

**Seven Counties Services, Inc.  
and SCS Learning, Inc.**

**Consolidated Financial Statements**

**Years Ended June 30, 2015 and 2014**

**Seven Counties Services, Inc. and SCS Learning, Inc.**

Table of Contents  
June 30, 2015 and 2014

	<u>Page</u>
Independent Auditor's Report .....	1 - 2
<b>Consolidated Financial Statements</b>	
Consolidated Statements of Financial Position.....	3
Consolidated Statements of Operations and Changes in Net Assets .....	4
Consolidated Statements of Cash Flows.....	5 - 6
Notes to Consolidated Financial Statements.....	7 - 17
<b>Supplementary Information</b>	
Consolidating Statements of Financial Position .....	18 - 19
Consolidating Statements of Operations and Changes in Net Assets .....	20



## **Independent Auditor's Report**

To the Board of Directors  
**Seven Counties Services, Inc. and SCS Learning, Inc.**

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

We have audited the accompanying consolidated financial statements of Seven Counties Services, Inc., and SCS Learning, Inc. (nonprofit organizations), which comprise the consolidated statements of financial positions as of June 30, 2015 and 2014, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Kentucky**  
**Indiana**  
**Ohio**

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## **Independent Auditor's Report (Continued)**

### **Opinion**

In our opinion, their consolidated financial statements referred to above present fairly, in all material respects, the financial position of Seven Counties Services, Inc. and SCS Learning, Inc. as of June 30, 2015 and 2014, and the results of their operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Report on Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental consolidating information as of and for the years ended June 30, 2015 and 2014 on pages 18-20 is presented for purposes of additional analysis and is 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 consolidating 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.

A handwritten signature in black ink, appearing to read "Muenzger Chilton Muddley LLP". The signature is written in a cursive, flowing style.

Louisville, Kentucky  
October 30, 2015

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidated Statements of Financial Position**  
**June 30, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
<b>Assets</b>		
Current Assets		
Cash	\$ 5,182,297	\$ 4,230,952
Investments	4,671,855	4,621,651
Accounts and grants receivable, less allowance for doubtful accounts of \$4,016,000 in 2015 and \$3,794,000 in 2014	11,884,402	9,070,735
Contributed rent receivable, current	256,203	270,787
Prepaid expenses and other current assets	<u>1,013,260</u>	<u>933,284</u>
Total Current Assets	<u>23,008,017</u>	<u>19,127,409</u>
Property, Plant and Equipment		
Land	1,807,050	1,807,050
Buildings and improvements	13,762,287	13,428,781
Leasehold improvements	4,388,959	4,317,021
Equipment and vehicles	21,978,678	21,672,554
Construction in progress	<u>2,458,322</u>	<u>227,528</u>
	44,395,296	41,452,934
Less: accumulated depreciation	<u>29,526,035</u>	<u>27,380,279</u>
Property, Plant and Equipment, net	14,869,261	14,072,655
Other Assets		
Contributed rent receivable, less current	2,358,704	2,614,906
Bond costs, net of amortization of \$153,340 in 2015 and \$141,123 in 2014	72,562	84,779
Franchise fees, net of amortization of \$14,214 in 2015 and \$9,938 in 2014	40,086	44,362
Long-term investments	<u>80,000</u>	<u>80,000</u>
Total Other Assets	<u>2,551,352</u>	<u>2,824,047</u>
Total Assets	<u>\$ 40,428,630</u>	<u>\$ 36,024,111</u>

	<u>2015</u>	<u>2014</u>
<b>Liabilities and Net Assets</b>		
Current Liabilities		
Current maturities of bonds and note payable	\$ 575,962	\$ 327,972
Accounts payable	7,335,713	2,284,090
Accrued payroll and vacation	4,506,860	4,181,729
Accrued expenses and other current liabilities	1,239,410	1,779,139
Deferred revenue	<u>1,641,604</u>	<u>1,120,279</u>
Total Current Liabilities	<u>15,299,549</u>	<u>9,693,209</u>
Bonds and Note Payable, less current maturities	<u>3,894,489</u>	<u>4,470,451</u>
Total Liabilities Not Subject to Compromise	<u>19,194,038</u>	<u>14,163,660</u>
Liabilities Subject to Compromise		
Accounts payable	-	521,914
Accrued expenses and other current liabilities	<u>-</u>	<u>697,699</u>
Total Liabilities Subject to Compromise	<u>-</u>	<u>1,219,613</u>
Total Liabilities	<u>19,194,038</u>	<u>15,383,273</u>
Net Assets, temporarily restricted	2,724,663	2,885,693
Net Assets, unrestricted	<u>18,509,929</u>	<u>17,755,145</u>
Total Net Assets	<u>21,234,592</u>	<u>20,640,838</u>
Total Liabilities and Net Assets	<u>\$ 40,428,630</u>	<u>\$ 36,024,111</u>

See accompanying notes.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidated Statements of Operations and Changes in Net Assets**  
**Years Ended June 30, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
Changes in Unrestricted Net Assets:		
Revenues:		
Reimbursements under Kentucky Department for Behavioral Health, Developmental & Intellectual Disabilities	\$ 15,686,468	\$ 22,070,451
Net reimbursements under Medicaid	55,454,192	41,044,559
Net reimbursements under Medicare	963,721	577,449
Federal, state and local grants	22,882,608	29,382,068
Private pay and commercial insurance	1,956,854	2,164,711
Other revenues	1,582,813	1,862,836
Provision for bad debts	(3,023,082)	(4,142,529)
Assets released from restrictions	270,786	150,320
	<u>95,774,360</u>	<u>93,109,865</u>
Expenses:		
Salaries and fringe benefits	57,001,016	59,708,581
Subcontract services	12,649,475	4,265,413
Purchased services	12,313,482	14,806,407
Building rentals, maintenance and utilities	4,232,466	4,475,650
Program supplies	2,978,419	2,921,662
Transportation and travel	954,095	1,054,107
Depreciation and amortization	2,226,973	2,070,305
Interest expense	105,044	9,980
General and administrative expenses	3,298,567	3,051,123
	<u>95,759,537</u>	<u>92,363,228</u>
Operating Income	<u>14,823</u>	<u>746,637</u>
Nonoperating income (loss):		
Investment income and other	1,206,255	127,025
Impairment of electronic medical record system	-	(2,703,422)
(Loss) gain on disposal of property and equipment	(82,511)	1,305
	<u>1,123,744</u>	<u>(2,575,092)</u>
Increase (Decrease) in Unrestricted Net Assets Before Reorganization Items	1,138,567	(1,828,455)
Reorganization Items	383,783	917,319
	<u>754,784</u>	<u>(2,745,774)</u>
Increase (Decrease) in Unrestricted Net Assets		
Changes in Temporarily Restricted Net Assets:		
Restricted grant revenue	109,756	-
Contributed rent	-	353,513
Assets released from restrictions	(270,786)	(150,320)
	<u>(161,030)</u>	<u>203,193</u>
(Decrease) Increase in Temporarily Restricted Net Assets		
Increase (Decrease) in Total Net Assets	593,754	(2,542,581)
Net Assets at Beginning of Year,	20,640,838	23,183,419
	<u>\$ 21,234,592</u>	<u>\$ 20,640,838</u>

See accompanying notes.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities		
Cash received for services	\$ 91,738,175	\$ 93,916,976
Cash paid to suppliers and employees	(89,425,608)	(90,777,572)
Interest income received	1,222,742	155,071
Interest paid	(105,044)	(9,980)
Other revenues received	<u>1,582,813</u>	<u>1,662,836</u>
Net Cash Provided by Operating Activities	<u>5,013,078</u>	<u>4,947,331</u>
Cash Flows from Investing Activities		
Purchases of property and equipment	(3,294,136)	(2,087,774)
Purchases of investments	(1,649,692)	(1,683,190)
Maturities of investments	1,583,000	1,602,000
Proceeds from sale of assets	<u>10,850</u>	<u>1,305</u>
Net Cash Used by Investing Activities	<u>(3,349,978)</u>	<u>(2,167,659)</u>
Cash Flows from Financing Activities		
Payments for reorganization items	(383,783)	(917,319)
Principal payments on bonds and note payable	<u>(327,972)</u>	<u>(561,577)</u>
Net Cash Used by Financing Activities	<u>(711,755)</u>	<u>(1,478,896)</u>
Net Increase in Cash and Cash Equivalents	951,345	1,300,776
Cash and Cash Equivalents at Beginning of Year	<u>4,230,952</u>	<u>2,930,176</u>
Cash and Cash Equivalents at End of Year	<u>\$ 5,182,297</u>	<u>\$ 4,230,952</u>

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidated Statements of Cash Flows (Continued)**  
**Years Ended June 30, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
Reconciliation of Net Decrease in Total Net Assets to Net Cash Provided by Operating Activities		
Change in Net Assets	\$ 593,754	\$ (2,542,581)
Adjustments to reconcile net decrease in unrestricted net assets to net cash provided by (used in) operating activities:		
Contributed rent received	-	(353,513)
Contributed rent expensed	270,786	150,320
Depreciation and amortization	2,226,973	2,070,305
Amortization of bond issuance costs and franchise fees	16,493	19,516
Cash flows used by reorganization items	383,783	917,319
Increase in allowance for doubtful accounts and contractual adjustments	194,689	957,119
Change in investment interest receivable	8,283	1,382
Unrealized loss on investments	8,204	26,664
Loss (gain) on disposal of property and equipment	82,511	(1,305)
Donation of capital asset	-	(200,000)
Impairment of electronic medical record system	-	2,703,422
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(3,008,356)	1,205,771
Prepaid expenses and other current assets	(79,976)	34,297
Increase (decrease) in:		
Accounts payable	4,706,906	(714,213)
Accrued payroll and vacation	325,131	(163,861)
Accrued expenses and other current liabilities	(1,237,428)	179,312
Deferred revenue	521,325	657,377
	<u>4,419,324</u>	<u>7,489,912</u>
Total Adjustments	<u>4,419,324</u>	<u>7,489,912</u>
Net Cash Provided by Operating Activities	<u>\$ 5,013,078</u>	<u>\$ 4,947,331</u>
Supplemental Schedule Noncash Investing and Financing Activities		
Accounts payable incurred to acquire equipment	<u>\$ 412,726</u>	<u>\$ 589,923</u>
Note payable incurred to acquire leasehold improvements	<u>\$ -</u>	<u>\$ 500,000</u>

See accompanying notes.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2015 and 2014**

**Note A - Nature of Organization and Operations**

Seven Counties Services, Inc. (SCS) is a community mental health - developmental disabilities organization which provides planning, coordination and direct delivery of mental health, substance abuse and developmental disability services, primarily on an outpatient basis, to residents of Jefferson County and six adjoining counties in the Commonwealth of Kentucky. These services are provided at various centers located within the seven county area. SCS also has contracts with other health care and social agencies for the provision of additional mental health, substance abuse and developmental disability services.

SCS is the sole member of Personnel Best, LLC, a limited liability company. Personnel Best, LLC performs as a pass-through entity to receive benefit payments and process the corresponding payroll to providers for Kentucky Medicaid recipients who receive benefits under the Kentucky Consumer Directed Options program.

SCS Learning, Inc. provides cognitive training to children and others with academic difficulties and utilizes a program through LearningRx Franchise Corporation under a franchise agreement. During the year, SCS Learning, Inc. operated in two locations with the rights to open an additional site within the appointed area.

**Note B - Summary of Significant Accounting Policies**

This summary of significant accounting policies is presented to assist in understanding the Organization's consolidated financial statements. The consolidated financial statements and notes are representations of the Organizations' management who is responsible for the integrity and objectivity of the consolidated financial statements. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the consolidated financial statements.

1. Principles of Consolidation: The consolidated financial statements include the accounts of Seven Counties Services, Inc. and SCS Learning, Inc. SCS controls and appoints the Board of Directors of SCS Learning, Inc. as well as providing other support services. SCS and SCS Learning, Inc. are collectively "the Organization." All intercompany balances and transactions have been eliminated in consolidation.
2. Revenue Recognition: Revenues from services to clients covered under Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities contracts are recognized at SCS' established billing rates, subject to annual contract limitations.

Revenues from services to clients covered under Medicaid, including Managed Care Organizations (MCOs), and Medicare are recognized at SCS' established billing rates less contractual adjustments. Contractual adjustments represent the differences between established billing rates and the amounts estimated to be reimbursable under the Medicaid, MCOs and Medicare programs.

Revenues from federal, state and local grants are recognized when the qualifying expenditures are made.

The Organization recognizes revenues earned from private payers by assessment of a fee based upon the client's ability to pay for services. Revenues earned from payers covered by commercial insurance are recognized based upon the Organization's established billing rates.

3. Accounts Receivable: The valuation of accounts receivable is based upon a detailed analysis of past due accounts and the history of uncollectible accounts. Estimated uncollectible accounts increase the allowance for doubtful accounts and when the accounts receivable are written off, the allowance for doubtful accounts is decreased. The Organization reviews the net accounts receivable with subsequent collections to determine the accuracy of the allowance for doubtful accounts. Included in accounts receivable is \$9,897,235 and \$7,517,398 due from the Kentucky Medicaid program, including Medicaid MCOs, for the years ended June 30, 2015 and 2014, respectively.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note B - Summary of Significant Accounting Policies (Continued)**

4. Investments: The Organization records all investments at fair market value. See Note D for discussion of fair market value measurements.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of the investment securities will occur in the near term and that such changes could materially affect the financial condition of the Organization. Though the market value of investments is subject to fluctuations on a year-to-year basis, management believes the investment policy is prudent for the long-term welfare of the Organization.

5. Cash and Cash Equivalents: For purposes of the statement of cash flows, the Organization considers unrestricted cash and investments with original maturities of three months or less, excluding those amounts held as part of an investment fund, to be cash and cash equivalents.
6. Income Taxes: Seven Counties Services, Inc. and SCS Learning, Inc. are exempt from federal, state and local income taxes as a not-for-profit corporation as described under Internal Revenue Code Section 501(c)(3). The Organizations file an informational tax return in the U.S. federal jurisdiction and with the Kentucky Office of the Attorney General. Personnel Best, LLC is a disregarded entity for tax purposes, and its activity is included with SCS for tax reporting. However, income from certain activities not directly related to the Organizations' tax-exempt purpose may be subject to taxation as unrelated business income.

As of June 30, 2015 and 2014, the Organization did not have any accrued interest or penalties related to income tax liabilities, and no interest or penalties have been charged to operations for the years then ended. The Organization's 2011 through 2014 tax years remain open and subject to examination.

7. Property and Equipment: Property and equipment are stated at cost, if purchased, or at fair market value as of the date of donation, if donated. The Organization's policy is to capitalize asset purchases exceeding \$1,000 for equipment and \$5,000 for leasehold improvements and building and improvements. Depreciation of property and equipment is computed by the straight-line method. The following estimated useful lives were used:

	<u>Years</u>
Buildings and improvements	10 - 30
Equipment and vehicles	3 - 10

Amortization of leasehold improvements is provided using the straight-line method over the lease term or estimated lives of the improvements, whichever is less.

Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

8. Bond Costs: Bond costs are amortized by the effective interest method over the terms of the bonds.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note B - Summary of Significant Accounting Policies (Continued)**

9. Deferred Revenue: Deferred revenue represents amounts received in advance under various cost reimbursement grants for which the expenditures have not yet been incurred as of the consolidated statement of financial position date.

Deferred revenue also represents fees paid in advance to SCS Learning, Inc. for classes extending past the consolidated statement of financial position date.

10. Compensated Absences: Employees of the Organization are entitled to paid leave (including vacation, holiday and sick) and short-term disability, depending on job classification, length of service, and other factors. It is impractical to estimate the amount of compensation for future sick pay and short-term disability and, accordingly, no liability has been recorded in the accompanying consolidated financial statements. The Organization's policy is to recognize the costs of sick time and short-term disability absences when actually paid to employees.
11. Donated Services and Materials: Donated services which require specific expertise and would normally have been purchased, and donated services which create or enhance nonfinancial assets, are required to be reflected in the consolidated financial statements. The Organization has received services from a substantial number of unpaid volunteers who donated significant amounts of time to the services provided by the Organization. However, only donated services that meet the criteria for recognition are recorded on the consolidated financial statements. The estimated value of volunteer services which did not meet the criteria for recognition totaled approximately \$24,000 and \$34,000 during the years ended 2015 and 2014, respectively. Also, approximately \$161,000 and \$288,000 of donated pharmaceuticals were recorded as other revenues and expenses during the years ended 2015 and 2014, respectively.
12. Contributions: Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when the stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements. Donations of long-lived assets with explicit restrictions that specify how the assets are to be used and donations 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-lived assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. There were temporarily restricted net assets of \$2,614,907 and \$2,885,693 for contributed rent receivable at June 30, 2015 and 2014, respectively. In addition there was a temporarily restricted grant for \$109,756 included in temporarily restricted net assets at June 30, 2015. There were no permanently restricted net assets as of June 30, 2015 and 2014.
13. Subcontract Services: Certain services covered under Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities contracts are subcontracted to other health care and social agencies. The consolidated financial statements recognize the revenues and expenses for these program services, and the related amounts paid to subcontractors.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note B - Summary of Significant Accounting Policies (Continued)**

14. Charity Care: Services are provided to clients with a demonstrated inability to pay based on certain criteria under the Organization's charity care policies without charge or at amounts less than their established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as net revenue. The Organization maintains records to identify and monitor the level of charity care it provides. The total cost incurred based on the Organization's overall cost to charge ratio to provide charity care was approximately \$1,832,000 and \$2,573,000, for the years ended June 30, 2015 and 2014, respectively. Charges forgone, based on established rates, was approximately \$2,577,000 and \$3,539,000 for the years ended 2015 and 2014, respectively.
15. 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.
16. Subsequent Events: Subsequent events for the Organization have been considered through the date of the Independent Auditor's Report which represents the date the consolidated financial statements were available to be issued.

**Note C - Business and Revenue Concentrations and Vulnerability**

SCS provides services without obtaining payment from many of its clients, most of whom are insured under third-party agreements or covered by Medicaid or under contracts with the Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities (DBHDID) or Central State Hospital. The percentage of revenues obtained from major revenue contracts was as follows:

	<u>2015</u>	<u>2014</u>
Medicaid and Medicaid MCOs	58%	44%
DBHDID	16%	24%
Central State Hospital	13%	17%

The Organization's operations are concentrated in the health care industry. In the health care industry, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Compliance with health care industry laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note D - Investments and Fair Value Measurements**

Accounting principles generally accepted in the United States of America establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

Level 2 - Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active or inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

All assets have been valued using a market approach. Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies used at June 30, 2015 and 2014.

Cash equivalents - the carrying amounts approximate fair value because of the short maturity of these financial instruments.

Certificates of deposit - valued at the closing price reported on the active market.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair value of investments as of June 30, 2015 and 2014 is summarized below:

	<u>2015</u>	<u>2014</u>
Level 1 investments:		
Cash equivalents	\$ 978,503	\$ 39,402
Certificates of deposit	<u>3,693,352</u>	<u>4,582,249</u>
	<u>\$ 4,671,855</u>	<u>\$ 4,621,651</u>

All certificates of deposit are held at various financial institutions and are fully insured by the Federal Deposit Insurance Corporation (FDIC).

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note E - Long-term Investment**

SCS owns approximately 5% of the outstanding common stock of Mental Health Risk Retention Group (MHRRG). MHRRG provides professional liability insurance to mental health care providers and an organization must have "ownership" to participate. SCS does not maintain control over the operations of MHRRG. The investment of \$80,000 by SCS in MHRRG is recorded on the cost method.

**Note F - Bonds and Note Payable**

In December 2005, Louisville/Jefferson County Metro Government issued the proceeds from \$3,500,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to SCS. The bonds are backed by a letter of credit from Fifth Third Bank. The letter of credit is scheduled to expire on December 15, 2016. The bonds will be repaid in annual installments with the final payment due December 1, 2020. The 2005 bonds were issued for the purpose of financing costs of acquiring, constructing, and equipping a new community mental health facility in Louisville, Kentucky, improvements to or acquisition of an adolescent residential treatment facility in Louisville, a new community mental health facility for Oldham, Henry and Trimble Counties and expansion to an existing Bullitt County facility. Collateral consists of the facilities constructed with the proceeds of the bonds with a net book value of approximately \$3,179,000 and \$3,417,000 as of June 30, 2015 and 2014, respectively.

In December 2011, Louisville/Jefferson County Metro Government issued the proceeds from \$2,600,000 of Adjustable Rate Demand Industrial Building Revenue Bonds to SCS. The bonds are backed by a letter of credit from Fifth Third Bank. The letter of credit is scheduled to expire on December 15, 2016. The bonds will be repaid in annual installments with the final payment due December 1, 2021. The bonds were issued for the purpose of financing the Electronic Enterprise Solution software system. Collateral consists of all accounts receivable, equipment, and general intangibles with a net book value of approximately \$15,106,000 and \$13,179,000 as of June 30, 2015 and 2014, respectively.

In June 2014, SCS entered into a debt agreement with the Landlord of a leased facility. The debt acquired was for \$500,000 used to finance the construction of leasehold improvements with the debt being repaid to the landlord over the life of the lease. This note payable is unsecured.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note F - Bonds and Note Payable (Continued)**

Outstanding principal and future maturities of the above bonds payable are as follows:

	<u>2015</u>	<u>2014</u>
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2020 (interest rate of .16% at June, 30, 2015).	\$ 1,650,000	\$ 1,890,000
Industrial Revenue Bonds, payable to The Bank of New York in annual installments including interest (variable) through December 1, 2021 (interest rate of .14% at June 30, 2015).	2,340,000	2,410,000
Note payable, payable to Landlord in monthly installments of \$4,494 including interest at 7.00% through July 1, 2029.	480,451	498,423
	<u>4,470,451</u>	<u>4,798,423</u>
Less current maturities	<u>575,962</u>	<u>327,972</u>
	<u>\$ 3,894,489</u>	<u>\$ 4,470,451</u>

Future Maturities:

June 30,	
2016	\$ 575,962
2017	587,478
2018	589,102
2019	595,845
2020	602,713
2021-2030	<u>1,519,351</u>
	<u>\$ 4,470,451</u>

In accordance with the trust indentures, SCS must comply with certain financial covenants relating to the above bonds. Management is not aware of any violations of covenants as of June 30, 2015.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note G - Lease Commitments**

The Organization leases administrative and clinical space at several locations as well as several vehicles under noncancelable operating leases with initial terms of at least one year. The Organization leases other equipment on a month-to-month basis. Total rental expense for all leases was approximately \$1,981,000 and \$2,229,000 for the years ended June 30, 2015 and 2014 respectively, which includes \$587,073 and \$580,186 for the years ended June 30, 2015 and 2014, respectively, for the fair market value of the donated lease of the Jefferson Alcohol and Drug Abuse Center (JADAC) from Louisville Metro Government. Future contributed rent under this lease is valued at \$2,392,500 and \$2,537,500 at June 30, 2015 and 2014, respectively, and is being amortized over the life of the lease which matures December 31, 2031. In addition the Company received donated rent from a landlord for the use of two additional facilities during 2015 and 2014 of which \$125,787 and \$5,320, respectively, is included in the above rental expense and the remaining contributed receivable of \$222,407 and \$348,193, respectively, is treated as a temporarily restricted assets receivable in the months specified in the related agreements.

At June 30, 2015, the minimum annual lease commitments under agreements having initial terms of more than one year were as follows:

2016	\$ 1,304,735
2017	1,096,230
2018	1,010,589
2019	864,416
2020	324,399
2021-2029	<u>1,701,750</u>
	<u>\$ 6,302,119</u>

**Note H - Retirement Plan**

Although SCS is a separate Kentucky non-for-profit corporation as described under Internal Revenue Code Section 501(c)(3) (See Note B), SCS participated in the Kentucky Employees Retirement System (KERS), which is a cost-sharing multiple-employer defined benefit plan. Full-time employees of SCS who were hired subsequent to January 23, 1979 were covered under this plan. The Organization's contribution to the plan was based on a percentage of the employees' gross salaries as determined by KERS on an annual basis. Other full-time employees hired prior to that date are covered under a separate tax-deferred annuity plan. The Organization's contributions were approximately \$420,000 and \$3,940,000 for the years ended June 30, 2015 and 2014, respectively.

SCS filed bankruptcy on April 4, 2013 (see Note N), seeking relief from the burden of unsustainable mandatory employer contribution rates imposed by KERS and to replace the KERS retirement plan with a stable, affordable plan for their employees. During 2014, SCS continued to make contributions to KERS for their employees at Central States Hospital and other state funded facilities. In May 2014, the bankruptcy court ruled that the SCS had legal standing to seek relief in Chapter 11 and withdraw from KERS. The SCS emerged from bankruptcy in February 2015.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note I - Medical Malpractice Insurance**

The Organization participates in a multi-provider insurance program which provides coverage on a claims-made basis for medical malpractice liabilities. Insurance coverages are \$1,000,000 individually and \$3,000,000 in the aggregate annually. Management intends to maintain such coverages in the future and is of the opinion that insurance coverages are adequate to cover any potential losses on asserted claims. Liabilities for incurred but not reported losses, if any, as of June 30, 2015 and 2014 are not determinable and no provision for such losses has been made in the financial statements. Management is unaware of any incidents which would ultimately result in a loss in excess of its insurance coverages (see Note O).

**Note J - Functional Classification of Expenses**

Expenses by functional classification are as follows:

	<u>2015</u>	<u>2014</u>
Program Services:		
Mental health	\$ 50,672,764	\$ 43,569,907
Developmental disabilities	12,031,050	11,401,324
Chemical dependency	6,244,254	5,966,880
Trust and agency programs	13,438,212	18,005,614
SCS Learning, Inc.	711,815	861,748
	<u>83,098,095</u>	<u>79,805,473</u>
Management and general	12,570,221	12,440,259
Fundraising	91,221	117,496
	<u>\$ 95,759,537</u>	<u>\$ 92,363,228</u>

**Note K - Concentration of Credit Risk**

The Organization maintains its cash accounts at various banks located in Kentucky. Accounts at each bank are guaranteed by the FDIC up to \$250,000. The Organization requires funds in the operating account to be maintained in a Commercial Overnight Repurchase Sweep Account with funds collateralized by U.S. government securities. At June 30, 2015, the Organization's uncollateralized cash balances totaled approximately \$215,000.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note L - Self-insured Health Plan**

The Organization participates in a self-insurance program for its employees' health care costs. The Organization is liable for claims of \$200,000 per employee annually with a maximum of approximately \$5,200,000 in total for all plan participants for the year. The Organization has third-party insurance coverage for any losses in excess of such amounts. The accrued liability for such covered medical claims at June 30, 2015 and 2014 is approximately, \$207,000 and \$135,000, respectively, and is included in accrued expenses on the consolidated statement of financial position.

**Note M- Construction in Progress**

During 2014, the Organization's project to implement a new electronic medical record system had stalled due to negotiations with the software vendor. As of June 30, 2014, management deemed this project to be impaired as the Organization has started to implement a new system (see below). The old system was impaired during 2014 for its total cost of approximately \$2,703,000 as it was not expected to be utilized by the Organization in the future (see Note O).

During 2014, the Organization started to implement a new electronic medical records and financial and human resources software included in construction in progress at June 30, 2015 and 2014 at a total cost of approximately \$2,436,000 and \$228,000.

**Note N - Bankruptcy - Description of Petition**

On April 4, 2013, the Organization filed a petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Western District of Kentucky, Louisville Division. On April 5, 2013, the Organization filed a motion to terminate participation in KERS. Under Chapter 11, certain claims against the Organization in existence prior to the filing of the petitions for relief under the federal bankruptcy laws are stayed while the Organization continues business operations as Debtor-in-possession. These claims are reflected in the June 30, 2014 balance sheet as "liabilities subject to compromise." Additional claims (liabilities subject to compromise) may arise subsequent to the filing date resulting from rejection of executory contracts, including leases, and from the determination by the court (or agreed to by the parties in interest) of allowed claims for contingencies and other disputed amounts. Claims secured against the Organization's assets ("secured claims") also are stayed, although the holders of such claims have the right to move the court for relief from the stay. Secured claims are secured primarily by liens on the Organization's property, plant and equipment. The Organization received approval from the Bankruptcy Court to pay or otherwise honor certain of its prepetition obligations, including employee wages.

The Organization was granted exclusive authority by the Bankruptcy court to propose a plan of reorganization any time prior to October 6, 2014, and it is the opinion of the Management, Board of Directors and legal counsel of the Organization that absent the alleged liability to KERS, the Organization is financially sound, and would not likely need to reorganize under Chapter 11. In May of 2014 the Bankruptcy Court ruled that the Organization had legal standing to seek relief in Chapter 11 and withdraw from KERS. The Organization officially emerged from Chapter 11 bankruptcy effective February 6, 2015.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Notes to Consolidated Financial Statements (Continued)**  
**June 30, 2015 and 2014**

**Note N - Bankruptcy - Description of Petition (Continued)**

The Organization has not contributed to the KERS plan (see Note H) for its employees since April 7, 2013. KERS did not present a formal request for payment for these amounts, or any other amount, to the Bankruptcy Court within the allowed time. Various motions have been filed related to the April 4, 2013 and April 5, 2013 filings, and the court has ruled, following an evidentiary hearing, that KERS is not entitled to injunctive relief to compel the Organization to continue making reports and employer and employee contributions into the KERS plan. Therefore, there has been no liability recorded on the consolidated statement of financial position for the estimated contributions based on eligible employees' wages subsequent to April 7, 2013. KERS is currently appealing the court's ruling allowing SCS relief under Chapter 11.

At June 30, 2015 and 2014 liabilities subject to compromise consist of:

	<u>2015</u>	<u>2014</u>
Accounts payable	\$ -	\$ 521,914
Accrued expense	-	697,699
	<u>\$ -</u>	<u>\$ 1,219,613</u>

At June 30, 2015 and 2014 reorganization items are comprised of:

	<u>2015</u>	<u>2014</u>
Legal fees	\$ 223,783	\$ 771,034
Trustee fees	80,000	90,000
Other fees	80,000	56,285
	<u>\$ 383,783</u>	<u>\$ 917,319</u>

**Note O - Other Commitments and Contingencies**

SCS filed a lawsuit on January 16, 2014, against a software vendor due to significant problems and challenges with implementation of software provided by the vendor. In May 2013, the software vendor had filed a proof of claim against SCS and in July 2013, the Bankruptcy Court (see Note N) granted SCS's unopposed motion to reject its contract with the software vendor, thus this amount has not been recorded as a liability on the statement of financial position. The vendor's proof of claim against SCS was withdrawn during 2014. The parties settled the dispute in October 2014, awarding SCS a settlement, which is included in other revenue on the consolidated statement of operations.

The Organization is a party to various legal and/or administrative proceedings arising out of the operation of facilities and programs and arising in the ordinary course of business. Management believes that, generally, these claims are without merit. Management does not believe the results of these proceedings or claims, individually or in the aggregate, will have a material adverse effect on the financial condition, results of operations or liquidity.

## **Supplementary Information**

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidating Statements of Financial Position**  
**June 30, 2015 and 2014**

Assets	2015				2014			
	Seven Counties				Seven Counties			
	Services	SCS Learning	Eliminations	Consolidated	Services	SCS Learning	Eliminations	Consolidated
<b>Current Assets</b>								
Cash	\$ 5,161,372	\$ 20,925	\$ -	\$ 5,182,297	\$ 4,124,936	\$ 106,016	\$ -	\$ 4,230,952
Investments	4,671,855	-	-	4,671,855	4,621,651	-	-	4,621,651
Accounts and grants receivable, less allowance for doubtful accounts	12,037,609	64,617	(217,824)	11,884,402	9,154,293	119,317	(202,875)	9,070,735
Contributed rent receivable, current	256,203	-	-	256,203	270,787	-	-	270,787
Prepaid expenses and other current assets	1,008,004	5,256	-	1,013,260	928,030	5,254	-	933,284
<b>Total Current Assets</b>	<b>23,135,043</b>	<b>90,798</b>	<b>(217,824)</b>	<b>23,008,017</b>	<b>19,099,697</b>	<b>230,587</b>	<b>(202,875)</b>	<b>19,127,409</b>
<b>Property, Plant and Equipment</b>								
Land	1,807,050	-	-	1,807,050	1,807,050	-	-	1,807,050
Buildings and improvements	13,762,287	-	-	13,762,287	13,428,781	-	-	13,428,781
Leasehold improvements	4,252,262	136,697	-	4,388,959	4,180,324	136,697	-	4,317,021
Equipment and vehicles	21,952,180	26,498	-	21,978,678	21,646,056	26,498	-	21,672,554
Construction in progress	2,458,322	-	-	2,458,322	227,528	-	-	227,528
	44,232,101	163,195	-	44,395,296	41,289,739	163,195	-	41,452,934
Less: accumulated depreciation	29,426,311	99,724	-	29,526,035	27,313,194	67,085	-	27,380,279
	14,805,790	63,471	-	14,869,261	13,976,545	96,110	-	14,072,655
<b>Other Assets</b>								
Contributed rent receivable, less current	2,358,704	-	-	2,358,704	2,614,906	-	-	2,614,906
Bond costs, net of amortization	72,562	-	-	72,562	84,779	-	-	84,779
Franchise fees, net of amortization	-	40,086	-	40,086	-	44,362	-	44,362
Long-term investments	80,000	-	-	80,000	80,000	-	-	80,000
<b>Total Other Assets</b>	<b>2,511,266</b>	<b>40,086</b>	<b>-</b>	<b>2,551,352</b>	<b>2,779,685</b>	<b>44,362</b>	<b>-</b>	<b>2,824,047</b>
<b>Total Assets</b>	<b>\$ 40,452,099</b>	<b>\$ 194,355</b>	<b>\$ (217,824)</b>	<b>\$ 40,428,630</b>	<b>\$ 35,855,927</b>	<b>\$ 371,059</b>	<b>\$ (202,875)</b>	<b>\$ 36,024,111</b>

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidating Statements of Financial Position (Continued)**  
**June 30, 2015 and 2014**

	2015				2014			
	Seven Counties Services	SCS Learning	Eliminations	Consolidated	Seven Counties Services	SCS Learning	Eliminations	Consolidated
<b>Liabilities and Net Assets</b>								
Current Liabilities								
Current maturities of bonds and note payable	\$ 575,962	\$ -	\$ -	\$ 575,962	\$ 327,972	\$ -	\$ -	\$ 327,972
Accounts payable	7,335,713	217,824	(217,824)	7,335,713	2,283,281	203,684	(202,875)	2,284,090
Accrued payroll and vacation	4,503,889	2,971	-	4,506,860	4,168,192	13,537	-	4,181,729
Accrued expenses and other current liabilities	1,232,876	6,534	-	1,239,410	1,773,095	6,044	-	1,779,139
Deferred revenue	1,476,009	165,595	-	1,641,604	861,182	259,097	-	1,120,279
Total Current Liabilities	15,124,449	392,924	(217,824)	15,299,549	9,413,722	482,362	(202,875)	9,693,209
Bonds and Note Payable, less current maturities	3,894,489	-	-	3,894,489	4,470,451	-	-	4,470,451
Total Liabilities Not Subject to Compromise	19,018,938	392,924	(217,824)	19,194,038	13,884,173	482,362	(202,875)	14,163,660
Liabilities Subject to Compromise								
Accounts payable	-	-	-	-	521,914	-	-	521,914
Accrued expenses and other current liabilities	-	-	-	-	697,699	-	-	697,699
Total Liabilities Subject to Compromise	-	-	-	-	1,219,613	-	-	1,219,613
Total Liabilities	19,018,938	392,924	(217,824)	19,194,038	15,103,786	482,362	(202,875)	15,383,273
Net Assets, temporarily restricted	2,724,663	-	-	2,724,663	2,885,693	-	-	2,885,693
Net Assets, unrestricted	18,708,498	(198,569)	-	18,509,929	17,866,448	(111,303)	-	17,755,145
Total Net Assets	21,433,161	(198,569)	-	21,234,592	20,752,141	(111,303)	-	20,640,838
Total Liabilities and Net Assets	\$ 40,452,099	\$ 194,355	\$ (217,824)	\$ 40,428,630	\$ 35,855,927	\$ 371,059	\$ (202,875)	\$ 36,024,111

See accompanying independent auditor's report.

**Seven Counties Services, Inc. and SCS Learning, Inc.**  
**Consolidating Statements of Operations and Changes in Net Assets**  
**Years Ended June 30, 2015 and 2014**

	2015				2014			
	Seven Counties Services	SCS Learning	Eliminations	Consolidated	Seven Counties Services	SCS Learning	Eliminations	Consolidated
Changes in Net Assets:								
Revenues:								
Reimbursements under Kentucky Department for Behavioral Health, Developmental & Intellectual Disabilities	\$ 15,686,468	\$ -	\$ -	\$ 15,686,468	\$ 22,070,451	\$ -	\$ -	\$ 22,070,451
Net reimbursements under Medicaid	55,454,192	-	-	55,454,192	41,044,559	-	-	41,044,559
Net reimbursements under Medicare	963,721	-	-	963,721	577,449	-	-	577,449
Federal, state and local grants	22,992,364	-	-	22,992,364	29,382,068	-	-	29,382,068
Private pay and commercial insurance	1,397,957	624,550	(65,653)	1,956,854	1,498,246	750,812	(84,347)	2,164,711
Other revenues	1,582,813	-	-	1,582,813	2,216,349	-	-	2,216,349
Provision for bad debts	(3,023,082)	-	-	(3,023,082)	(4,142,529)	-	-	(4,142,529)
<b>Total Revenues</b>	<b>95,054,433</b>	<b>624,550</b>	<b>(65,653)</b>	<b>95,613,330</b>	<b>92,646,593</b>	<b>750,812</b>	<b>(84,347)</b>	<b>93,313,058</b>
Expenses:								
Salaries and fringe benefits	56,669,031	331,985	-	57,001,016	59,322,637	385,944	-	59,708,581
Subcontract services	12,649,475	-	-	12,649,475	4,265,413	-	-	4,265,413
Purchased services	12,289,222	24,260	-	12,313,482	14,789,469	16,938	-	14,806,407
Building rentals, maintenance and utilities	4,157,225	75,241	-	4,232,466	4,399,993	75,657	-	4,475,650
Program supplies	2,977,046	67,026	(65,653)	2,978,419	2,906,955	99,054	(84,347)	2,921,662
Transportation and travel	951,054	3,041	-	954,095	1,048,997	5,110	-	1,054,107
Depreciation and amortization	2,194,335	32,638	-	2,226,973	2,037,666	32,639	-	2,070,305
Interest expense	105,044	-	-	105,044	9,980	-	-	9,980
General and administrative expenses	3,120,942	177,625	-	3,298,567	2,804,717	246,406	-	3,051,123
<b>Total Expenses</b>	<b>95,113,374</b>	<b>711,816</b>	<b>(65,653)</b>	<b>95,759,537</b>	<b>91,585,827</b>	<b>861,748</b>	<b>(84,347)</b>	<b>92,363,228</b>
Operating income (loss)	(58,941)	(87,266)	-	(146,207)	1,060,766	(110,936)	-	949,830
Nonoperating income (loss):								
Investment income and other	1,206,255	-	-	1,206,255	127,025	-	-	127,025
Impairment of electronic medical record system	-	-	-	-	(2,703,422)	-	-	(2,703,422)
(Loss) gain on disposal of property and equipment	(82,511)	-	-	(82,511)	1,305	-	-	1,305
<b>Total Nonoperating Income (Loss)</b>	<b>1,123,744</b>	<b>-</b>	<b>-</b>	<b>1,123,744</b>	<b>(2,575,092)</b>	<b>-</b>	<b>-</b>	<b>(2,575,092)</b>
Increase (Decrease) in total net assets before reorganization items	1,064,803	(87,266)	-	977,537	(1,514,326)	(110,936)	-	(1,625,262)
Reorganization items	383,783	-	-	383,783	917,319	-	-	917,319
Increase (Decrease) in total net assets	681,020	(87,266)	-	593,754	(2,431,645)	(110,936)	-	(2,542,581)
Total Net Assets at Beginning of Year	20,752,141	(111,303)	-	20,640,838	23,183,786	(367)	-	23,183,419
<b>Total Net Assets at End of Year</b>	<b>\$ 21,433,161</b>	<b>\$ (198,569)</b>	<b>\$ -</b>	<b>\$ 21,234,592</b>	<b>\$ 20,752,141</b>	<b>\$ (111,303)</b>	<b>\$ -</b>	<b>\$ 20,640,838</b>

See accompanying independent auditor's report.