u>
Total	<u>\$ 4,132,357</u>	<u>\$ 2,554,523</u>	<u>\$ -</u>	<u>\$ 6,686,880</u>

#### (6) Trusteed funds

Trusteed funds consist of the following:

	<u>2013</u>	<u>2012</u>
Debt reserve funds	\$ 2,606,227	\$ 2,545,932
Debt service funds	1,092,324	1,017,421
Renewal and replacement funds	<u>1,134,456</u>	<u>2,204,612</u>
	<u>\$ 4,833,007</u>	<u>\$ 5,767,965</u>

The bond funds are maintained in accordance with the trust indentures related to the bond issue described in Note 7. Amounts on deposit in the debt service and debt reserve funds are required to be used to pay interest, principal and provide security (collateral) for indebtedness on the bonds. Amounts on deposit in the renewal and replacement funds are excess funds to be used in the event there are insufficient moneys available to pay all amounts due as to principal and interest on the Series 1998 Bonds, payment of operating expenses to the extent of any deficiency in the operating and maintenance fund, and payment of the cost of additions and capital improvements.

#### (7) Long-term debt

Long-term debt consists of the following:

	<u>2013</u>	<u>2012</u>
The Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County, Tennessee Health Facility Revenue Refunding Bonds Series 1998 (Series 1998 Bonds), interest varying from 5.0% to 5.1% through 2019.	\$ 12,860,000	\$ 14,655,000

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

The Health, Educational and Housing Facility Board of the County of Shelby, Tennessee; interest at 4.34% per annum due July 1, 2023.	846,742	926,734
Less bond issue discount	<u>(15,641)</u>	<u>(20,880)</u>
	13,691,101	15,560,854
Less current portion	<u>(1,964,992)</u>	<u>(1,874,992)</u>
Long-term debt, net of current portion	<u>\$ 11,726,109</u>	<u>\$ 13,685,862</u>

In 1998, the Company issued \$32,585,000 Series 1998 Bonds. The Series 1998 Bonds were issued under the terms of a Note and Master Trust Indenture dated September 1, 1998. The proceeds of the Series 1998 Bonds were used to refund all of The 1992 Health, Educational and Housing Facility Board of the county of Shelby, Tennessee Revenue Bonds, fund a debt service fund for the Series 1998 Bonds, and pay a portion of the costs of issuing the bonds.

The Series 1998 Bonds are insured by a municipal bond insurance policy with Radian Group, Inc. ("Radian") and are secured by the assets of the Company. Bonds that mature on or after August 1, 2012 are subject to redemption in whole or in part at any time after August 1, 2008 at par.

Under the terms of the Series 1998 Bonds, the Company has agreed to certain covenants, which among other things, limit additional indebtedness and guarantees, and require the Company to maintain certain financial covenants. The Company was not in compliance with certain covenants at December 31, 2013. On August 12, 2014, the Company entered into a forbearance agreement with Radian. Radian agreed to not exercise its rights under the previous default at December 31, 2013 so long as no default occurs under the forbearance agreement or the amended Master Trust Indenture. Under the forbearance agreement, should the bonds not be paid off by January 1, 2015, the forbearance agreement would terminate. The Company is currently in the process of seeking alternative financing to redeem the Series 1998 Bonds by January 1, 2015. The Company was in compliance with its financial covenants on December 31, 2012.

In 2003, the Company borrowed \$1,600,000 at an interest rate equal to 4.38% per annum from the Health, Educational, and Housing Facility Board of the county of Shelby, Tennessee maturing on July 1, 2023 for the purchase of the new land and building in Memphis, Tennessee. The original loan agreement stated a call provision that allowed the holder to demand full payment on February 1, 2009. On April 13, 2009, this loan agreement was amended and the call provision was extended until April 1, 2011 and the interest rate was reduced to 3.47%. On May 17, 2011, this loan agreement was amended and the call provision was extended until April 1, 2016 and the interest rate was increased to 4.34%.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

A summary of approximate future maturities on long-term debt as of December 31, 2013 is as follows:

<u>Year</u>	
2014	\$ 1,964,992
2015	2,060,000
2016	2,165,000
2017	2,270,000
2018	2,380,000
2019 and later years	2,866,750
Less bond issue discount	<u>(15,641)</u>
	<u>\$ 13,691,101</u>

### (8) Investment income

Investment income during 2013 and 2012 was comprised of the following:

	<u>2013</u>	<u>2012</u>
Interest and dividend	\$ 111,637	\$ 97,971
Realized gain	63,742	85,244
Change in unrealized gain (loss)	<u>34,186</u>	<u>(23,678)</u>
	<u>\$ 209,565</u>	<u>\$ 159,537</u>

### (9) Commitments and Contingencies

#### Operating Lease Commitments

Future minimum annual rental payments under noncancelable operating lease and service agreements as of December 31, 2013 are as follows:

<u>Year</u>	
2014	\$ 401,000
2015	278,000
2016	255,000
2017	208,000
2018	<u>14,000</u>
	<u>\$ 1,156,000</u>

Total rental expense under noncancelable operating leases and service agreements, which includes amounts applicable to short-term leases, was approximately \$934,000 and \$935,000 for 2013 and 2012, respectively. The expense for 2013 is higher than the future commitments due to vehicle leases that have cancellation features at the Company's option.

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

### Healthcare Regulation

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 Company is in compliance with fraud and abuse statutes, as well as other applicable government laws and regulations.

### Healthcare Reform

In March 2010, Congress adopted comprehensive health care insurance legislation, the Patient Care Protection and Affordable Care Act and the Health Care and Education Reconciliation Act ("collectively, the "Health Care Reform Legislation"). The Health Care Reform Legislation, among other matters, is designed to expand access to health care coverage to substantially all citizens through a combination of public program expansion and private industry health insurance. Provisions of the Health Care Reform Legislation become effective at various dates over the next several years and a number of additional steps are required to implement these requirements. Due to the complexity of the Health Care Reform Legislation, reconciliation and implementation of the legislation continues to be under consideration by lawmakers, and it is not certain as to what changes may be made in the future regarding health care policies. Changes to existing Medicaid coverage and payments are also expected to occur as a result of this legislation. While the full impact of Health Care Reform Legislation is not yet fully known, changes to policies regarding reimbursement, universal health insurance and managed competition may materially impact the Company's operations.

### Insurance

The Company maintains claims made basis professional and occurrence basis general liability insurance for primary coverage. The Company also maintains excess insurance coverage.

### Litigation

The Company is subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of pending legal proceedings will not have a material effect on the Company's financial position.

#### (10) Related party transactions

The Company incurred professional fees and expenses totaling approximately \$87,000 and \$62,000 in 2013 and 2012, respectively, for services provided by an entity owned by a board member.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

Notes to the Consolidated Financial Statements

December 31, 2013 and 2012

(11) Functional expenses

The Company provides intermediate care services to individuals with intellectual and developmental disabilities within certain geographic locations. Expenses related to providing these services are as follows:

	<u>2013</u>	<u>2012</u>
Intellectual and developmental services	\$ 35,413,920	\$ 35,706,995
General and administrative	3,213,287	3,293,236
Fundraising	<u>53,733</u>	<u>106,521</u>
	<u>\$ 38,680,940</u>	<u>\$ 39,106,752</u>

(12) Retirement plan

The Company has a defined contribution 403(b) retirement plan for employees who have two years of service. For the years ended December 31, 2013 and 2012, the Company contributed 1.0% and 1.2%, respectively, of each participants' compensation, subject to Internal Revenue Code limitations. The Company contributed approximately \$146,000 and \$180,000 to the plan in 2013 and 2012, respectively. During 2012, the Company became aware that certain previous employer contributions for part-time employees had been calculated incorrectly. Based on consultation with ERISA counsel and the Company's calculation of the required contributions, the Company remitted approximately \$94,000 to the plan during 2012 for lost earnings that the participants would have earned.



# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Supplemental Schedule - Consolidating Balance Sheet

December 31, 2013

	<u>Chattanooga</u>	<u>Knoxville</u>	<u>Memphis</u>	<u>Nashville</u>	<u>Headquarters</u>	<u>Subtotal Open Arms Care Corporation</u>	<u>Open Arms Health System, LLC</u>	<u>Total Open Arms Care Corporation</u>	<u>Open Arms Care Foundation</u>	<u>Total Consolidated Open Arms Care Corporation</u>
Current Assets:										
Cash and cash equivalents	\$ 4,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 1,938,447	\$ 1,957,447	\$ 117,166	\$ 2,074,613	\$ 167,054	\$ 2,241,667
Funds held in custody for others	47,367	45,185	48,927	86,488	-	227,967	-	227,967	-	227,967
Patient accounts receivable, net	852,350	856,766	781,230	745,299	318	3,235,963	-	3,235,963	-	3,235,963
Prepaid expenses and other current assets	16,122	13,961	7,822	11,574	15,889	65,368	-	65,368	-	65,368
Trusteed funds - current portion	-	-	-	-	1,092,324	1,092,324	-	1,092,324	-	1,092,324
Total current assets	919,839	920,912	842,979	848,361	3,046,978	6,579,069	117,166	6,696,235	167,054	6,863,289
Property and equipment:										
Land and land improvements	646,811	861,081	672,897	1,227,954	-	3,408,743	-	3,408,743	-	3,408,743
Buildings and improvements	4,999,627	4,800,316	6,103,116	4,495,379	23,479	20,421,917	-	20,421,917	-	20,421,917
Furniture and equipment	834,377	939,344	855,232	839,096	474,657	3,942,706	-	3,942,706	-	3,942,706
Vehicles	11,667	18,555	25,610	36,957	-	92,789	-	92,789	-	92,789
Accumulated depreciation and amortization	6,492,482	6,619,296	7,656,855	6,599,386	498,136	27,866,155	-	27,866,155	-	27,866,155
	(5,179,419)	(5,609,270)	(5,453,528)	(5,310,779)	(454,842)	(22,007,838)	-	(22,007,838)	-	(22,007,838)
Property and equipment	1,313,063	1,010,026	2,203,327	1,288,607	43,294	5,858,317	-	5,858,317	-	5,858,317
Other assets:										
Trusteed funds	795,513	475,716	470,639	796,527	1,202,288	3,740,683	-	3,740,683	-	3,740,683
Bond issue costs, less accumulated amortization	59,433	35,548	43,297	59,508	-	197,786	-	197,786	-	197,786
Investments and other long-term assets	14,264	16,115	14,360	302	1,048,642	1,093,683	-	1,093,683	-	1,093,683
Total other assets	869,210	527,379	528,296	856,337	2,250,930	5,032,152	-	5,032,152	-	5,032,152
Total assets	\$ 3,102,112	\$ 2,458,317	\$ 3,574,602	\$ 2,993,305	\$ 5,341,202	\$ 17,469,538	\$ 117,166	\$ 17,586,704	\$ 167,054	\$ 17,753,758

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Supplemental Schedule - Consolidating Balance Sheet (continued)

December 31, 2013

	<u>Chattanooga</u>	<u>Knoxville</u>	<u>Memphis</u>	<u>Nashville</u>	<u>Headquarters</u>	<u>Subtotal Open Arms Care Corporation</u>	<u>Open Arms Health System, LLC</u>	<u>Total Open Arms Care Corporation</u>	<u>Open Arms Care Foundation</u>	<u>Total Consolidated Open Arms Care Corporation</u>
Current liabilities:										
Accounts payable	\$ 110,893	\$ 132,632	\$ 166,144	\$ 133,461	\$ 113,100	\$ 656,230	\$ 4,059	\$ 660,289	\$ 1,590	\$ 661,879
Funds held in custody for others	47,367	45,185	48,927	86,488	-	227,967	-	227,967	-	227,967
Accrued salaries and benefits	230,397	217,388	190,248	200,607	54,121	912,761	-	912,761	-	912,761
Accrued interest	85,638	51,221	52,305	85,745	-	274,909	-	274,909	-	274,909
Current portion of long-term debt	590,715	353,309	429,512	591,456	-	1,964,992	-	1,964,992	-	1,964,992
Total current liabilities	1,085,010	799,735	887,136	1,097,757	167,221	4,036,859	4,059	4,040,918	1,590	4,042,508
Intercompany payable/(receivable)	(4,018,787)	(1,142,386)	(1,595,103)	(3,521,251)	10,277,527	-	-	-	-	-
Long-term debt, less current portion	3,433,854	2,054,137	2,798,858	3,439,260	-	11,726,109	-	11,726,109	-	11,726,109
Total liabilities	500,077	1,711,486	2,090,891	1,015,766	10,444,748	15,762,968	4,059	15,767,027	1,590	15,768,617
Net assets (deficit), unrestricted	2,602,035	746,831	1,483,711	1,977,539	(5,103,546)	1,706,570	113,107	1,819,677	165,464	1,985,141
Total liabilities and net assets (deficit)	\$ 3,102,112	\$ 2,458,317	\$ 3,574,602	\$ 2,993,305	\$ 5,341,202	\$ 17,469,538	\$ 117,166	\$ 17,586,704	\$ 167,054	\$ 17,753,758

# OPEN ARMS CARE CORPORATION INC., AND AFFILIATES

## Supplemental Schedule - Consolidating Statement of Operations and Changes in Net Assets (Deficit)

For the year ended December 31, 2013

	Chattanooga	Knoxville	Memphis	Nashville	Headquarters	Subtotal Open Arms Care Corporation	Open Arms Health System, LLC	Total Open Arms Care Corporation	Open Arms Care Foundation	Total Consolidated Open Arms Care Corporation
Unrestricted revenue										
Net patient services revenue	\$ 10,200,751	\$ 9,914,842	\$ 9,314,790	\$ 9,136,530	\$ -	\$ 38,566,913	\$ -	\$ 38,566,913	\$ -	\$ 38,566,913
Investment income	(14,109)	(8,436)	(8,347)	(14,126)	254,368	209,350	-	209,350	215	209,565
Net special events revenue	-	-	-	-	-	-	-	-	29,486	29,486
Intercompany revenue	20,959	3,723	535	6,939	-	32,156	-	32,156	(32,156)	-
Other revenues	3,079	1,862	13,100	1,082	250	19,373	10,000	29,373	16,478	45,851
Total unrestricted revenues	10,210,680	9,911,991	9,320,078	9,130,425	254,618	38,827,792	10,000	38,837,792	14,023	38,851,815
Expenses:										
Salaries and wages	5,625,767	5,890,896	5,145,184	5,154,000	516,152	22,331,999	-	22,331,999	-	22,331,999
Employee benefits	1,240,794	1,210,109	921,727	952,621	51,318	4,376,569	-	4,376,569	-	4,376,569
Professional services	254,238	195,461	610,484	216,621	288,480	1,565,284	16,509	1,581,793	1,000	1,582,793
Supplies and expenses	1,139,021	1,069,169	1,022,575	928,800	496,410	4,655,975	5,484	4,661,459	11,092	4,672,551
Maintenance and repairs	134,034	122,140	104,548	132,292	1,123	494,137	-	494,137	-	494,137
Utilities	179,661	147,111	147,258	193,103	-	667,133	-	667,133	-	667,133
Insurance	117,994	121,733	113,348	112,330	29,113	494,518	-	494,518	-	494,518
Depreciation and amortization	277,214	251,380	300,716	254,623	26,740	1,110,673	-	1,110,673	-	1,110,673
Interest expense	222,266	132,938	170,522	222,544	-	748,270	-	748,270	-	748,270
Loss (gain) on disposal of property and equipment	246	5,653	(1,782)	(3,426)	-	691	-	691	-	691
Taxes and licenses	576,552	557,878	529,569	519,233	2,068	2,185,300	-	2,185,300	-	2,185,300
Provisions for doubtful accounts	15,654	-	652	-	-	16,306	-	16,306	-	16,306
Intercompany expense	330,255	330,258	330,257	330,259	(1,321,029)	-	-	-	-	-
Total expenses	10,113,696	10,034,726	9,395,058	9,013,000	90,375	38,646,855	21,993	38,668,848	12,092	38,680,940
Increase (decrease) in net assets (deficit)	96,984	(122,735)	(74,980)	117,425	164,243	180,937	(11,993)	168,944	1,931	170,875
Net assets (deficit) at beginning of year	2,505,051	869,566	1,558,691	1,860,114	(5,142,689)	1,650,733	-	1,650,733	163,533	1,814,266
Intercompany contribution	-	-	-	-	(125,100)	(125,100)	125,100	-	-	-
Net assets (deficit) at end of year	\$ 2,602,035	\$ 746,831	\$ 1,483,711	\$ 1,977,539	\$ (5,103,546)	\$ 1,706,570	\$ 113,107	\$ 1,819,677	\$ 165,464	\$ 1,985,141