# CENTERSTONE OF TENNESSEE, INC.

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**JUNE 30, 2010 AND 2009**

# CENTERSTONE OF TENNESSEE, INC.

TABLE OF CONTENTS
JUNE 30, 2010 AND 2009

CPAS / ADVISORS

blue

Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

# REPORT OF INDEPENDENT AUDITORS

Board of Directors
Centerstone of America, Inc.
Bloomington, Indiana

We have audited the accompanying consolidated statements of financial position of Centerstone of Tennessee, Inc. (the Center) as of June 30, 2010 and 2009 and the related statements of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Center's management. Our responsibility is to express an opinion on the Center's consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2010 and 2009, and the changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Notes 1 and 2 to the consolidated financial statements, the Center is part of an affiliated group of entities. The Center is included in the reporting entity, Centerstone of America, and these consolidated financial statements include only the financial position, changes in net assets and cash flows of the Center.

Board of Directors
Centerstone of America, Inc.
Bloomington, Indiana

In accordance with *Government Auditing Standards*, we have issued our report dated December 23, 2010, on our consideration of Centerstone of Tennessee, Inc.'s internal control over financial reporting and on 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 effectiveness of 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 considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information listed in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements of the Center. The accompanying schedule of expenditures of federal awards is presented for 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 is also 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 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 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

December 23, 2010

# CENTERSTONE OF TENNESSEE, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2010 AND 2009

## ASSETS

| | 2010 | 2009 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | $ 355,139 | $ 2,579,969 |
| Restricted cash | 39,732 | 39,694 |
| Unconditional promises to give, current | 761,062 | 1,027,363 |
| Accounts receivable, net | 3,707,754 | 2,703,820 |
| Other receivables | 2,676,437 | 3,536,951 |
| Due from affiliated entities | 6,665,485 | 778,696 |
| Prepaid expenses and other current assets | 292,820 | 277,604 |
| Total current assets | 14,498,429 | 10,944,097 |
| **Property and equipment, net** | 21,349,671 | 27,658,579 |
| **Other assets** | 92,878 | 2,054,116 |
| **Unconditional promises to give** | 1,784,636 | 1,751,942 |
| **Assets whose use is limited** | 4,893,801 | 4,644,149 |
| Total assets | $ 42,619,415 | $ 47,052,883 |

## LIABILITIES AND NET ASSETS

| | 2010 | 2009 |
|---|---|---|
| **Current liabilities** | | |
| Current portion of long term debt | $ 336,356 | $ 469,771 |
| Accounts payable and accrued expenses | 2,686,057 | 2,093,107 |
| Accrued payroll, benefits and taxes | 4,573,904 | 5,064,800 |
| Estimated third party settlements | 2,876,750 | 2,196,750 |
| Other current liabilities | 3,612 | 109,944 |
| Total current liabilities | 10,476,679 | 9,934,372 |
| **Long term debt, net of current portion** | 2,049,806 | 2,573,953 |
| Total liabilities | 12,526,485 | 12,508,325 |
| **Net assets** | | |
| Unrestricted | 20,761,888 | 25,442,230 |
| Temporarily restricted | 4,685,935 | 4,786,534 |
| Permanently restricted | 4,645,107 | 4,315,794 |
| Total net assets | 30,092,930 | 34,544,558 |
| Total liabilities and net assets | $ 42,619,415 | $ 47,052,883 |

See accompanying notes to consolidated financial statements.

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
## YEARS ENDED JUNE 30, 2010 AND 2009

| | 2010 | 2009 |
|---|---|---|
| **Revenue and other support** | | |
| Net client service revenue | $ 37,355,433 | $ 43,947,997 |
| Public support | 21,214,918 | 20,201,669 |
| Net assets released from restriction | 901,630 | 873,794 |
| Other | 549,816 | 1,069,688 |
| Total revenue and other support | 60,021,797 | 66,093,148 |
| **Expenses** | | |
| Salary and fringe benefits | 38,150,881 | 45,575,398 |
| Telephone | 1,591,510 | 1,825,276 |
| Travel | 1,437,830 | 1,609,923 |
| Drugs and supplies | 3,101,271 | 3,884,796 |
| Printing and postage | 187,898 | 277,012 |
| Contracted services | 4,579,288 | 4,468,354 |
| Purchased services | 1,490,439 | 2,656,316 |
| Affiliated management fees | 4,131,470 | 1,511,956 |
| Rents and leases | 252,375 | 306,898 |
| Utilities | 2,388,097 | 2,982,764 |
| Repairs and maintenance | 341,589 | 528,591 |
| Depreciation and amortization | 1,710,448 | 2,447,330 |
| Insurance | 409,757 | 556,637 |
| Bad debt | 2,674,622 | 3,605,105 |
| Interest | 44,649 | 99,177 |
| Miscellaneous | 609,065 | 1,694,956 |
| Total expenses | 63,101,189 | 74,030,489 |
| Operating loss | (3,079,392) | (7,937,341) |
| **Nonoperating revenues (expenses)** | | |
| Loss on disposal of equipment | (5,727) | (21,713) |
| Gain (loss) on investments | 428 | (1,856) |
| Interest and dividend income | 3,198 | 41,658 |
| Other nonoperating expense | (7,148) | (132,732) |
| Total nonoperating revenues and expenses | (9,249) | (114,643) |
| Excess of revenue over (under) expenses | (3,088,641) | (8,051,984) |
| **Other changes in unrestricted net assets** | | |
| Equity transfer from Centerstone Research Institute | 1,769,083 | -0- |
| Equity transfer to Advantage Behavioral Health | (3,360,784) | -0- |
| Change in unrestricted net assets | (4,680,342) | (8,051,984) |
| **Temporarily restricted net assets** | | |
| Contributions and pledges | 501,031 | 732,757 |
| Transfer from permanently restricted | 300,000 | 300,000 |
| Net assets released from restriction | (901,630) | (873,794) |
| Change in temporarily restricted net assets | (100,599) | 158,963 |
| **Permanently restricted net assets** | | |
| Gain (loss) on investments | 575,796 | (1,269,857) |
| Transfer to temporarily restricted | (300,000) | (300,000) |
| Interest and dividend income | 53,517 | 146,709 |
| Change in permanently restricted net assets | 329,313 | (1,423,148) |
| Change in net assets | (4,451,628) | (9,316,169) |
| **Net assets, beginning of year** | 34,544,558 | 43,860,727 |
| **Net assets, end of year** | $ 30,092,930 | $ 34,544,558 |

See accompanying notes to consolidated financial statements.

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2010 AND 2009

| | 2010 | 2009 |
|---|---|---|
| **Operating activities** | | |
| Net loss | $ (4,451,628) | $ (9,316,169) |
| Adjustments to reconcile change in net assets to net cash flows from operating activities | | |
| Depreciation and amortization | 1,710,448 | 2,447,330 |
| Bad debt | 2,674,622 | 3,605,105 |
| (Gains) losses on investments | (576,224) | 1,271,713 |
| Allowance on unconditional promises to give | 161,069 | 291,608 |
| Loss on disposal of assets | 5,727 | 21,713 |
| Equity transfer from Centerstone Research Institute | (1,769,083) | -0- |
| Equity transfer to Advantage Behavioral Health | 3,360,784 | -0- |
| Changes in operating assets and liabilities | | |
| Accounts receivable, net | (3,678,556) | (1,921,686) |
| Other receivables | 860,514 | 616,669 |
| Prepaid expenses and other current assets | (15,216) | 478,169 |
| Other assets | 1,961,238 | 109 |
| Due to/from affiliate entities | (697,035) | (193,265) |
| Promises to give, net | 72,538 | 993,095 |
| Accounts payable and accrued expenses | 592,950 | (526,803) |
| Accrued payroll, benefits and taxes | (490,896) | (905,596) |
| Estimated third party settlements and other liabilities | 573,668 | 2,306,694 |
| Net cash flows from operating activities | 294,920 | (831,314) |
| **Investing activities** | | |
| Purchase of property and equipment | (597,021) | (2,273,727) |
| Change in assets whose use is limited, net | 326,572 | 516,567 |
| Net cash flows from investing activities | (270,449) | (1,757,160) |
| **Financing activities** | | |
| Equity transfer from Centerstone Research Institute | 1,769,083 | -0- |
| Equity transfer to Advantage Behavioral Health | (3,360,784) | -0- |
| Principal payments on long term debt | (657,562) | (1,032,445) |
| Net cash flows from financing activities | (2,249,263) | (1,032,445) |
| Net change in cash and cash equivalents | (2,224,792) | (3,620,919) |
| **Cash and cash equivalents, beginning of year** | 2,619,663 | 6,240,582 |
| **Cash and cash equivalents, end of year** | $ 394,871 | $ 2,619,663 |
| **Noncash financing activities** | | |
| Property transfers recorded in due from affiliated entities | $ (5,189,754) | $ -0- |
| **Supplemental cash flows information** | | |
| Cash paid for interest | $ 44,350 | $ 99,177 |

See accompanying notes to consolidated financial statements.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Organization

Centerstone of Tennessee, Inc. and its consolidated entities (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 consolidated entities share a common management team and Board of Directors. Consolidated entities include Cumberland Holding Corporation and Centerstone Endowment Trust.

### Principles of Consolidation

The consolidated financial statements include the accounts of Centerstone of Tennessee, Inc., Cumberland Holding Corporation, and Centerstone Endowment Trust. All material intercompany accounts and transactions have been eliminated.

The Center is part of an affiliated group of entities. The Center is included in the reporting entity, Centerstone of America, and these consolidated financial statements include only the financial position, changes in net assets and cash flows of the Center.

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 and the reported amounts of the revenues, expenses, gains, losses and other changes in net assets during the reporting period. Significant estimates sensitive to change in the near term include the allowance on accounts receivable, estimated third party settlements and self insurance for employee health claims incurred but not reported. Actual results could differ from those estimates.

Basis of Presentation

Financial statement presentation follows the recommendations outlined in the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) for Non-Profit Entities. The Center 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 and to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets.

Affiliated Entities

Centerstone of America, Inc. is the holding company of the Center.

Advantage Behavioral Health is a not-for-profit organization that provides billing and administrative services and support to behavioral health organizations. Advantage Behavioral Health is a Sister corporation of the Center.

Centerstone of Indiana, Inc. is a not-for-profit community mental health center with locations in various counties in Indiana. Centerstone of Indiana, Inc. is a Sister corporation of the Center.

Centerstone Research Institute is a not-for-profit company dedicated to improving health care delivery through research and technology.

Centerstone Housing Resources, Inc. is a not-for-profit agency and is a Sister corporation the Center.

Net Asset Classifications

Net assets are to be classified as unrestricted, temporarily restricted, and permanently restricted.

*Unrestricted Net Assets*

The unrestricted net asset class includes general assets and liabilities of the Center. The unrestricted net assets of the Center may be used at the discretion of management to support the Center’s purposes and operations.

*Temporarily Restricted Net Assets*

The Center’s temporarily restricted net assets consist of contributions to the Centerstone of Tennessee where the use of the funds is restricted by the donor.

*Permanently Restricted Net Assets*

The Center's permanently restricted net assets consist of gifts where the use of the funds is restricted by the terms of the gift. The corpuses of the gifts are restricted in perpetuity.

Cash and Cash Equivalents

For purposes of reporting cash flows, the Center considers all liquid investments with an original maturity of three months or less to be cash equivalents. The Center maintains these deposits with banks. At times, these deposits may exceed federally insured limits. The Center believes it is not exposed to any significant credit risk on cash and cash equivalents.

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 an agreement with The Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County.

Income Taxes

The Center and its consolidated entities are exempt from federal income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code.

Unconditional Promises to Give

Contributions are recognized when the donor makes a promise to give to the Center that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

The Center uses the allowance method to determine uncollectible promises receivable. The allowance is based on prior years' experience and management's analysis of specific promises made.

Donor Support

The Center reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support.

Absent explicit donor stipulations regarding how long those long-lived assets must be maintained, the Center reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service, as instructed by the donor. The Center reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Investments and Investment Income

Investments in equity securities and debt securities are measured at fair value in the balance sheets. Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Unrealized and realized gains and losses on investments, interest, and dividends from all investments are reported as a component of the performance indicator unless the income is restricted by donor or law.

Assets Whose Use Limited

The Center has established Centerstone Endowment Trust for the purpose of serving as a permanent charitable endowment fund for the support of the Center. The Center is the sole trustee of the Trust. Currently, the terms of the Trust require annual distributions to the Center of an amount equal to 4.5% of the average of the net fair market values of the Trust assets as determined at the end of the three most recently completed calendar years. The fair value of the Trust assets as of June 30, 2010 and 2009 was $4,893,801 and $4,644,149, respectively. The Trust 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 Trust to the Center. The funds consist of cash and cash equivalents, bonds, and common stocks.

Performance Indicator and Operating Indicator

The consolidated statements of activities and changes in net assets include a performance indicator, excess of revenue over (under) expenses. Changes in unrestricted net assets which would be excluded from net income, include distributions to members, capital contributions from members, gifts of long-lived property and changes in unrealized gains (losses) on other than trading securities. The consolidated statements of activities and changes in net assets also include an operating indicator, operating income (loss). Certain nonoperating items are excluded from the operating indicator including investment income (loss), gains and losses on investments, and gains (losses) on disposal of equipment.

Advertising Cost

The Center uses advertising to promote its programs and services among the clients it serves. The advertising costs are expensed as incurred. Advertising costs for the Center totaled $119,135 and $234,113 for June 30, 2010 and 2009, respectively.

Property and Equipment and Depreciation

Expenditures for property and equipment and items which substantially increase the useful lives of existing assets are capitalized at cost. The Center provides for depreciation on the straight-line method at rates designed to depreciate the costs of assets over estimated useful lives as follows:

| | Years |
|---|---|
| Furniture and equipment | 3-10 |
| Leasehold improvements | 10 |
| Buildings | 18-30 |
| Building and land improvements | 5-20 |

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenue over (under) expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Net Client Service Revenue and Accounts Receivable

The Center has agreements with third-party payors that provide for payments to the Center at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, discounted charges, and per diem payments. Net client service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under agreements with third-party payors for audits. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. No accrual is made for those retroactive adjustments that are not reasonably estimable.

The Center estimates an allowance for doubtful accounts based on an evaluation of historical adjustments and losses, current economic conditions and factors unique to payor situations. The Center's allowances for doubtful accounts as of June 30, 2010 and 2009 were $2,455,607 and $2,307,172, respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Given the current regulatory and reimbursement environment, there can be no assurances that adequate reimbursement levels will continue to be available for the services provided by the Center. Significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on the Center's liquidity, financial condition and results of operations.

Public Support

The Center receives federal and state grants for providing services in specific program areas. Receipt of these funds is subject to the fulfillment of certain obligations by the Center as prescribed by these programs and funds may be subject to repayment upon a determination of noncompliance made by a funding agency.

The Center derives a significant portion of its revenue from third-party payors and federal and state funding programs. The receipt of future revenues by the Center is subject to among other factors, federal and state policies affecting the health care industry, economic conditions that may include an inability to control expenses in periods of inflation, increased competition, market pressures on premium rates and other conditions which are impossible to predict.

Estimated Third Party Settlements

The Center has estimated third party liabilities for certain programs reflecting the difference between interim reimbursement and reimbursement as determined by contractual agreements and third-party audits. Based upon payments received the Center has estimated third party settlements of $2,876,750 and $2,196,750 as of June 30, 2010 and 2009, respectively.

Charity Care

The Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The charity care amounts are not reported as net client service revenue as the Center does not pursue collection.

Subsequent Events

The Center evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is December 23, 2010.

Reclassification

Certain amounts in the financial statements have been reclassified herein to conform to the current year presentation

## 2. AFFILIATED ENTITY TRANSACTIONS

The Center entered certain working capital transactions, administrative and general transactions, and property transfers with its Parent and Sister corporations as are disclosed in Note 1. The Center has recorded a related receivable in the amount of $6,665,485 and $778,696 as of June 30, 2010 and 2009, respectively. The Center transferred certain property and equipment to affiliated entities through the due from affiliates account in the amount of $5,189,754 for the year ended June 30, 2010. For the years ended June 30, 2010 and 2009, the Center incurred malpractice and liability insurance expense in the approximate amount of $410,000 and $556,000, which was paid by the Parent corporation. In addition for the years ended June 30, 2010 and 2009 the Center incurred affiliated management fees in the amount of $4,131,470 and $1,511,956, respectively for services provided by its Parent corporation.

## 3. ASSETS WHOSE USE IS LIMITED

The composition of assets limited as to use at June 30, 2010 and 2009 is set forth in the following table. Investments are stated at fair.

| | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | $ 81,911 | $ 184,551 |
| Mutual funds and equities | 4,811,890 | 4,459,598 |
| | $ 4,893,801 | $ 4,644,149 |

Investment income (loss) consists of the following for 2010 and 2009:

| | 2010 | 2009 |
|---|---|---|
| Interest and dividend income | $ 56,715 | $ 188,367 |
| Unrealized gain (loss) on investments | 246,349 | (45,579) |
| Realized gain (loss) on investments | 329,875 | (1,226,134) |
| | $ 632,939 | $ (1,083,346) |

## 4. FAIR VALUE OF FINANCIAL INSTRUMENTS

Major classes of assets and liabilities that are measured at fair value are categorized according to a fair value hierarchy that prioritizes the inputs to value techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Level 1 inputs are readily determinable using unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 inputs are derived from quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets (other than those included in Level 1) which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. If the inputs used fall within different levels of the hierarchy, the categorization is based upon the lowest level input that is significant to the fair value measurement.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 and 2009 are as follows:

| | June 30, 2010 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets limited as to use | | | | |
| Mutual funds and equities | $ 4,811,890 | $ 4,811,890 | $ -0- | $ -0- |
| | 4,811,890 | $ 4,811,890 | $ -0- | $ -0- |
| Cash and cash equivalents | 81,911 | | | |
| Total | $ 4,893,801 | | | |

| | June 30, 2009 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets limited as to use | | | | |
| Mutual funds and equities | $ 4,459,598 | $ 4,459,598 | $ -0- | $ -0- |
| | 4,459,598 | $ 4,459,598 | $ -0- | $ -0- |
| Cash and cash equivalents | 184,551 | | | |
| Total | $ 4,644,149 | | | |

The following methods and assumptions were used by the Center in estimating the fair value of its financial instruments:

- Cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses: The carrying amount reported in the consolidated statements of financial position for cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and estimated contractual settlements approximate fair value.

- Long-term debt: Fair value of the Center's revenue bonds is based on current traded value. The fair value of the Center’s remaining long-term debt approximates carrying value.

## 5. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of June 30:

| | 2010 | 2009 |
|---|---|---|
| Land | $ 2,957,557 | $ 2,956,557 |
| Buildings and improvements | 25,257,497 | 25,431,590 |
| Furnishings, equipment and vehicles | 11,731,518 | 17,502,648 |
| Construction in progress | 2,665,148 | 3,109,152 |
| | 42,611,720 | 48,999,947 |
| Accumulated depreciation and amortization | (21,262,049) | (21,341,368) |
| | $ 21,349,671 | $ 27,658,579 |

## 6. PROMISES TO GIVE

Promises to give consist of pledges restricted to the support of the Center. Promises to give are adjusted to the present value of the estimated future cash flows using a discount rate of 6% and also include an allowance for estimated uncollectable pledges.

| | 2010 | 2009 |
|---|---|---|
| Promises to give | $ 3,401,059 | $ 3,480,489 |
| Net present value discount | (515,255) | (419,626) |
| Allowance for uncollectible pledges | (340,106) | (281,558) |
| | $ 2,545,698 | $ 2,779,305 |
| Amounts due in: | | |
| Less than one year | $ 761,062 | $ 1,027,363 |
| One to five years | 1,784,636 | 1,751,942 |
| | $ 2,545,698 | $ 2,779,305 |

## 7. LONG TERM DEBT

Long term debt consists of the following:

| | 2010 | 2009 |
|---|---|---|
| Note payable, 8.37% fixed interest rate, requiring monthly principal and interest payments of $1,468 through March, 2031, collateralized by real estate located in Clarksville, TN | $ 177,321 | $ 178,952 |
| Note payable, variable interest rate, which was 2.24% at June 30, 2010, monthly principal and interest payments averaging $16,739 with a balloon payoff of $1,636,250 in May 2012, collateralized by building in Shelbyville, TN | 1,820,000 | 1,925,000 |
| Note payable, 4.58% fixed interest rate, monthly principal and interest payments of $20,138 through February 2012, collateralized by equipment located throughout Middle Tennessee | 388,841 | 606,903 |
| Note payable, variable interest rate, paid in full during 2010. | -0- | 132,869 |
| Bonds payable, variable interest rate, paid in full during 2010. | -0- | 200,000 |
| | 2,386,162 | 3,043,724 |
| Current portion | (336,356) | (469,771) |
| Total long term debt | $ 2,049,806 | $ 2,573,953 |

The future maturities of long-term debt are as follows for the years ending June 30:

| | |
|---|---|
| 2011 | $ 336,356 |
| 2012 | 1,877,836 |
| 2013 | 3,829 |
| 2014 | 4,163 |
| 2015 | 4,525 |
| Thereafter | 159,453 |
| | $ 2,386,162 |

## 8. NET ASSETS

Temporarily restricted net assets are available for the following purposes as of June 30, 2010 and 2009:

| | 2010 | 2009 |
|---|---|---|
| Dede Wallace Campus | $ 3,076,275 | $ 2,580,851 |
| CAFS Programs | 1,000 | 1,000 |
| Unmet Needs | 267,911 | 595,935 |
| SE Middle TN Programs | 1,600 | 2,700 |
| Research | 1,332,131 | 1,606,048 |
| Not alone | 5,000 | -0- |
| Charity care | 2,018 | -0- |
| | $ 4,685,935 | $ 4,786,534 |

Permanently restricted net assets consist of the following as of June 30, 2010 and 2009:

| | 2010 | 2009 |
|---|---|---|
| Foundation Endowments | $ 4,645,107 | $ 4,315,794 |

## 9. ENDOWMENT FUND

The Center's endowment consists of a fund established for a specific purpose. The endowment includes only donor-restricted funds to function as an endowment. Net assets associated with the endowment fund are classified and reported based on the existence or absence of donor-imposed restrictions.

The objective is to meet or exceed the market index, or blended market index, selected and agreed upon by the Center or provide an acceptable return with lower volatility or credit risk. In order to meet its needs, the investment strategy of the Center is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income. Specifically, the primary objective in the investment management for endowment fund assets shall be long-term growth of capital and to emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated in as much as it is consistent with the volatility of a comparable market index. The board of directors has interpreted the relevant law as requiring prudent preservation of the fund and evaluates the amounts of unrestricted income and the unrealized gains and losses periodically.

The Center has a policy of appropriating for distribution an amount of earned income based upon a stipulated formula.

The endowment net assets by type of fund as of:

| | 2010 | 2009 |
|---|---|---|
| Donor-restricted endowment funds | | |
| Permanently restricted | $ 4,645,107 | $ 4,315,794 |
| Total endowment funds | $ 4,645,107 | $ 4,315,794 |

The Center had the following endowment-related activities:

| | Permanently restricted | |
|---|---|---|
| | 2010 | 2009 |
| Endowment net assets, beginning of year | $ 4,315,794 | $ 5,738,942 |
| Net investment income and other changes | 329,313 | (1,423,148) |
| Endowment net assets, end of year | $ 4,645,107 | $ 4,315,794 |

The Center has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Center classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Center in a manner consistent with the standard of prudence prescribed by law. In accordance with the law, the Center considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Center, and (7) the Center's investment policies.

## 10. FUNCTIONAL EXPENSES

The Center provides behavioral healthcare services to residents within its geographic location. Expenses related to providing these services for 2010 and are as follows:

| | 2010 | 2009 |
|---|---|---|
| Behavioral health care services | $ 54,456,326 | $ 62,185,611 |
| General and administrative | 8,644,863 | 11,844,878 |
| | $ 63,101,189 | $ 74,030,489 |

## 11. PENSION PLAN

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. During 2009, the Center voted to freeze employer contributions. Pension expense for the years ended June 30, 2010 and 2009 was $-0- and $741,944.

## 12. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Center has several operating leases, for certain operating facilities and equipment through 2016. Total rent expense was and $252,375 and $306,898 for the year ended June 30, 2010 and 2009, respectively.

Future minimum lease payments under non-cancelable operating leases are as follows for the years ending June 30:

| | |
|---|---|
| 2011 | $ 153,928 |
| 2012 | 37,663 |
| 2013 | 33,734 |
| 2014 | 28,649 |
| 2015 | 28,713 |
| Thereafter | 33,892 |
| Total minimum lease payments | $ 316,579 |

Medical Malpractice Claims

The Center purchases professional and general liability insurance to cover medical malpractice claims. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to clients. The Center's deductible allows for $1,000,000 per claim and an aggregate amount of $3,000,000.

Self Insurance

The Center has elected to act as a self-insurer for certain costs related to employee health, dental and accident benefit programs. Expenses resulting from claims experience are recorded as incurred including an estimate of claims incurred but not reported. The related expense for the years ended June 30, 2010 and 2009 aggregated $3,998,533 and $5,095,276 respectively. The Center has purchased insurance, which limits its exposure on a per individual basis to $135,000, with no annual aggregate basis stop loss provision.

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 as of June 30, 2010 and 2009 was $2,817,202 and $3,220,741, respectively.

Litigation

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.

Guarantee

The Center is a guarantor along with certain other Sister corporations to a line of credit providing maximum borrowings of $3,500,000 issued to the Parent corporation. Any draws bear interest at 3.25%. Balance at June 30, 2010 is $-0-. The line expires May 27, 2011. Should the Center be required to pay any portion of the total amount of the loans it has guaranteed, the Center could attempt to recover some or the entire amount from guaranteed parties. The Center holds no collateral in respect of the guarantees.

## 13. CONCENTRATIONS OF CREDIT RISK

The Center's main offices are located throughout the State of Tennessee. The Center grants credit without collateral to its clients, most of who are local residents and are insured under third-party payor agreements. Accounts receivable and net revenues from clients and third-party payors were as follows:

| | Receivables | | Revenue | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Medicare | 14% | 16% | 6% | 6% |
| Medicaid | 2% | 8% | 1% | 1% |
| TennCare | 70% | 45% | 85% | 87% |
| Self-pay | 2% | 12% | 5% | 3% |
| Other third-party payors | 12% | 19% | 3% | 3% |
| | 100% | 100% | 100% | 100% |

## 14. MANAGEMENTS PLAN

The fiscal year ended June 30, 2010 saw a continuation of revenue reductions (approximately $6 million) which began in 2009 due to new TennCare contracts. In addition multiple insurance payors transitioned to new systems creating delays in reimbursement and charge capture. Management was able to reduce expenses (approximately $11 million) during 2010 such that the clinical programs achieved a break-even operation for the year based on interim financial statements.

Management reports that significant efforts expended on improving the CenterNet billing and receivables system have resulted in a more efficient and effective process for billing, collections, and the related reporting.

New contracts for services, continued expense controls, and additional philanthropic support results in an expected surplus for the year ended June 30, 2011.

## 15. SUPPORT FROM AFFILIATED ENTITIES

As is disclosed in Note 1, the Center has certain affiliated entities, including its Parent corporation, Centerstone of America, Inc. and Sister corporation, Centerstone of Indiana, Inc. In the event of cash flow or other financing needs, these two affiliated entities pledge their support to the Center.

# SUPPLEMENTARY INFORMATION

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATING STATEMENT OF FINANCIAL POSITION
## JUNE 30, 2010

| ASSETS | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Co., Inc | Eliminations | Total |
|---|---|---|---|---|---|
| **Current assets** | | | | | |
| Cash and cash equivalents | $ 316,249 | $ -0- | $ 38,890 | $ -0- | $ 355,139 |
| Restricted cash | -0- | -0- | 39,732 | -0- | 39,732 |
| Unconditional promises to give, current | 761,062 | -0- | -0- | -0- | 761,062 |
| Accounts receivable, net | 3,707,754 | -0- | -0- | -0- | 3,707,754 |
| Other receivables | 2,676,437 | -0- | -0- | -0- | 2,676,437 |
| Due from affiliated entities | 7,034,192 | -0- | -0- | (368,707) | 6,665,485 |
| Prepaid expenses and other current assets | 292,820 | -0- | -0- | -0- | 292,820 |
| Total current assets | 14,788,514 | -0- | 78,622 | (368,707) | 14,498,429 |
| **Property and equipment, net** | 21,205,893 | -0- | 143,778 | -0- | 21,349,671 |
| **Other assets** | 92,878 | -0- | -0- | -0- | 92,878 |
| **Unconditional promises to give** | 1,784,636 | -0- | -0- | -0- | 1,784,636 |
| **Assets whose use is limited** | 6,966 | 4,886,835 | -0- | -0- | 4,893,801 |
| Total assets | $ 37,878,887 | $ 4,886,835 | $ 222,400 | $ (368,707) | 42,619,415 |
| **LIABILITIES AND NET ASSETS** | | | | | |
| **Current liabilities** | | | | | |
| Current portion of long term debt | $ 333,415 | $ -0- | $ 2,941 | $ -0- | $ 336,356 |
| Accounts payable and accrued expenses | 2,681,051 | -0- | 5,006 | -0- | 2,686,057 |
| Accrued payroll, benefits and taxes | 4,573,904 | -0- | -0- | -0- | 4,573,904 |
| Estimated third party settlements | 2,876,750 | -0- | -0- | -0- | 2,876,750 |
| Due to affiliated entities | -0- | 226,020 | 142,687 | (368,707) | -0- |
| Other current liabilities | -0- | -0- | 3,612 | -0- | 3,612 |
| Total current liabilities | 10,465,120 | 226,020 | 154,246 | (368,707) | 10,476,679 |
| **Long term debt, net of current portion** | 1,875,426 | -0- | 174,380 | -0- | 2,049,806 |
| Total liabilities | 12,340,546 | 226,020 | 328,626 | (368,707) | 12,526,485 |
| **Net assets** | | | | | |
| Unrestricted | 21,158,110 | 10,004 | (106,226) | (300,000) | 20,761,888 |
| Temporarily restricted | 4,380,231 | 5,704 | -0- | 300,000 | 4,685,935 |
| Permanently restricted | -0- | 4,645,107 | -0- | -0- | 4,645,107 |
| Total net assets | 25,538,341 | 4,660,815 | (106,226) | -0- | 30,092,930 |
| Total liabilities and net assets | $ 37,878,887 | $ 4,886,835 | $ 222,400 | $ (368,707) | $ 42,619,415 |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2010

| | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Corp | Eliminations | Total |
|---|---|---|---|---|---|
| **Revenue and other support** | | | | | |
| Net client service revenue | $ 37,355,433 | $ -0- | $ -0- | $ -0- | $ 37,355,433 |
| Public support | 21,514,818 | 100 | -0- | (300,000) | 21,214,918 |
| Net assets released from restriction | 901,630 | -0- | -0- | -0- | 901,630 |
| Other | 512,447 | 2,102 | 35,267 | -0- | 549,816 |
| Total revenue and other support | 60,284,328 | 2,202 | 35,267 | (300,000) | 60,021,797 |
| **Expenses** | | | | | |
| Salary and fringe benefits | 38,150,881 | -0- | -0- | -0- | 38,150,881 |
| Telephone | 1,586,478 | -0- | 5,032 | -0- | 1,591,510 |
| Travel | 1,431,994 | -0- | 5,836 | -0- | 1,437,830 |
| Drugs and supplies | 3,086,491 | 113 | 14,667 | -0- | 3,101,271 |
| Printing and postage | 187,807 | 12 | 79 | -0- | 187,898 |
| Contracted services | 4,579,288 | -0- | -0- | -0- | 4,579,288 |
| Purchased services | 1,487,859 | 1,290 | 1,290 | -0- | 1,490,439 |
| Affiliated management fees | 4,131,470 | -0- | -0- | -0- | 4,131,470 |
| Rents and leases | 251,271 | -0- | 1,104 | -0- | 252,375 |
| Utilities | 2,367,921 | -0- | 20,176 | -0- | 2,388,097 |
| Repairs and maintenance | 340,875 | -0- | 714 | -0- | 341,589 |
| Depreciation and amortization | 1,704,549 | -0- | 5,899 | -0- | 1,710,448 |
| Insurance | 408,149 | -0- | 1,608 | -0- | 409,757 |
| Bad debt | 2,674,622 | -0- | -0- | -0- | 2,674,622 |
| Interest | 29,850 | -0- | 14,799 | -0- | 44,649 |
| Miscellaneous | 602,577 | 1,647 | 4,841 | -0- | 609,065 |
| Total expenses | 63,022,082 | 3,062 | 76,045 | -0- | 63,101,189 |
| Operating loss | $ (2,737,754) | $ (860) | $ (40,778) | $ (300,000) | $ (3,079,392) |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2010

| | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Corp | Eliminations | Total |
|---|---|---|---|---|---|
| **Nonoperating revenues (expenses)** | | | | | |
| Loss on disposal of equipment | $ (5,727) | $ -0- | $ -0- | $ -0- | $ (5,727) |
| Gain on investments | 428 | -0- | -0- | -0- | 428 |
| Interest and dividend income | 1,240 | -0- | 1,958 | -0- | 3,198 |
| Other nonoperating expense | (7,148) | -0- | -0- | -0- | (7,148) |
| Total nonoperating revenues and expenses | (11,207) | -0- | 1,958 | -0- | (9,249) |
| Excess of revenue over (under) expenses | (2,748,961) | (860) | (38,820) | (300,000) | (3,088,641) |
| **Other changes in unrestricted net assets** | | | | | |
| Equity transfer to Centerstone Research Institute | 1,769,083 | -0- | -0- | -0- | 1,769,083 |
| Equity transfer to Advantage Behavioral Health | (3,360,784) | -0- | -0- | -0- | (3,360,784) |
| Change in unrestricted net assets | (4,340,662) | (860) | (38,820) | (300,000) | (4,680,342) |
| **Changes in temporarily restricted net assets** | | | | | |
| Contributions and pledges, net | 498,282 | 2,749 | -0- | -0- | 501,031 |
| Transfer from permanently restricted | -0- | 300,000 | -0- | -0- | 300,000 |
| Net assets released from restriction | (901,630) | (300,000) | -0- | 300,000 | (901,630) |
| Change in temporarily restricted net assets | (403,348) | 2,749 | -0- | 300,000 | (100,599) |
| **Changes in permanently restricted net assets** | | | | | |
| Gain on investments | -0- | 575,796 | -0- | -0- | 575,796 |
| Transfer to temporarily restricted | -0- | (300,000) | -0- | -0- | (300,000) |
| Interest and dividend income | -0- | 53,517 | -0- | -0- | 53,517 |
| Change in permanently restricted net assets | -0- | 329,313 | -0- | -0- | 329,313 |
| Change in net assets | (4,744,010) | 331,202 | (38,820) | -0- | (4,451,628) |
| **Net assets, beginning of year** | 30,282,351 | 4,329,613 | (67,406) | -0- | 34,544,558 |
| **Net assets, end of year** | $ 25,538,341 | $ 4,660,815 | $ (106,226) | $ -0- | $ 30,092,930 |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATING STATEMENT OF FINANCIAL POSITION
JUNE 30, 2009

| ASSETS | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Co., Inc | Eliminations | Total |
|---|---|---|---|---|---|
| **Current assets** | | | | | |
| Cash and cash equivalents | $ 2,535,398 | $ -0- | $ 44,571 | $ -0- | $ 2,579,969 |
| Restricted cash | -0- | -0- | 39,694 | -0- | 39,694 |
| Unconditional promises to give, current | 1,027,363 | -0- | -0- | -0- | 1,027,363 |
| Accounts receivable, net | 2,703,820 | -0- | -0- | -0- | 2,703,820 |
| Other receivables | 3,536,951 | -0- | -0- | -0- | 3,536,951 |
| Due from affiliated entities | 1,197,209 | -0- | -0- | (418,513) | 778,696 |
| Prepaid expenses and other current assets | 277,323 | -0- | 281 | -0- | 277,604 |
| Total current assets | 11,278,064 | -0- | 84,546 | (418,513) | 10,944,097 |
| **Property and equipment, net** | 27,514,801 | -0- | 143,778 | -0- | 27,658,579 |
| **Other assets** | 2,054,116 | -0- | -0- | -0- | 2,054,116 |
| **Unconditional promises to give** | 1,751,942 | -0- | -0- | -0- | 1,751,942 |
| **Assets whose use is limited** | 6,627 | 4,637,522 | -0- | -0- | 4,644,149 |
| Total assets | $ 42,605,550 | $ 4,637,522 | $ 228,324 | $ (418,513) | $ 47,052,883 |
| **LIABILITIES AND NET ASSETS** | | | | | |
| **Current liabilities** | | | | | |
| Current portion of long term debt | $ 466,972 | $ -0- | $ 2,799 | $ -0- | $ 469,771 |
| Accounts payable and accrued expenses | 2,086,933 | -0- | 6,174 | -0- | 2,093,107 |
| Accrued payroll, benefits and taxes | 5,064,800 | -0- | -0- | -0- | 5,064,800 |
| Estimated third party settlements | 2,196,750 | -0- | -0- | -0- | 2,196,750 |
| Due to affiliated entities | -0- | 307,909 | 110,604 | (418,513) | -0- |
| Other current liabilities | 109,944 | -0- | -0- | -0- | 109,944 |
| Total current liabilities | 9,925,399 | 307,909 | 119,577 | (418,513) | 9,934,372 |
| **Long term debt, net of current portion** | 2,397,800 | -0- | 176,153 | -0- | 2,573,953 |
| Total liabilities | 12,323,199 | 307,909 | 295,730 | (418,513) | 12,508,325 |
| **Net assets** | | | | | |
| Unrestricted | 25,498,772 | 10,864 | (67,406) | -0- | 25,442,230 |
| Temporarily restricted | 4,783,579 | 2,955 | -0- | -0- | 4,786,534 |
| Permanently restricted | -0- | 4,315,794 | -0- | -0- | 4,315,794 |
| Total net assets | 30,282,351 | 4,329,613 | (67,406) | -0- | 34,544,558 |
| Total liabilities and net assets | $ 42,605,550 | $ 4,637,522 | $ 228,324 | $ (418,513) | $ 47,052,883 |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
## YEAR ENDED JUNE 30, 2009

| | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Corp | Eliminations | Total |
|---|---|---|---|---|---|
| **Revenue and other support** | | | | | |
| Net client service revenue | $ 43,947,997 | $ -0- | $ -0- | $ -0- | $ 43,947,997 |
| Public support | 20,501,669 | -0- | -0- | (300,000) | 20,201,669 |
| Net assets released from restriction | 873,794 | -0- | -0- | -0- | 873,794 |
| Other | 1,028,134 | -0- | 41,554 | -0- | 1,069,688 |
| Total revenue and other support | 66,351,594 | -0- | 41,554 | (300,000) | 66,093,148 |
| **Expenses** | | | | | |
| Salary and fringe benefits | 45,575,313 | -0- | 85 | -0- | 45,575,398 |
| Telephone | 1,823,031 | -0- | 2,245 | -0- | 1,825,276 |
| Travel | 1,603,378 | -0- | 6,545 | -0- | 1,609,923 |
| Drugs and supplies | 3,866,619 | -0- | 18,177 | -0- | 3,884,796 |
| Printing and postage | 276,925 | -0- | 87 | -0- | 277,012 |
| Contracted services | 4,468,024 | 330 | -0- | -0- | 4,468,354 |
| Purchased services | 2,653,736 | 1,290 | 1,290 | -0- | 2,656,316 |
| Affiliated management fees | 1,511,956 | -0- | -0- | -0- | 1,511,956 |
| Rents and leases | 302,240 | -0- | 4,658 | -0- | 306,898 |
| Utilities | 2,969,413 | -0- | 13,351 | -0- | 2,982,764 |
| Repairs and maintenance | 528,591 | -0- | -0- | -0- | 528,591 |
| Depreciation and amortization | 2,447,330 | -0- | 0 | -0- | 2,447,330 |
| Insurance | 556,637 | -0- | -0- | -0- | 556,637 |
| Bad debt | 3,605,105 | -0- | -0- | -0- | 3,605,105 |
| Interest | 82,147 | -0- | 17,030 | -0- | 99,177 |
| Miscellaneous | 1,683,641 | 8,425 | 2,890 | -0- | 1,694,956 |
| Total expenses | 73,954,086 | 10,045 | 66,358 | -0- | 74,030,489 |
| Operating loss | $ (7,602,492) | $ (10,045) | $ (24,804) | $ (300,000) | $ (7,937,341) |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

## CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
## YEAR ENDED JUNE 30, 2009

| | Centerstone of Tennessee, Inc. | Centerstone Endowment Trust | Cumberland Holding Corp | Eliminations | Total |
|---|---|---|---|---|---|
| **Nonoperating revenues (expenses)** | | | | | |
| Loss on disposal of equipment | $ (21,713) | $ -0- | $ -0- | $ -0- | $ (21,713) |
| Loss on investments | (1,856) | -0- | -0- | -0- | (1,856) |
| Interest and dividend income | 41,457 | -0- | 201 | -0- | 41,658 |
| Other nonoperating expenses | (132,732) | -0- | -0- | -0- | (132,732) |
| Total nonoperating revenues and expenses | (114,844) | -0- | 201 | -0- | (114,643) |
| Excess of revenue over (under) expenses / Change in unrestricted net assets | (7,717,336) | (10,045) | (24,603) | (300,000) | (8,051,984) |
| **Changes in temporarily restricted net assets** | | | | | |
| Contributions and pledges, net | 729,802 | 2,955 | -0- | -0- | 732,757 |
| Transfer from permanently restricted | -0- | 300,000 | -0- | -0- | 300,000 |
| Net assets released from restriction | (873,794) | (300,000) | -0- | 300,000 | (873,794) |
| Change in temporarily restricted net assets | (143,992) | 2,955 | -0- | 300,000 | 158,963 |
| **Changes in permanently restricted net assets** | | | | | |
| Loss on investments | -0- | (1,269,857) | -0- | -0- | (1,269,857) |
| Transfer to temporarily restricted | -0- | (300,000) | -0- | -0- | (300,000) |
| Interest and dividend income | -0- | 146,709 | -0- | -0- | 146,709 |
| Change in permanently restricted net assets | -0- | (1,423,148) | -0- | -0- | (1,423,148) |
| Change in net assets | (7,861,328) | (1,430,238) | (24,603) | -0- | (9,316,169) |
| **Net assets, beginning of year** | 38,143,679 | 5,759,851 | (42,803) | -0- | 43,860,727 |
| **Net assets, end of year** | $ 30,282,351 | $ 4,329,613 | $ (67,406) | $ -0- | $ 34,544,558 |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

`

| Federal Grantor/Pass-through Grantor/Program Title | Federal CFDA Number | Pass-through Grantor Number | June 30, 2009 (Accrued) | Federal Receipts | Federal Expenditures | June 30, 2010 (Accrued) |
|---|---|---|---|---|---|---|
| **U.S. Dept. of Housing & Urban Development** | | | | | | |
| Tennessee Department of Human Services | | | | | | |
| Emergency Shelter Grant | 14.231 | ESG-09-17 | $ -0- | $ 14,276 | $ 14,276 | $ -0- |
| HOME | 14.239 | HM-07-09 | (10,044) | 10,044 | -0- | -0- |
| Subtotal - U.S. Dept. of Housing and Urban Development | | | (10,044) | 24,320 | 14,276 | -0- |
| **U.S. Dept. Of Justice** | | | | | | |
| **TN Dept of Finance and Administration** | | | | | | |
| Victims of Crime Assistance | 16.575 | 3963 | -0- | 31,640 | 33,547 | (1,907) |
| Victims of Crime Assistance | 16.575 | 3982 | -0- | 31,415 | 33,400 | (1,985) |
| JAG - ARRA | 16.803 | 3517 | -0- | 6,594 | 10,184 | (3,590) |
| Subtotal - U.S. Dept. of Justice | | | -0- | 69,649 | 77,132 | (7,482) |
| **U.S. Dept. Of Labor** | | | | | | |
| TN Dept of Finance and Administration | | | | | | |
| Career Resource Center | 17.275 | GJ-20090-10-60-A-47 | -0- | -0- | 42,868 | (42,868) |
| Subtotal - U.S. Dept. of Labor | | | -0- | -0- | 42,868 | (42,868) |
| **U.S. Dept. of Education** | | | | | | |
| Clarksville Montgomery Co. School System | | | | | | |
| Fund for the Improvement of Education FY09 | 84.215 | | (66,477) | 66,477 | -0- | -0- |
| Clarksville Montgomery Co. School System | | | | | | |
| Fund for the Improvement of Education FY10 | 84.215 | | -0- | 366,758 | 388,992 | (22,234) |
| Subtotal - U.S. Dept. of Education | | | (66,477) | 433,235 | 388,992 | (22,234) |
| **U.S. Dept. of Health & Human Services** | | | | | | |
| IMPACT-Centerstone's Older Adult Program | 93.243 | 5 H79-SM056910 | (11,052) | 53,511 | 42,459 | -0- |
| Methamphetamine Awareness & Prevention | 93.243 | 5H79SP014042 | (25,390) | 239,720 | 240,378 | (26,049) |
| Project Self | 93.243 | 5H79T017755 | (26,922) | 82,351 | 55,429 | -0- |
| Project Self | 93.243 | 1H79T1019313 | (31,940) | 400,953 | 419,034 | (50,021) |
| Project Free | 93.243 | 1H79TI020403 | (32,275) | 478,186 | 485,734 | (39,823) |
| Project Real | 93.243 | 1U79SP014998 | (24,220) | 304,520 | 323,006 | (42,706) |
| Co-Occuring Continuum HIV | 93.243 | 1H79TI018870 | (29,967) | 434,305 | 440,131 | (35,794) |
| SAMHSA-Clarksville Homeless Adult Program | 93.243 | 5H79TI016562 | (40,596) | 317,658 | 296,922 | (19,861) |
| National Research Service Awards | 93.226 | GMO-801101 | (39,837) | 70,149 | 170,739 | (140,427) |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

## SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
## YEAR ENDED JUNE 30, 2010

| Federal Grantor/Pass-through Grantor/Program Title | Federal CFDA Number | Pass-through Grantor Number | June 30, 2009 (Accrued) | Federal Receipts | Federal Expenditures | June 30, 2010 (Accrued) |
|---|---|---|---|---|---|---|
| **TN Dept. of Mental Health & Developmental Disabilities** | | | | | | |
| Regional Housing Facilitator Program | 93.001 | 7512-GR1028481 | -0- | 2,207 | 3,002 | (795) |
| Building Strong Families | 93.087 | GR-09-25412 | (108,564) | 108,564 | -0- | -0- |
| Building Strong Families | 93.087 | 10245-GR1028832 | -0- | 380,864 | 444,568 | (63,704) |
| Muletown Family Network | 93.104 | GR-09-25601 | (343,509) | 343,509 | -0- | -0- |
| Muletown Family Network | 93.104 | 12088-GR1029594 | -0- | 640,696 | 837,684 | (196,989) |
| PATH | 93.150 | GR-09-25012 | (31,745) | 30,863 | -0- | (882) |
| Wrote off balance for PATH | 93.150 | GR-09-25012 | 882 | -0- | -0- | 882 |
| CMHS Suicide | 93.243 | GR-06-17680 | (9,758) | 9,758 | -0- | -0- |
| TLC-Juvenille Prevention | 93.243 | GR-09-27191 | (34,916) | 34,916 | -0- | -0- |
| TLC-Juvenille Prevention | 93.243 | 6999-GR-09-27191-01 | -0- | 76,335 | 93,274 | (16,939) |
| Data Infrastructure Grant | 93.243 | Z-07-033417 | (9,750) | 9,750 | -0- | -0- |
| Substance Abuse Treatment/Meth | 93.243 | GR-06-17745 | (9,259) | 9,259 | -0- | -0- |
| BASIC | 93.958 | GR-09-25470 | (71,685) | 71,685 | -0- | -0- |
| BASIC | 93.958 | 7226-GR27898 | -0- | 223,340 | 257,151 | (33,811) |
| Early Childhood Network | 93.958 | GR-09-25703 | (14,321) | 14,321 | -0- | -0- |
| Early Childhood Network | 93.958 | 7221-GR1027904 | -0- | 50,845 | 62,696 | (11,851) |
| Peer Power Program | 93.958 | 7673-GR1028746 | -0- | 93,387 | 100,000 | (6,613) |
| Peer Support Drop-In Center | 93.958 | GR-09-24414 | (87,501) | 87,501 | -0- | -0- |
| Peer Support Drop-In Center | 93.958 | 7542-GR1028549 | -0- | 564,423 | 564,423 | -0- |
| Planned Respite Services | 93.958 | GR-09-25738 | (19,155) | 19,155 | -0- | -0- |
| Planned Respite Services | 93.958 | 7223-GR1027915 | -0- | 45,831 | 58,948 | (13,117) |
| Older Adult | 93.958 | GR-09-24675 | (22,514) | 22,514 | -0- | -0- |
| Criminal Justice Liason | 93.958 | GR-09-24247 | (21,148) | 21,148 | -0- | -0- |
| Alcohol & Drug Abuse Services for Intensive Focus | 93.959 | Z-09-216513 | (85,150) | 85,150 | -0- | -0- |
| Alcohol & Drug Abuse Services for Be Sharp | 93.959 | 10242-GR1028833 | -0- | 169,598 | 216,930 | (47,332) |
| Alcohol & Drug Abuse Services Adolescent Day/Eve Tx | 93.959 | Z-09-216541-01 | -0- | 104,472 | 113,858 | (9,386) |
| FEMA | 97.032 | 21351-GR1032189 | -0- | -0- | 61,105 | (61,105) |
| **TN Dept of Finance & Administration** | | | | | | |
| General Continuum Crisis Services | 93.778 | GR-07-21536 | (187,466) | 187,466 | -0- | -0- |
| Not included previously--FY07 | 93.778 | GR-07-21537 | (29,683) | 29,683 | -0- | -0- |
| **TN Dept. of Health** | | | | | | |
| Community Prevention Initiative (Strengthening Families) | 93.959 | GR-09-26585 | (23,517) | 23,517 | -0- | -0- |
| Project Star | 93.959 | GR-09-26585 | (34,556) | 34,556 | -0- | -0- |
| **TN Dept. of Children Services** | | | | | | |
| Responsible Parenting | 93.590 | GR-10-29379-00 | -0- | 10,557 | 11,341 | (784) |
| Subtotal U.S. Dept. of Health & Human Services | | | (1,405,516) | 5,887,222 | 5,298,814 | (817,108) |
| Total Federal Awards | | | $ (1,482,037) | $ 6,414,427 | $ 5,822,082 | $ (889,692) |

See Report of Independent Auditors on Pages 1 and 2.

## CENTERSTONE OF TENNESSEE, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

| CFDA # | Total Expenditures |
|---|---|
| 16.575 | $ 66,947 |
| 14.231 | 14,276 |
| 16.803 | 10,184 |
| 17.275 | 42,868 |
| 84.215 | 388,992 |
| 93.001 | 3,002 |
| 93.087 | 444,568 |
| 93.104 | 837,684 |
| 93.243 | 2,396,368 |
| 93.226 | 170,739 |
| 93.590 | 11,341 |
| 93.958 | 1,043,218 |
| 93.959 | 330,788 |
| 97.032 | 61,105 |
| | $ 5,822,082 |

See Report of Independent Auditors on Pages 1 and 2.

## CENTERSTONE OF TENNESSEE, INC.

SCHEDULE OF EXPENDITURES OF STATE FINANCIAL ASSISTANCE
YEAR ENDED JUNE 30, 2010

| State Grantor/Program Title | Grantor Number | June 30, 2009 (Accrued) | State Receipts | State Expenditures | June 30, 2010 (Accrued) |
|---|---|---|---|---|---|
| **TN Dept. of Mental Health & Developmental Disabilities** | | | | | |
| PATH | GR-09-25012 | $ (548) | $ 452 | $ - | $ (96) |
| Balance Write Off | GR-09-25012 | 96 | -0- | -0- | 96 |
| Homeless Outreach Program | GR-09-25012 | (3,763) | 3,763 | -0- | -0- |
| Homeless Outreach Program | 12467-GR1029674 | -0- | 3,068 | 5,042 | (1,973) |
| Regional Housing | GR-09-25128 | (16,618) | 16,618 | -0- | -0- |
| Regional Housing | 7512-GR1028481 | -0- | 72,392 | 76,812 | (4,420) |
| Regional Intervention Program Expanded | GR-09-25821 | (101,235) | 101,235 | -0- | -0- |
| Regional Intervention Program | 7668-GR1028761 | -0- | 196,562 | 223,309 | (26,747) |
| Independent Living Assistance | GR-09-25127 | (598) | 598 | -0- | -0- |
| Independent Living Assistance | 7660-GR1028743 | -0- | 108,956 | 107,998 | 958 |
| Targeted Transitional Support | GR-09-25127 | (6,750) | 6,750 | -0- | -0- |
| Targeted Transitional Support | GR-09-25127-00 | -0- | 35,151 | 51,667 | (16,516) |
| Peer Support Drop-In Center | GR-09-24414 | (211,399) | 211,399 | -0- | -0- |
| Peer Support Drop-In Center and Transportation | 7542-GR1028549 | -0- | 194,779 | 419,837 | (225,058) |
| Transportation | GR-09-24414 | (7,998) | 7,998 | -0- | -0- |
| Peer Power Program | GR-09-25239 | (24,676) | 24,676 | -0- | -0- |
| School Based MH Liaison | GR-09-25413 | (30,046) | 30,046 | -0- | -0- |
| School Based MH Liaison | 7667-GR1028754 | -0- | 81,135 | 86,468 | (5,334) |
| Criminal Justice Liason | GR-09-24247 | (8,945) | 8,945 | -0- | -0- |
| Criminal Justice Liason | 17640-GR1030093 | -0- | 67,909 | 132,908 | (64,999) |
| Alcohol and Drug Abuse Treatment Services fo Adolescents | Z-09-216541 | (21,276) | 21,275 | -0- | (1) |
| Safety Net | 10885-GR1029090-01 | -0- | -0- | -0- | -0- |
| Suspender Residential | GR-09-25127 | (115,236) | 115,203 | -0- | (33) |
| Balance Write Off | | 33 | -0- | -0- | 33 |
| Permenant Housing Suspender Residential | 7636-GR1028675 | -0- | 322,599 | 370,992 | (48,393) |
| Permenant Housing HUD | 7636-GR1028675 | -0- | 30,686 | 32,354 | (1,668) |
| All Hazard Training | GR-07-18131 | (9,744) | 9,744 | -0- | -0- |
| All Hazard Training | 5754-GR-07-18131-03 | -0- | 12,957 | 12,957 | -0- |
| Walk-In Triage | GR-09-25823 | (30,384) | 30,384 | -0- | -0- |
| Walk-In Triage | 11219-GR1029376 | -0- | 65,644 | 92,147 | (26,503) |
| Mobile Crisis Intervention | GR-09-26958 | (289,783) | 289,783 | -0- | -0- |
| Mobile Crisis Intervention | 7279-GR1028046 | -0- | 616,270 | 616,270 | -0- |
| Older Adult | 12084-GR1029592 | -0- | 40,205 | 49,262 | (9,057) |

See Report of Independent Auditors on Pages 1 and 2.

# CENTERSTONE OF TENNESSEE, INC.

SCHEDULE OF EXPENDITURES OF STATE FINANCIAL ASSISTANCE
YEAR ENDED JUNE 30, 2010

| State Grantor/Program Title | Grantor Number | June 30, 2009 (Accrued) | State Receipts | State Expenditures | June 30, 2010 (Accrued) |
|---|---|---|---|---|---|
| **TN Housing Development Agency** | | | | | |
| Trinity House | HTF-07-32 | (370) | 923 | 553 | -0- |
| **TN Dept. of Children's Services** | | | | | |
| Level II Continuum | P2C000001 | (207,456) | 207,818 | -0- | 362 |
| Level II Continuum | P2C000017 | -0- | 2,180,256 | 2,488,032 | (307,776) |
| Level III Continuum | P3C000001 | (96,075) | 96,075 | -0- | -0- |
| Level III Continuum | P3C000012 | -0- | 1,510,075 | 1,644,825 | (134,750) |
| Level I Fosters Care | PFC000001 | (24,935) | 24,934 | -0- | (1) |
| Level I Fosters Care | PFC000019 | -0- | 303,450 | 368,367 | (64,917) |
| Level III Continuum | P3C000027 | -0- | 183,101 | 279,774 | (96,674) |
| Responsible Parenting | GR-08-21351 | (6,730) | 6,730 | -0- | -0- |
| Responsible Parenting | GR-10-29379-00 | -0- | 25,338 | 27,221 | (1,883) |
| Special Education | Z-08-212411 | (1,130) | 1,928 | 798 | -0- |
| **Clarksville Montgomery County Comm. Action Agency** | | | | | |
| Head Start | N/A | (412) | 413 | -0- | 1 |
| Total State Grant Activity | | $ (1,215,978) | $ 7,268,223 | $ 7,087,593 | $ (1,035,348) |

See Report of Independent Auditors on Pages 1 and 2.

CPAS / ADVISORS

blue

Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

# REPORT OF INDEPENDENT AUDITORS 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*

Board of Directors
Centerstone of America, Inc.
Bloomington, Indiana

We have audited the consolidated financial statements of Centerstone of Tennessee, Inc., (the Center), as of and for the year ended June 30, 2010, and have issued our report thereon dated December 23, 2010. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and question costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and another deficiency that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies, 2010-1 and 2010-2, in the accompanying schedule of findings and questioned costs to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention by those charged with governance. We consider the deficiency, 2010-3, in the accompanying schedule of findings and questioned costs to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Center in a separate letter dated December 23, 2010.

The Center's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Center's response, and accordingly, we express no opinion on it.

This report is intended for the information of the Board of Directors, 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.

Blue & Co., LLC

December 23, 2010

CPAS / ADVISORS

blue

Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

# REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Directors
Centerstone of America, Inc.
Bloomington, Indiana

## Compliance

We have audited the compliance of Centerstone of Tennessee, Inc., (the Center), with the types of compliance requirements described in the U*.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. The Center's major federal programs are identified in the summary of the 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 the Center's management. Our responsibility is to express an opinion on the Center'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. 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 could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Center'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 the Center's compliance with those requirements.

In our opinion, the Center complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

The management of the Center 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 the Center'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 A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended for the information of the Board of Directors, 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.

Blue & Co., LLC

December 23, 2010

# CENTERSTONE OF TENNESSEE, INC.

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS
## YEAR ENDED JUNE 30, 2010

**Section I -- Summary of Audit Results:**

***Financial Statements***

| | |
|---|---|
| Type of auditor's report issued: | Unqualified |
| Internal control over financial reporting: | |
| Material weakness(es) identified? | X yes ___ no |
| Significant deficiency(s) identified that are not considered to be material weakness(es)? | X yes ___ none reported |
| Noncompliance material to financial statements noted? | ___ yes X no |

***Federal Awards***

| | |
|---|---|
| Internal controls over major programs: | |
| Material weakness(es) identified? | ___ yes X no |
| Significant deficiency(s) identified that are not considered to be material weakness(es)? | ___ yes X none reported |
| Type of auditor's report issued on compliance for major programs: | Unqualified |
| Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? | ___ yes X no |

Identification of major program:

| CFDA Number | Name of Federal Program or Cluster |
|---|---|
| 93.243 | Projects of Regional and National Significance - Substance Abuse and Mental Health Services (SAMHSA) - Department of Health and Human Service |
| 93.104 | Comprehensive Community Mental Health Services for Children with Serious Emotion Disturbance (SED) Substance Abuse and Mental Health Services (SAMHSA) - Department of Health and Human Service |
| 93.958 | Block Grants for Community Menalth Health Services Substance Abuse and Mental Health Services (SAMHSA) - Department of Health and Human Service |

| | |
|---|---|
| Dollar threshold used to distinguish between type A and B programs: | $300,000 |
| Auditee qualified as low-risk auditee? | ___ yes X no |

**Section II – Findings related to financial statements reported in accordance with *Government Auditing Standards:***

10-1 Financial Reporting Process

Condition and Criteria – During 2009 and continuing into 2010, the Center experienced a period of significant growth and complexity due to mergers, information technology changes, and the related organizational restructuring. Concurrently, unexpected turnover with certain key members of financial management took place.

Cause and Effect – Due to increased size and complexity, the changes in the information technology, and the financial management turnover, the financial reporting process including financial statement preparation and certain related functions such as reconciliation and journal entry preparation were not completed timely.

Recommendation – We understand management has made significant improvements to the financial reporting process during 2010 compared to 2009, including the use of a closing process/checklist, various due dates to insure timeliness, and the review and approval of financials from non accounting/finance department management. Changes have been made in the management structure in order to address issues reported in the financial reporting process. However, these changes occurred throughout 2010. We continue to suggest evaluations of the reporting process be made during the next fiscal year to ensure efficiency and effectiveness. The most significant areas still in progress include the monthly maintenance of the due to/from accounts and the monthly reconcilement and allowances related to patient accounts receivable.

Response – Management has made significant improvements in the financial reporting process during FY 2010. The financial statement closing process has been documented and check lists were created to guide the completeness of the statements. Due dates have been established for various steps in the process to insure timeliness. Several review and approval points are included in the timeline where management outside the finance department is involved. These steps have greatly improved the accuracy and timeliness of the financial statements. We will continue the improvements related to the due to/from accounts and the monthly reconcilement related to patient accounts receivable.

10-2 Patient Accounts Receivable and Revenue Valuation

Condition and Criteria – During 2009, in addition to the merger and key financial management turnover the Center converted to a new billing system. Significant time and effort was put forth to convert to the system. Management experienced difficulty with the new system related to reporting and reconciling including reporting related to collection/adjustment experience. During 2010, the Center has put in considerable time and effort into documenting and verifying the reporting processes within the billing system and making the necessary edits in order to achieve accurate and complete reporting to facilitate patient accounts receivable reconcilement and allowance computations.

Cause and Effect – Due to the conditions noted the allowance recorded was not based upon a consistently applied methodology which reflects payment history and the resulting expected net realizable value.

Recommendation – Management did make significant progress during 2010. As of the end of the year management had reconciled the accounts receivable balances and had established allowances. Management should continue in the effort to have a consistently applied allowance methodology which contemplates both the contractual allowance and the allowance for bad debt by payor which is applied monthly. The collection/adjustment experience should be updated on a routine basis (i.e. quarterly). In addition, appropriate internal controls should maintained and documented including reviews, approvals and data integrity audits.

Response – Management understands the need for a more sophisticated allowance methodology that includes both the contractual allowance and the allowance for bad debt by payor. Management is in the process of developing an allowance methodology which will include appropriate internal control.

10-3 Restricted Net Assets

Condition and Criteria – It was noted that the finance department is recording gifts as unrestricted, temporarily restricted or permanently restricted as appropriate and recording releases from restricted to unrestricted net assets as donor restrictions are met each month. We do note, however, that income earned on the permanently restricted investments was not properly recorded in temporarily restricted income and released as expended.

Cause and Effect – Accounting standards require that, unless restricted into perpetuity by the donor, any income earned on permanently restricted net assets be recorded within the temporary classification and appropriately released when expended.

Recommendation – We recommend that management fully adopt the accounting standards that require, unless restricted into perpetuity by the donor, any income earned on permanently restricted net assets be recorded within the temporary classification and appropriately released when expended.

Response – Management understands the need to fully adopt the accounting standards that require, unless restricted into perpetuity by the donor, any income earned on permanently restricted net assets be recorded within the temporary classification and appropriately released when expended and will proceed accordingly to complete the necessary steps to adopt the recommendation.

**Section III – Federal Award Findings and Questioned Costs:**

No matters reported.

**Section IV – Summary Schedule of Prior Audit Findings:**

No matters reported.