

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

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)



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

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

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INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying consolidated balance sheets of Open Arms Care Corporation Inc., and Affiliate (collectively the "Company") as of December 31, 2012 and 2011, 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 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 Affiliate as of December 31, 2012 and 2011, 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 Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental consolidating balance sheet and statement of operations and changes in net assets are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such 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. The information has been subjected to the auditing procedures 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 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
March 7, 2013

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Consolidated Balance Sheets

December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Assets</u>		
Current assets:		
Cash and cash equivalents	\$ 2,773,760	\$ 3,344,817
Funds held in custody for others	225,743	259,671
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$89,000 in 2012 and 2011	3,372,624	3,475,824
Prepaid expenses and other current assets	42,871	217,054
Trusteed funds - current portion	<u>1,017,421</u>	<u>959,031</u>
Total current assets	<u>7,432,419</u>	<u>8,256,397</u>
Property and equipment:		
Land and land improvements	3,376,360	3,320,816
Buildings and improvements	20,532,693	20,312,563
Furniture and equipment	4,492,711	4,384,155
Vehicles	<u>156,931</u>	<u>151,051</u>
	28,558,695	28,168,585
Accumulated depreciation and amortization	<u>(21,834,246)</u>	<u>(20,742,402)</u>
Property and equipment	<u>6,724,449</u>	<u>7,426,183</u>
Other Assets:		
Trusteed funds	4,750,544	4,330,692
Bond issue costs, less accumulated amortization of approximately \$1,626,000 and 1,553,000 in 2012 and 2011, respectively	262,935	336,204
Investments and other long-term assets	<u>969,456</u>	<u>877,154</u>
Total other assets	<u>5,982,935</u>	<u>5,544,050</u>
Total assets	<u>\$ 20,139,803</u>	<u>\$ 21,226,630</u>
<u>Liabilities and Net Assets</u>		
Current liabilities:		
Accounts payable	\$ 663,512	\$ 851,390
Funds held in custody for others	225,743	259,671
Accrued salaries and benefits	1,562,221	1,524,998
Accrued interest	313,207	348,987
Current portion of long-term debt	<u>1,874,992</u>	<u>1,796,689</u>
Total current liabilities	4,639,675	4,781,735
Long-term debt, less current portion	<u>13,685,862</u>	<u>15,554,959</u>
Total liabilities	18,325,537	20,336,694
Net assets	<u>1,814,266</u>	<u>889,936</u>
Total liabilities and net assets	<u>\$ 20,139,803</u>	<u>\$ 21,226,630</u>

See accompanying notes to the consolidated financial statements.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted revenues:		
Net patient service revenues	\$ 39,819,475	\$ 40,604,096
Investment income	159,537	169,000
Net special events revenue	22,920	26,645
Other revenues	<u>29,150</u>	<u>25,330</u>
Total unrestricted revenues	<u>40,031,082</u>	<u>40,825,071</u>
Expenses:		
Salaries and wages	22,474,632	23,170,031
Employee benefits	4,460,706	4,789,126
Professional services	1,782,578	1,689,545
Supplies and expenses	4,434,791	4,814,205
Maintenance and repairs	491,083	519,275
Utilities	666,381	704,546
Insurance	522,013	528,283
Depreciation and amortization	1,174,031	1,274,551
Interest expense	840,079	923,908
(Gain) loss on disposal of property and equipment	(300)	21,854
Taxes and licenses	2,260,032	2,297,763
Provision for (recoveries of) doubtful accounts	<u>726</u>	<u>(60,512)</u>
Total expenses	<u>39,106,752</u>	<u>40,672,575</u>
Excess of revenues over expenses	924,330	152,496
Net assets at beginning of year	<u>889,936</u>	<u>737,440</u>
Net assets at end of year	<u>\$ 1,814,266</u>	<u>\$ 889,936</u>

See accompanying notes to the consolidated financial statements.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Excess of revenues over expenses	\$ 924,330	\$ 152,496
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Net (gains) losses on investments	(61,566)	(54,880)
Depreciation and amortization	1,174,031	1,274,551
Provision for (recoveries of) doubtful accounts	726	(60,512)
(Gain) loss on disposal of property and equipment	(300)	21,854
(Increase) decrease in operating assets:		
Patient accounts receivable	102,474	(61,739)
Prepaid expenses and other current assets	174,183	(46,756)
Other assets	(30,736)	(20,736)
Increase (decrease) in operating liabilities:		
Accounts payable	(187,878)	(123,334)
Accrued salaries and benefits	37,223	129,410
Accrued interest	(35,780)	(33,578)
Net cash provided by operating activities	<u>2,096,707</u>	<u>1,176,776</u>
Cash flows from investing activities:		
Proceeds from disposal of property and equipment	300	7,645
Purchase of property and equipment	(393,132)	(602,390)
Decrease (increase) in trustee funds	(478,242)	679,629
Net cash used in investing activities	<u>(871,074)</u>	<u>84,884</u>
Cash flows from financing activities -		
principal payments of long-term debt	<u>(1,796,690)</u>	<u>(1,707,354)</u>
Decrease in cash and cash equivalents	(571,057)	(445,694)
Cash and cash equivalents at beginning of year	<u>3,344,817</u>	<u>3,790,511</u>
Cash and cash equivalents at end of year	\$ <u>2,773,760</u>	\$ <u>3,344,817</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ <u>875,859</u>	\$ <u>957,486</u>

See accompanying notes to the consolidated financial statements.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

(1) Organization

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

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.

(2) Summary of significant accounting policies

(a) Principles of consolidation

These consolidated financial statements include the accounts of Open Arms Care Corporation, Inc. and Open Arms Care Foundation, Inc. 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 trust funds designated for operating expenditures, to be cash and cash equivalents.

(c) Investments

Investments, which are comprised of equity 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.

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.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

(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.

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, 2012, 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, 2009 through 2012.

(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 AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

(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) Reclassifications

Certain reclassifications have been made to the 2011 consolidated financial statements in order to conform to the 2012 presentation. These reclassifications have no effect on the excess of revenues over expenses or net assets as previously reported.

(k) Events occurring after reporting date

The Company has evaluated events and transactions that occurred between December 31, 2012 and March 7, 2013, 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 \$2,197,000 and \$2,232,000 of Tennessee provider tax expense for 2012 and 2011, respectively. Additionally, net patient service revenues include approximately \$2,197,000 and \$2,232,000 in reimbursement related to per diem rates as a result of the provider tax for 2012 and 2011, respectively.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

Substantially all net patient service revenues in 2012 and 2011 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.

(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, 2012 or 2011.

Financial Instruments

The carrying amount of financial instruments, consisting of cash and cash equivalents, trustee funds, 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, 2012 and 2011, 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.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

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, 2012 and 2011:

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>

Fair Value Measurements as of December 31, 2011 using the following inputs

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and equivalents	\$ 1,998,197	\$ -	\$ -	\$ 1,998,197
Marketable equity securities	808,456	-	-	808,456
Corporate & government debt securities	<u>984,971</u>	<u>2,330,712</u>	<u>-</u>	<u>3,315,683</u>
Total	\$ <u>3,791,624</u>	\$ <u>2,330,712</u>	\$ <u>-</u>	\$ <u>6,122,336</u>

(6) Trusteed funds

Trusteed funds consist of the following:

	<u>2012</u>	<u>2011</u>
Debt reserve funds	\$ 2,545,932	\$ 2,551,072
Debt service funds	1,017,421	959,031
Renewal and replacement funds	<u>2,204,612</u>	<u>1,779,620</u>
	\$ <u>5,767,965</u>	\$ <u>5,289,723</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.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

(7) Long-term debt

Long-term debt consists of the following:

	<u>2012</u>	<u>2011</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.	\$ 14,655,000	\$ 16,365,000
The Health, Educational and Housing Facility Board of the County of Shelby, Tennessee; interest at 4.34% per annum due July 1, 2023.	926,734	1,006,726
Capital lease obligations	-	6,697
Less bond issue discount	<u>(20,880)</u>	<u>(26,775)</u>
	15,560,854	17,351,648
Less current portion	<u>(1,874,992)</u>	<u>(1,796,689)</u>
Long-term debt, net of current portion	<u>\$ 13,685,862</u>	<u>\$ 15,554,959</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, 2011. On September 11, 2012, the Company entered into a forbearance agreement with Radian and amended the Master Trust Indenture. Radian agreed to not exercise its rights under the previous default at December 31, 2011 so long as no default occurs under the forbearance agreement or the amended Master Trust Indenture. Under the new agreements, the Company has agreed to certain covenants, which among other things, limit additional indebtedness and guarantees without written approval by Radian, requires the submission of quarterly unaudited financial statements to Radian and the Master Trustee, limits capital expenditures and requires the Company to comply with certain financial covenants including the maintenance of days cash on hand equal to or greater than 35 days and total income available for debt service of at least 100% as defined in the agreement. The Company was in compliance with its financial covenants on December 31, 2012.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

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%.

A summary of approximate future maturities on long-term debt as of December 31, 2012 is as follows:

<u>Year</u>	
2013	\$ 1,874,992
2014	1,965,000
2015	2,060,000
2016	2,165,000
2017	2,270,000
2018 and later years	5,246,742
Less bond issue discount	<u>(20,880)</u>
	<u>\$ 15,560,854</u>

(8) Investment income

Investment income during 2012 and 2011 was comprised of the following:

	<u>2012</u>	<u>2011</u>
Interest and dividend	\$ 97,971	\$ 114,120
Realized gain (loss)	85,244	3,995
Change in unrealized gain (loss)	<u>(23,678)</u>	<u>50,885</u>
	<u>\$ 159,537</u>	<u>\$ 169,000</u>

(9) Commitments and Contingencies

Operating Lease Commitments

Future minimum annual rental payments under noncancelable operating lease and service agreements as of December 31, 2012 are as follows:

<u>Year</u>	
2013	\$ 444,000
2014	277,000
2015	244,000
2016	223,000
2017	197,000
Thereafter	<u>7,000</u>
	<u>\$ 1,392,000</u>

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

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Total rental expense under noncancelable operating leases and service agreements, which includes amounts applicable to short-term leases, was approximately \$935,000 and \$1,083,000 for 2012 and 2011, respectively. The expense for 2012 is higher than the future commitments due to vehicle leases that have cancellation features at the Company's option.

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.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Notes to the Consolidated Financial Statements

December 31, 2012 and 2011

(10) Related party transactions

The Company incurred professional fees and expenses totaling approximately \$62,000 and \$44,000 in 2012 and 2011, respectively, for services provided by an entity owned by a board member.

(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>2012</u>	<u>2011</u>
Intellectual and developmental services	\$ 35,706,995	\$ 36,889,900
General and administrative	3,293,236	3,713,111
Fundraising	<u>106,521</u>	<u>69,564</u>
	<u>\$ 39,106,752</u>	<u>\$ 40,672,575</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, 2012 and 2011, the Company contributed 1.2% and 2.0%, respectively, of each participants' compensation, subject to Internal Revenue Code limitations. The Company contributed approximately \$180,000 and \$283,000 to the plan in 2012 and 2011, 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 AFFILIATE

Supplemental Schedule - Consolidating Balance Sheet

December 31, 2012

Assets

	Chattanooga	Knoxville	Memphis	Nashville	Headquarters*	Total Open Arms Care Corporation	Open Arms Care Foundation	Total Combined Open Arms Care Corporation
Current assets:								
Cash and cash equivalents	\$ 4,000	\$ 5,000	\$ 3,500	\$ 5,000	\$ 2,592,238	\$ 2,609,738	\$ 164,022	\$ 2,773,760
Funds held in custody for others	49,207	44,441	34,624	96,956	515	225,743	-	225,743
Patient accounts receivable, net	871,255	852,714	842,148	803,545	2,962	3,372,624	-	3,372,624
Prepaid expenses and other current assets	8,950	12,855	3,909	6,419	10,738	42,871	-	42,871
Trusteed funds - current portion	-	-	-	-	1,017,421	1,017,421	-	1,017,421
Total current assets	933,412	915,010	884,181	911,920	3,623,874	7,268,397	164,022	7,432,419
Property and equipment:								
Land and land improvements	632,980	859,971	672,897	1,210,512	-	3,376,360	-	3,376,360
Buildings and improvements	5,012,332	4,810,249	6,092,870	4,593,763	23,479	20,532,693	-	20,532,693
Furniture and equipment	999,032	996,342	953,508	1,069,172	474,657	4,492,711	-	4,492,711
Vehicles	26,071	18,555	54,707	57,598	-	156,931	-	156,931
Accumulated depreciation and amortization	6,670,415	6,685,117	7,773,982	6,931,045	498,136	28,558,695	-	28,558,695
	(5,146,119)	(5,485,505)	(5,325,292)	(5,449,229)	(428,101)	(21,834,246)	-	(21,834,246)
Property and equipment	1,524,296	1,199,612	2,448,690	1,481,816	70,035	6,724,449	-	6,724,449
Other Assets:								
Trusteed funds	795,513	475,716	470,639	796,527	2,212,149	4,750,544	-	4,750,544
Bond issue costs, less accumulated amortization	79,340	47,454	56,702	79,439	-	262,935	-	262,935
Other assets	14,264	21,115	14,360	302	919,415	969,456	-	969,456
Total assets	\$ 3,346,825	\$ 2,658,907	\$ 3,874,572	\$ 3,270,004	\$ 6,825,473	\$ 19,975,781	\$ 164,022	\$ 20,139,803

*For 2012, the Georgia location was included within the Headquarters column. In previous years, it was presented separately. Management does not expect any future operations within Georgia.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

Supplemental Schedule - Consolidating Balance Sheet (continued)

December 31, 2012

Liabilities and Net Assets (Deficit)

	Chattanooga	Knoxville	Memphis	Nashville	Headquarters*	Total Open Arms Care Corporation	Open Arms Care Foundation	Total Combined Open Arms Care Corporation
Current liabilities:								
Accounts payable	\$ 121,540	\$ 126,720	\$ 234,033	\$ 126,724	\$ 54,006	\$ 663,023	\$ 489	\$ 663,512
Funds held in custody for others	49,207	44,440	34,624	96,957	515	225,743	-	225,743
Accrued salaries and benefits	411,317	383,826	350,004	341,640	75,434	1,562,221	-	1,562,221
Accrued interest	97,591	58,370	59,532	97,714	-	313,207	-	313,207
Current portion of long-term debt	562,511	336,440	412,824	563,217	-	1,874,992	-	1,874,992
Total current liabilities	1,242,166	949,796	1,091,017	1,226,252	129,955	4,639,186	489	4,639,675
Intercompany payable/(receivable)	(4,423,319)	(1,566,919)	(2,002,536)	(3,845,433)	11,838,207	-	-	-
Long-term debt, less current portion	4,022,927	2,406,464	3,227,400	4,029,071	-	13,685,862	-	13,685,862
Total liabilities	841,774	1,789,341	2,315,881	1,409,890	11,968,162	18,325,048	489	18,325,537
Net assets (deficit), unrestricted	2,505,051	869,566	1,558,691	1,860,114	(5,142,689)	1,650,733	163,533	1,814,266
Total liabilities and net assets (deficit)	\$ 3,346,825	\$ 2,658,907	\$ 3,874,572	\$ 3,270,004	\$ 6,825,473	\$ 19,975,781	\$ 164,022	\$ 20,139,803

*For 2012, the Georgia location was included within the Headquarters column. In previous years, it was presented separately. Management does not expect any future operations within Georgia.

OPEN ARMS CARE CORPORATION INC., AND AFFILIATE

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

Year ended December 31, 2012

	Chattanooga	Knoxville	Memphis	Nashville	Headquarters*	Total Open Arms Care Corporation	Open Arms Care Foundation	Total Combined Open Arms Care Corporation
Unrestricted revenue								
Net patient service revenues	\$ 10,537,779	\$ 9,961,681	\$ 9,805,881	\$ 9,514,134	\$ -	\$ 39,819,475	\$ -	\$ 39,819,475
Investment income	22,853	13,665	13,520	22,883	86,302	159,223	314	159,537
Net special events revenue	-	-	-	-	-	-	22,920	22,920
Intercompany revenue	12,319	4,765	2,884	23,516	25,000	68,484	(68,484)	-
Other revenues	1,585	1,138	1,874	1,269	175	6,041	23,109	29,150
Total unrestricted revenues	<u>10,574,536</u>	<u>9,981,249</u>	<u>9,824,159</u>	<u>9,561,802</u>	<u>111,477</u>	<u>40,053,223</u>	<u>(22,141)</u>	<u>40,031,082</u>
Expenses:								
Salaries and wages	5,685,260	5,942,207	5,232,426	5,039,123	575,616	22,474,632	-	22,474,632
Employee benefits	1,282,651	1,203,240	966,781	958,856	49,178	4,460,706	-	4,460,706
Professional services	269,026	204,315	769,926	273,321	263,635	1,780,223	-	1,782,578
Supplies and expenses	1,107,591	1,024,409	931,950	912,657	452,658	4,429,265	5,526	4,434,791
Maintenance and repairs	94,768	111,383	111,276	171,022	2,634	491,083	-	491,083
Utilities	170,655	149,072	154,325	192,329	-	666,381	-	666,381
Insurance	122,867	128,010	120,369	117,207	33,560	522,013	-	522,013
Depreciation and amortization	288,471	270,106	318,096	266,267	31,091	1,174,031	-	1,174,031
Interest expense	249,928	149,436	190,553	250,162	-	840,079	-	840,079
Gain on disposal of property and equipment	-	-	(300)	-	-	(300)	-	(300)
Taxes and licenses	602,876	553,673	559,475	542,223	1,785	2,260,032	-	2,260,032
Provision for (recoveries of) doubtful accounts	-	-	726	-	-	726	-	726
Intercompany expense	322,072	322,071	322,071	322,072	(1,288,286)	-	-	-
Total expenses	<u>10,196,165</u>	<u>10,057,922</u>	<u>9,677,674</u>	<u>9,045,239</u>	<u>121,871</u>	<u>39,098,871</u>	<u>7,881</u>	<u>39,106,752</u>
(Increase) decrease in net assets (deficit)	378,371	(76,673)	146,485	516,563	(10,394)	954,352	(30,022)	924,330
Net assets (deficit) at beginning of year	2,126,680	946,239	1,412,206	1,343,551	(5,132,295)	696,381	193,555	889,936
Net assets (deficit) at end of year	<u>\$ 2,505,051</u>	<u>\$ 869,566</u>	<u>\$ 1,558,691</u>	<u>\$ 1,860,114</u>	<u>\$ (5,142,689)</u>	<u>\$ 1,650,733</u>	<u>\$ 163,533</u>	<u>\$ 1,814,266</u>

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