

CENTERSTONE COMMUNITY MENTAL
HEALTH CENTERS, INC.
COMBINED FINANCIAL STATEMENTS
WITH ACCOMPANYING INFORMATION

YEAR ENDED JUNE 30, 2005

and

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINED FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION
Year Ended June 30, 2005

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THURMAN, CAMPBELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Centerstone Community Mental Health Centers, Inc.

We have audited the accompanying combined statement of financial position of Centerstone Community Mental Health Centers, Inc. (a non-profit organization) as of June 30, 2005, and the related combined statements of activities, functional expenses and cash flows for the year 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audit provides 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 Centerstone Community Mental Health Centers, Inc. as of June 30, 2005, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2005 on our consideration of Centerstone Community Mental Health Centers, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of Centerstone Community Mental Health Centers, Inc. taken as a whole. The combining statements of financial position and the combining statements of activities on pages 12 and 13 are presented for purposes of additional analysis and are not a required part of the basic financial information. The schedules of expenditures of federal awards and state grant activity on pages 14 and 15 are presented for the purposes of additional analysis as required by the U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the State of Tennessee, Department of Audit, *Audit Manual*, and are 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.

Shurman, Campbell & Co.

September 23, 2005

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINED STATEMENT OF FINANCIAL POSITION
June 30, 2005

ASSETS

Current assets:	
Cash	\$ 3,004,109
Investments	918,773
Accounts receivable (less allowance \$1,907,742)	5,528,359
Contributions receivable	40,244
Other receivables	185,465
Inventory	118,768
Prepaid expenses	712,061
Total current assets	<u>10,507,779</u>
Centerstone Trust investments:	
Cash and cash equivalents	585,544
Investments	6,604,921
Total endowment investments	<u>7,190,465</u>
Property, plant and equipment	29,912,980
Less accumulated depreciation	(13,748,459)
	<u>16,164,521</u>
Other assets:	
Cash limited as to use by Board	11,149,766
Deposits	28,203
Bond issue costs	1,648
	<u>11,179,617</u>
Restricted cash:	
Debt service	56,515
Cash	142,980
	<u>199,495</u>
TOTAL ASSETS	<u>\$ 45,241,877</u>

LIABILITIES AND NET ASSETS

Current liabilities:	
Current maturities of long-term debt	\$ 755,986
Accounts payable	880,666
Accrued expenses	4,716,648
Total current liabilities	<u>6,353,300</u>
Long-term debt less current maturities	<u>1,201,341</u>
TOTAL LIABILITIES	<u>7,554,641</u>
<u>NET ASSETS</u>	
Unrestricted	32,072,248
Temporarily restricted	5,614,988
TOTAL NET ASSETS	<u>37,687,236</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 45,241,877</u>

The accompanying notes are an integral part of these financial statements.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINED STATEMENT OF ACTIVITIES
Year ended June 30, 2005

CHANGES IN UNRESTRICTED NET ASSETS

Public Support:	
Contributions	\$ 771,191
Revenue:	
Government contracts	1,372,743
Program service fees	43,465,764
Investment return	321,525
Other	<u>798,199</u>
 TOTAL UNRESTRICTED SUPPORT AND REVENUE	 46,729,422
Net assets released from restrictions	
Restrictions satisfied by contract\grant compliance	<u>8,984,651</u>
 TOTAL UNRESTRICTED SUPPORT, REVENUE AND RECLASSIFICATIONS	 <u>55,714,073</u>
 Expenses and Losses:	
Program services	45,831,799
Supporting services	9,573,415
Development	<u>392,026</u>
 TOTAL EXPENSES	 <u>55,797,240</u>
 DECREASE IN UNRESTRICTED NET ASSETS	 <u>(83,167)</u>
 CHANGES IN TEMPORARILY RESTRICTED NET ASSETS	
Government contracts\grants	8,984,651
Net Investment return	419,714
Contributions made	(750,000)
Net assets released from restrictions	
Restrictions satisfied by contract\grant compliance	<u>(8,984,651)</u>
 DECREASE IN TEMPORARILY RESTRICTED NET ASSETS	 <u>(330,286)</u>
 DECREASE IN NET ASSETS	 (413,453)
 NET ASSETS BEGINNING OF YEAR	 <u>38,100,689</u>
 NET ASSETS END OF YEAR	 <u>\$ 37,687,236</u>

The accompanying notes are an integral part of these financial statements.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
 COMBINED STATEMENT OF FUNCTIONAL EXPENSES
 Year ended June 30, 2005

	Core Services	Adult Services	Children & Youth Services	Total Program Services	Management & General	Development	Total Functional Expenses
Salaries and benefits	\$ 10,524,958	\$ 8,996,407	\$ 8,733,154	\$ 28,254,519	\$ 9,906,774	\$ 192,437	\$ 38,353,730
Facilities	536,653	647,511	583,291	1,767,455	525,975	1,785	2,295,215
Interest	635	3,102	3,719	7,456	41,721	-	49,177
Communications	242,249	326,232	256,028	824,509	198,141	2,131	1,024,781
Travel & transportation	55,845	538,445	404,219	998,509	111,760	257	1,110,526
Supplies	3,100,572	197,740	317,542	3,615,854	324,388	10,510	3,950,752
Client assistance	7,650	350,293	261,498	619,441	-	-	619,441
Subcontracted services	691,352	1,295,470	702,838	2,689,660	10,932	-	2,700,592
Professional fees	111,342	15,170	874,259	1,000,771	694,941	1,846	1,697,558
Computer	6,906	9,034	9,629	25,569	260,293	11,265	297,127
Insurance	293,592	195,452	128,604	617,648	12,832	47	630,527
Depreciation	329,425	205,405	262,085	796,915	553,518	1,641	1,352,074
Advertising & promotion	23,556	42,683	21,340	87,579	447,903	20,392	555,874
Postage	27,322	13,490	11,261	52,073	63,979	3,775	119,827
Professional growth	33,657	75,037	109,838	218,532	89,767	283	308,582
Bad Debt	448,513	24,571	16,247	489,331	(389,974)	-	99,357
Other	92,539	58,347	67,176	218,062	268,381	145,657	632,100
Support Staff Allocation	1,933,300	818,579	796,037	3,547,916	(3,547,916)	-	-
Total Expenses	<u>\$ 18,460,066</u>	<u>\$ 13,812,968</u>	<u>\$ 13,558,765</u>	<u>\$ 45,831,799</u>	<u>\$ 9,573,415</u>	<u>\$ 392,026</u>	<u>\$ 55,797,240</u>

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINED STATEMENT OF CASH FLOWS
Year ended June 30, 2005

CASH FLOWS FROM OPERATING ACTIVITIES	
Decrease in Net Assets	(\$ 413,453)
Adjustments to Reconcile Increase in Net Assets to Net Cash Provided by Operating Activities:	
Depreciation	1,356,363
Unrealized gain on investments	(312,862)
(Increase) Decrease in:	
Receivables	(460,300)
Prepaid expenses	41,795
Other assets	(46,684)
Increase (Decrease) in:	
Accounts payable	(144,749)
Accrued liabilities	(162,209)
NET CASH USED BY OPERATING ACTIVITIES	(142,099)
CASH FLOWS FROM INVESTING ACTIVITIES	
Acquisition of property & equipment	(2,942,214)
Purchase of investments	(159,187)
NET CASH USED BY INVESTING ACTIVITIES	(3,101,401)
CASH FLOWS FROM FINANCING ACTIVITIES	
Principal payments on long-term debt	(195,902)
NET CASH USED BY FINANCING ACTIVITIES	(195,902)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,439,402)
BEGINNING CASH AND CASH EQUIVALENTS	17,593,277
ENDING CASH AND CASH EQUIVALENTS	<u>\$ 14,153,875</u>

Supplemental Disclosure of Cash Flow Information

Cash Paid During the Year for:

Interest	<u>\$ 60,798</u>
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The accompanying notes are an integral part of these financial statements.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO THE COMBINED FINANCIAL STATEMENTS

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Centerstone Community Mental Health Centers, Inc. and its affiliates (the Center) are private, non-profit corporations, that provide multi-funded, locally directed community mental health services for treatment and prevention of emotional, mental and social problems of everyday living. The Center maintains clinics in multiple Tennessee counties, with the main administrative offices located in Nashville, Tennessee. The Center and its affiliates share a common management team and Board of Directors.

Basis of Presentation - Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not-for-Profit Organizations and Statement of Financial Accounting Standards (SFAS) No. 116, Accounting for Contributions Received and Contributions Made. Under SFAS No. 117, 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. SFAS No. 116 requires the Organization to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets.

Principles of Combination - The combined financial statements include the accounts of Centerstone Community Mental Health Centers, Inc., Cumberland Holding Corporation, Advantage Behavioral Health and The Centerstone Trust. All material intercompany accounts and transactions have been eliminated.

Revenue Recognition - Support received is recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restriction.

Donated Services - The Organization receives donated services from a variety of unpaid volunteers. No amounts have been recognized in the accompanying statement of activities because the criteria for recognition of such volunteer effort under SFAS No. 116 have not been satisfied.

Investments - The organization has adopted SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations." Under SFAS No. 124, investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets. Investment income and gains restricted by a donor are reported as increases in unrestricted net assets if the restrictions are met (either by passage of time or by use) in the reporting period in which the income and gains are recognized.

Cash and cash equivalents - For purposes of the statement of cash flows, the Center considers all highly liquid instruments with maturities of three months or less to be cash equivalents.

Income taxes - The organizations combined herein are exempt from federal income taxes under Section 501 (c) (3) of the Internal Revenue Code.

Property, plant, and equipment - Property and equipment are carried at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

Retirement - The Center maintains a 403(b) Retirement Savings Plan for all eligible employees (See Note 6).

Advertising - Advertising costs are expensed as incurred and are included in advertising and promotion expense.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO THE COMBINED FINANCIAL STATEMENTS
(Continued)

Temporarily Restricted Net Assets – The Center's temporarily restricted net assets consist of a gift to The Centerstone Foundation where the use of the funds is restricted by the terms of the gift (See Note 13).

Restricted Cash - The Center's restricted cash includes debt service withheld by the Tennessee Local Development Authority pooled loan program representing one year of debt service, cash restricted by HUD regulations and a debt service reserve required by agreement with The Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County.

Bond Issue Costs - Bond issue costs related to the issue of Tennessee Local Development Authority's pooled loan program and The Health & Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County, Tennessee, Revenue Bonds are being amortized over the life of the bonds using the straight-line method.

Use of Accounting Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following (includes cash limited as to use by board):

Cash on hand	\$ 16,822
Cash in checking accounts	2,569,796
Money market accounts	11,567,257
	<u>\$ 14,138,735</u>

3 INVESTMENTS

The Center carries its investments at fair market value. Investments at June 30, 2005 consist of the following:

	Cost	Fair Value
Money Markets	\$ 504,420	\$ 504,420
Common stocks	3,071,630	4,183,613
Bonds	3,408,853	3,421,205
	<u>\$ 6,984,903</u>	<u>\$ 8,109,238</u>

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO THE COMBINED FINANCIAL STATEMENTS
(Continued)

4 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	Cost	Accumulated Depreciation	Estimated Useful Lives
Land	2,531,514	\$ 0	
Buildings and improvements	18,439,228	7,104,863	10-40 years
Equipment and vehicles	8,942,238	6,643,596	5-20 years
	<u>29,912,980</u>	<u>13,748,459</u>	

Total depreciation expense for 2005 was \$1,356,363.

5 NOTES PAYABLE

4.69 % financed insurance	\$ 401,049
Variable rate bonds payable	1,300,000
6.65% pooled loan agreement	69,448
8.375% note payable	186,830
	<u>1,957,327</u>
Less current maturities	755,986
	<u>\$ 1,201,341</u>

The 4.69 percent note in the amount of \$401,049 is unsecured. The note requires monthly principal and interest payments of \$58,192 through February 2006.

Per an agreement dated March 1, 1996, The Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County, Tennessee, (the "Metropolitan Board") issued Revenue Bonds in the principle amount of \$4,000,000. The Metropolitan Board agreed to lend to Dede Wallace Center, from the sale proceeds, \$4,000,000 to pay the costs of renovating and equipping certain facilities. Under the terms of the promissory note, principal payments are deposited into a reserve account monthly at various amounts, beginning with \$30,000 and declining over the term to \$8,333 through March 2011. Interest on the outstanding balance is due monthly at variable rates. Principal is paid from the reserve annually. The promissory note is secured by a negative pledge on certain land, buildings, and improvements of the organization and a \$3,761,667 bank letter of credit guaranteed by the Centerstone Community Mental Health Centers Endowment Trust. The agreements related to the bonds contain various requirements and financial covenants. Management is of the opinion that the Organization is in compliance with all requirements and covenants. The balance was \$1,300,000 at June 30, 2005.

During 1992, the Center refinanced four loans through the pooled loan program with the Tennessee Local Development Authority. This 6.65 percent loan is secured by a deed of trust on the Martin Street, Greenwood Avenue and Tennessee Ridge properties together with all machinery, apparatus, equipment, fittings and fixtures actually or constructively attached to these properties. The loan requires a monthly payment of \$4,231 through October 1993 then monthly payments of \$4,710 through October 2006. The balance was \$69,448 at June 30, 2005.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO THE COMBINED FINANCIAL STATEMENTS
(Continued)

5 NOTES PAYABLE (Continued)

The 8.375 percent note in the amount of \$186,830 is secured by real estate located in Clarksville, Tennessee. The note requires monthly principal and interest payments of \$1,468 through March 2031.

Maturities of long-term debt in each of the next five years are as follows:

2006	\$	755,986
2007		318,967
2008		302,523
2009		302,753
2010		102,981

6 RETIREMENT PLAN

On May 1, 1998 the Center implemented a 403(b) Retirement Savings Plan for all eligible employees. The plan allows employee contributions limited to the lesser of 20% of compensation or the maximum allowed by law. The plan also allows for employer matching at the discretion of the Center. Retirement expense for the year ended June 30, 2005 was \$813,351.

7 CONTRACTS

The Center enters into program administrative contracts and grants with the local, state and federal government agencies. These contracts are for the purpose of providing mental health and drug and alcohol services in accordance with applicable federal and state laws, regulations, program guidelines, service definitions and stated goals. Total revenue under these grants and contracts for 2005 was \$10,357,394.

8 LEASES

The Center leases property in several Tennessee counties. Total lease expense was \$647,083 for the year ended June 30, 2005.

Present values of future minimum lease payments are as follows:

2006	\$	433,694
2007		208,204
2008		83,500
2009		28,800
2010		26,400

9 COMPENSATED ABSENCES

Employees of the Center are entitled to paid time off depending on the length of service. The estimated value of accumulated paid time off was \$2,301,080 as of June 30, 2005.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO THE COMBINED FINANCIAL STATEMENTS
(Continued)

10 CONTINGENCIES

The Center has pending lawsuits for damages in which it is named as the defendant. The Center, after consultation with counsel, believes that these claims will not materially affect the Center's financial position.

Funding for the majority of the Center's programs is provided by federal, state, and local government agencies. These funds are to be used for designated purposes only. If, based on the grantor's/contractor's review, the funds are considered not to have been used for the intended purpose or the terms of the grant/contract, the grantor/contractor may request a refund of monies advanced or refuse to reimburse the Center for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the Center's programs is predicated upon the compliance of the Center with the grant/contract terms and the grantor's/contractor's intent to continue their programs.

The Center reimburses its health insurance trustee under its group health insurance plan on a claims made basis. The estimated liability for unpaid claims was \$374,816 as of June 30, 2005.

11 FINANCIAL INSTRUMENTS

The Center maintains cash balances at various local financial institutions. Balances, at times, may be uninsured or may exceed federally insured limits. The Center has not experienced any losses in such accounts. Management believes it is not exposed to any significant concentration risk on cash.

12 CONCENTRATION OF CREDIT RISK

The organization serves mental health clients that reside in middle Tennessee. Charges for services not covered by insurance or other third party agreements are billed and credit is granted according to the individual client's ability to pay.

13 THE CENTERSTONE FOUNDATION

On October 28, 2000 Centerstone Community Mental Health Centers, Inc. established The Centerstone Foundation for the purpose of serving as a permanent charitable endowment fund for the support of Centerstone. Centerstone Community Mental Health Centers, Inc. is the sole trustee of the Foundation. Currently, the terms of the Foundation require annual distributions to Centerstone of an amount equal to 4.5% of the average of the net fair market values of the Foundation assets as determined at the end of the three most recently completed calendar years. The fair value of the Foundation assets as of June 30, 2005 was \$7,190,465.

The Foundation was initially funded by a gift from the Dede Wallace Foundation. The terms of the gift included restrictions on the use of funds distributed by the Foundation to Centerstone.

ACCOMPANYING INFORMATION

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINING STATEMENTS OF FINANCIAL POSITION
June 30, 2005

	Centerstone	Cumberland Holding Corp.	Advantage Behavioral Health	The Centerstone Foundation	Sub-total	Eliminations	Combined Total
<u>ASSETS</u>							
Current assets:							
Cash	\$ 2,965,163	\$ 38,946	\$ -	\$ -	\$ 3,004,109	\$ -	\$ 3,004,109
Investments	918,773				918,773		918,773
Accounts receivable	5,528,359				5,528,359		5,528,359
Contributions receivable	865,721				865,721	(825,477)	40,244
Other receivables	2,109,483				2,109,483	(1,924,018)	185,465
Inventory	118,768				118,768		118,768
Prepaid expenses	712,061				712,061		712,061
Total current assets	13,218,328	38,946	-	-	13,257,274	(2,749,495)	10,507,779
Foundation investments:							
Cash and cash equivalents				585,544	585,544		585,544
Investments				6,604,921	6,604,921		6,604,921
Total foundation investments	-	-	-	7,190,465	7,190,465	-	7,190,465
Property, plant and equipment	29,709,930	203,050			29,912,980		29,912,980
Less accumulated depreciation	(13,670,706)	(77,753)			(13,748,459)		(13,748,459)
	16,039,224	125,297	-	-	16,164,521	-	16,164,521
Other assets:							
Cash limited as to use by Board	11,149,766				11,149,766		11,149,766
Deposits	28,203				28,203		28,203
Bond issue costs	1,648				1,648		1,648
	11,179,617	-	-	-	11,179,617	-	11,179,617
Restricted cash:							
Debt Service	56,515				56,515		56,515
Other	110,470	32,510			142,980		142,980
	166,985	32,510	-	-	199,495	-	199,495
TOTAL ASSETS	\$ 40,604,154	\$ 196,753	\$ -	\$ 7,190,465	\$ 47,991,372	\$ (2,749,495)	\$ 45,241,877
<u>LIABILITIES</u>							
Current liabilities:							
Current maturities of long-term debt	\$ 752,859	\$ 3,127	\$ -	\$ -	\$ 755,986	\$ -	\$ 755,986
Accounts payable	1,459,972	90,878	503,834	1,575,477	3,630,161	(2,749,495)	880,666
Accrued expenses	4,711,351	5,297			4,716,648		4,716,648
Total current liabilities	6,924,182	99,302	503,834	1,575,477	9,102,795	(2,749,495)	6,353,300
Long-term debt less current liabilities	1,017,638	183,703			1,201,341		1,201,341
TOTAL LIABILITIES	7,941,820	283,005	503,834	1,575,477	10,304,136	(2,749,495)	7,554,641
<u>NET ASSETS</u>							
Unrestricted	32,662,334	(86,252)	(503,834)		32,072,248		32,072,248
Temporarily restricted				5,614,988	5,614,988		5,614,988
TOTAL NET ASSETS	32,662,334	(86,252)	(503,834)	5,614,988	37,687,236	-	37,687,236
TOTAL LIABILITIES AND NET ASSETS	\$ 40,604,154	\$ 196,753	\$ -	\$ 7,190,465	\$ 47,991,372	\$ (2,749,495)	\$ 45,241,877

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
COMBINING STATEMENTS OF ACTIVITIES
Year ended June 30, 2005

	Centerstone	Cumberland Holding Corp.	Advantage Behaviorial Health	The Centerstone Foundation	Sub-total	Eliminations	Combined Total
CHANGES IN UNRESTRICTED NET ASSETS							
Public Support:							
Contributions	\$ 1,086,344	\$ -	\$ -	\$ -	\$ 1,086,344	\$ (315,153)	\$ 771,191
Revenue:							
Government contracts	1,372,743				1,372,743		1,372,743
Program service fees	43,437,829	27,935			43,465,764		43,465,764
Investment return	321,525				321,525		321,525
Other	798,199				798,199		798,199
TOTAL UNRESTRICTED SUPPORT & REVENUE	47,016,640	27,935	-	-	47,044,575	(315,153)	46,729,422
Net assets released from restrictions:							
Restrictions satisfied by grant compliance	8,984,651				8,984,651		8,984,651
TOTAL UNRESTRICTED SUPPORT, REVENUE AND RECLASSIFICATIONS	56,001,291	27,935	-	-	56,029,226	(315,153)	55,714,073
Expenses:							
Program services	45,762,452	69,347			45,831,799		45,831,799
Supporting services	9,239,470		333,945		9,573,415		9,573,415
Development	392,026				392,026		392,026
TOTAL EXPENSES	55,393,948	69,347	333,945	-	55,797,240	-	55,797,240
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	607,343	(41,412)	(333,945)	-	231,986	(315,153)	(83,167)
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS							
Government contracts\grants	8,984,651				8,984,651		8,984,651
Investment return				446,848	446,848		446,848
Investment/professional fees				(27,134)	(27,134)		(27,134)
Contributions made				(1,065,153)	(1,065,153)	315,153	(750,000)
Net assets released from restrictions							
Restrictions satisfied by grant compliance	(8,984,651)				(8,984,651)		(8,984,651)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	-	-	-	(645,439)	(645,439)	315,153	(330,286)
INCREASE (DECREASE) IN NETS ASSETS	607,343	(41,412)	(333,945)	(645,439)	(413,453)		(413,453)
NET ASSETS BEGINNING OF YEAR	32,054,991	(44,840)	(169,889)	6,260,427	38,100,689		38,100,689
NET ASSETS END OF YEAR	\$ 32,662,334	\$ (86,252)	\$ (503,834)	\$ 5,614,988	\$ 37,687,236	\$ -	\$ 37,687,236

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2005

Federal Grantor/ Pass-through Grantor/ Program Title	Federal CFDA Number	Pass-through Grantor Number	June 30, 2004 (Accrued)	Federal Receipts	Federal Expenditures	June 30, 2005 (Accrued)
U.S. Dept. of Agriculture						
TN Department of Education						
School Breakfast/Lunch Program	10.553/10.555	N/A	\$ (18,321)	\$ 18,321	\$ -	\$ -
School Breakfast/Lunch Program	10.553/10.555	DP0502082	-	41,743	(51,105)	(9,362)
TN Department of Human Services						
School Breakfast/Lunch Program	10.553/10.555	DA0400069	-	1,770	(1,770)	-
School Breakfast/Lunch Program	10.553/10.555	DA0500086	-	8,206	(9,071)	(865)
Subtotal-U.S. Dept. of Agriculture			<u>(18,321)</u>	<u>70,040</u>	<u>(61,946)</u>	<u>(10,227)</u>
U.S. Dept. of Housing & Urban Development						
Tennessee Housing Development Agency						
Community Development Block Grant-HOME	14.239	HM0314	-	-	(321,112)	(321,112)
Subtotal-U.S. Dept. of Housing & Urban Development			<u>-</u>	<u>-</u>	<u>(321,112)</u>	<u>(321,112)</u>
U.S. Dept. of Justice						
TN Dept. of Finance and Administration						
Victims of Crime Assistance	16.575	Z00099323	(7,292)	60,918	(59,446)	(5,820)
Victims of Crime Assistance	16.575	Z00099350	(4,580)	40,190	(39,443)	(3,833)
Victims of Crime Assistance	16.575	Z00004850	(1,659)	49,500	(51,454)	(3,613)
Victims of Crime Assistance	16.575	Z00004851	(1,416)	1,416	-	-
TN Department of Mental Health and Developmental Disabilities						
Peer Power	16.679	GR0415526	(8,012)	8,012	-	-
Peer Power	16.679	GR0516392	-	40,972	(64,925)	(23,953)
Subtotal-U.S. Dept. of Justice			<u>(22,959)</u>	<u>201,008</u>	<u>(215,268)</u>	<u>(37,219)</u>
U.S. Dept. of Labor						
Welfare to Work	17.253	N/A	(1,535,310)	1,593,348	(58,038)	-
Subtotal-U.S. Dept. of Labor			<u>(1,535,310)</u>	<u>1,593,348</u>	<u>(58,038)</u>	<u>-</u>
U.S. Dept. of Health & Human Services						
Bilingual/Bicultural Service Demonstration Program	93.105	MOA	-	-	(9,682)	(9,682)
SPRANS-Community Based Abstinence Program	93.110	1 H1DMC03202-01-0C	-	245,368	(373,378)	(128,010)
SAMHSA-Clarksville Homeless Adult Program	92.243	5H79T116562-02	-	46,746	(123,583)	(76,837)
TN Dept. of Mental Health & Developmental Disabilities						
Bio-Terror Response	93.003	GR0416110	(21,193)	21,193	-	-
Early Response Capacity	93.243	GR0415763	(4,439)	4,439	-	-
State Older Adult Coalition	93.958	GR0214579	(19,238)	19,238	-	-
Community Mental Health Services	93.958	GR0415533	(253,707)	253,707	-	-
Community Mental Health Services	93.958	GR0516314	-	1,197,349	(1,417,542)	(220,193)
Nashville Connection	93.104	GR0415555	(9,504)	9,504	-	-
Nashville Connection	93.104	GR0516303	-	34,569	(47,580)	(13,011)
Project for Assistance in Transition from Homeless	93.150	GR0516187	-	43,916	(50,000)	(6,084)
Substance Abuse Treatment for Older Adults	93.230	GR0516746	-	27,297	(168,502)	(141,205)
National Service Americorps	94.006	GR0415534	(10,620)	10,620	-	-
National Service Americorps	94.006	GR0516273	-	34,502	(53,050)	(18,548)
TN Dept. of Health						
Alcohol & Drug Abuse	93.959	GR0415718	(77,165)	77,165	-	-
Alcohol & Drug Abuse	93.959	GR0516555	-	381,803	(447,594)	(65,791)
Community Prevention Initiative (Strengthening Families)	93.959	Z-05020811	-	10,426	(48,458)	(38,032)
Metro Davidson Co. Board Of Health						
Community Prevention Initiative (Peer Power)	93.959	N/A	(3,777)	18,691	(18,199)	(3,285)
Subtotal U.S. Dept. of Health & Human Services			<u>(399,643)</u>	<u>2,436,533</u>	<u>(2,757,568)</u>	<u>(720,678)</u>
Total Federal Awards			<u>\$ (1,976,233)</u>	<u>\$ 4,300,929</u>	<u>\$ (3,413,932)</u>	<u>\$ (1,089,236)</u>

See accompanying notes to schedules.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
SCHEDULE OF STATE GRANT ACTIVITY
Year ended June 30, 2005

State Grantor/ Program Title	State Grantor Number	June 30, 2004 (Accrued)	State Receipts	State Expenditures	June 30, 2005 (Accrued)
TN Dept. of Mental Health & Developmental Disabilities					
Community Mental Health Services	GR0415533	\$ (106,565)	\$ 106,565	\$ -	\$ -
Community Mental Health Services	GR0516314	-	387,548	(695,008)	(307,460)
Peer Power	GR0415526	(2,670)	2,670	-	-
Peer Power	GR0516392	-	13,655	(21,639)	(7,984)
Targeted Transitional Support	GR0415433	(8,346)	8,346	-	-
Targeted Transitional Support	GR0516249	-	62,107	(75,940)	(13,833)
Project for Assistance in Transition from Homeless	GR0415521	(18,321)	18,321	-	-
Project for Assistance in Transition from Homeless	GR0516187	-	25,788	(37,023)	(11,235)
Regional Housing	GR0415468	(16,284)	16,284	-	-
Regional Housing	GR0516313	-	62,145	(136,857)	(74,712)
Nashville Connection	GR0415555	(22,176)	22,176	-	-
Nashville Connection	GR0516303	-	48,159	(66,882)	(18,723)
Forensic Services	GR0415375	(4,000)	4,000	-	-
Forensic Services	GR0516184	-	39,500	(57,000)	(17,500)
National Service Americorps	GR0415534	(5,719)	5,719	-	-
National Service Americorps	GR0516273	-	24,041	(32,555)	(8,514)
TN Dept. of Health					
Alcohol & Drug Abuse	GR0415718	(22,275)	22,275	-	-
Alcohol & Drug Abuse	GR0516555	-	105,750	(126,981)	(21,231)
TN Dept. of Corrections					
Alcohol & Drug Counseling	FA0013750	(8,135)	8,135	-	-
Alcohol & Drug Counseling	GR0516568	-	7,209	(8,544)	(1,335)
TN Dept. of Children's Services					
Child Abuse Prevention	GR0415445	(4,035)	4,035	-	-
Child Abuse Prevention	GR0516385	-	13,500	(13,500)	-
Child Abuse Prevention	GR0516816	-	10,081	(13,500)	(3,419)
Level II Continuum	H2C000004	-	2,394,933	(2,704,585)	(309,652)
Level II Continuum	FA0415518	(503,214)	494,176	-	(9,038)
Level II Special Population	H2P000012	-	261,535	(294,794)	(33,259)
Level II Special Population	FA0415495	(65,895)	62,535	-	(3,360)
Level III Continuum	H3C000005	-	470,274	(579,717)	(109,443)
Level III Continuum	FA0415520	(101,810)	90,470	-	(11,340)
Level I Foster Care	HFC000009	-	85,323	(95,355)	(10,032)
Level I Foster Care	FA0415507	(12,662)	12,662	-	-
Primary Treatment Center	HPT000002	-	538,152	(610,839)	(72,687)
Primary Treatment Center	FA0415509	(95,267)	93,585	-	(1,682)
Total State Grant Activity		<u>\$ (997,374)</u>	<u>\$ 5,521,654</u>	<u>\$ (5,570,719)</u>	<u>\$ (1,046,439)</u>

See accompanying notes to schedules.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
NOTES TO SCHEDULES OF EXPENDITURES OF FEDERAL AWARDS
AND STATE GRANT ACTIVITY

NOTE A BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards and state grant activity includes the federal and state grant activity of Centerstone Community Mental Health Centers, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB-Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the State of Tennessee, Department of Audit, Audit Manual. Therefore, some amounts presented in this schedule may differ from amounts presented in, or uses in the preparation of, the basic financial statements.



THURMAN, CAMPBELL & CO.
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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

F. English Lacy
Robert E. Yates, II
Christopher C. Johns
Paul S. Ellis
Sandra K. Boyd
Rick L. Davis

Kendra S. Bucciarelli
Lawrence F. Campbell
Stacy Boone

To the Board of Directors
Centerstone Community Mental Health Centers, Inc.

We have audited the financial statements of Centerstone Community Mental Health Centers, Inc. (Centerstone) as of and for the year ended June 30, 2005, and issued our report thereon dated September 23, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Centerstone's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Centerstone's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the finance committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Thurman Campbell & Co.
September 23, 2005



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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Board of Directors
Centerstone Community Mental Health Centers, Inc.

Compliance

We have audited the compliance of Centerstone Community Mental Health Centers, Inc. (Centerstone) with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. Centerstone's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Centerstone's management. Our responsibility is to express an opinion on Centerstone's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Centerstone Community Mental Health Centers, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Centerstone Community Mental Health Centers, Inc.'s compliance with those requirements.

In our opinion, Centerstone complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 05-1 and 05-2.

Internal Control Over Compliance

The management of Centerstone is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Centerstone's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the finance committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Thurman Campbell". The signature is written in a cursive, flowing style.

September 23, 2005

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Year ended June 30, 2005

None

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2005

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Centerstone Community Mental Health Centers, Inc.
2. No reportable conditions related to the audit of financial statements were reported in the Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*.
3. No instances of noncompliance material to the financial statements of Centerstone Community Mental Health Centers, Inc. were disclosed during the audit.
4. No reportable conditions relating to the audit of the major federal award programs were reported in the Auditor's Report on Compliance With Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance With OMB Circular A-133.
5. The auditor's report on compliance for the major federal award programs for Centerstone Community Mental Health Centers, Inc. expresses an unqualified opinion.
6. Audit findings relative to the major federal award programs for Centerstone Community Mental Health Centers, Inc. are reported in Part C. of this Schedule.
7. The programs tested as a major programs include: Community Development Block Grant CFDA# 14.239, SPRANS-Community Based Abstinence Program CFDA# 93.110, Community Mental Health Services Program CFDA# 93.958, Alcohol & Drug Abuse Block Grant CFDA# 93.959
8. The threshold for distinguishing Types A and B programs was \$300,000.
9. Centerstone Community Mental Health Centers, Inc. qualifies as a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

None

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

DEPARTMENT OF HEALTH & HUMAN SERVICES – CFDA# 93.958

05-1 Grant# GR-0516314-Year ended June 30, 2005

Condition and Criteria: A mechanism was not in place to receive community input into the operation of the individual drop-in centers as required by the grant.

Effect: The drop-in centers did not receive the required community input in regards to drop-in center issues.

Cause: The program coordinator did not implement the required mechanism in a timely manner.

Population and Items Tested: Findings were noted during the review of federal and state correspondence related to major programs. All federal and state correspondence was made available for review.

Auditor's recommendation: The Center should establish the mechanism community input.

Grantee response: The mechanism for community input is in the process of being established.

CENTERSTONE COMMUNITY MENTAL HEALTH CENTERS, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

05-2 Grant# GR-0516314-Year ended June 30, 2005

Condition and Criteria: Two of the drop-in centers did not meet the minimum attendance requirements for their locations as required by the grant.

Effect: The drop-in centers could be required to refund a portion of the grant.

Cause: The program was not marketed appropriately.

Population and Items Tested: Findings were noted during the review of federal and state correspondence related to major programs. All federal and state correspondence was made available for review.

Auditor's recommendation: The Center should implement a marketing plan to increase attendance rates.

Grantee response: The marketing plan is in the process of being established.