

ADCARE HEALTH SYSTEMS, INC

Form 10-Q/A

July 08, 2013

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 on

FORM 10-Q/A

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-33135

AdCare Health Systems, Inc.

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction)

31-1332119
(I.R.S. Employer Identification Number)

of incorporation)

1145 Hembree Road, Roswell, GA 30076

(Address of principal executive offices)

(678) 869-5116

(Registrant's telephone number, including area code)

5057 Troy Road, Springfield, OH 45502-9032

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of June 30, 2012: 13,696,538 shares of common stock with no par value were outstanding.

Table of Contents

EXPLANATORY NOTE

In this Amendment No.1 on Form 10-Q/A to AdCare Health Systems, Inc. and subsidiaries (collectively AdCare , the Company or we) Quarterly Report on Form 10-Q for the three months and six months ended June 30, 2012, we are restating the consolidated financial statements for the second quarter and the year-to-date period of 2012. Concurrent with the filing of this Form 10-Q/A, we are also filing amended quarterly reports on Form 10-Q/A for each of the first and third quarters of 2012 to restate our consolidated financial statements therein. The effects of these restatements, to the extent applicable, are reflected in the items revised herein. The restatements relate to the following:

- Accounting errors and certain accounting estimates that were identified in the process of finalizing our consolidated financial statements for the year ended December 31, 2012. These matters include the following:
 - The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily relate to required adjustments due to changes in Medicaid reimbursement rates for certain facilities, the timing of recognition for state recoupments for Medicaid overpayments for certain facilities.
 - The timing of recognition of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily related to insufficient processes related to accounting for accrued vacation, the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments, the untimely correction of a payroll accrual adjustment for a certain facility, and certain other resulting changes to the accrued performance-based incentive obligation due to the restatement impacts.
 - The timing of certain adjustments to the provision for bad debts in the appropriate interim reporting period within the 2012 year. The issues primarily relate to required adjustments resulting from delays in collection efforts and lack of timely follow-up on patient accounts during 2012 for certain facilities and the timing of other necessary adjustments to the provision for bad debts.
 - The correction of certain operating and other costs incurred within the 2012 year that were incorrectly deferred or capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred. The issues primarily relate to the misapplication of accounting principles related to two of the Company's facilities.
 - The timing of expense recognition related to direct care compensation obligations incurred for the facilities located in Arkansas to reflect proper recognition in the appropriate interim reporting period within the 2012 year. The issue primarily relates to the misapplication of accounting principles. The related expense and obligation were being recorded over the perceived requisite service period until the anticipated payment date. However, the obligations should have been expensed immediately in the period incurred as the obligation related to prior services rendered.

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

- The adjustment of amortization expense associated with certain capitalized intangible assets to adjust for the reallocation of costs between an intangible subject to amortization and goodwill.
- The timing of the write down to market value less cost to sell of an office building acquired through a 2011 acquisition that was vacated and abandoned in the first quarter of 2012.
- Correction in the application of the Company's accounting for certain variable interest entities further described as follows:

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions* found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report), effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 810, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

Table of Contents

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements, the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's second quarter and year to date 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

The restatements described above decreased the Company's total revenues by \$3.2 million and \$6.5 million, respectively, decreasing expenses by \$2.5 million and \$3.9 million, respectively, and decreasing net loss attributable to non-controlling interest by \$0.2 million and \$0.4 million for the three and six months ended June 30, 2012, and increasing our net loss attributable to AdCare by \$0.9 million and \$2.9 million for the same periods. Basic and diluted earnings per share decreased by \$0.06 and \$0.22, respectively, for the three and six months ended June 30, 2012.

As a result of the restatements at June 30, 2012, cash and cash equivalents decreased by \$0.3 million, accounts receivable, net decreased by \$1.8 million, prepaid expenses and other current assets decreased by \$0.1 million, property and equipment, net decreased \$11.5 million, goodwill decreased by \$0.5 million, deferred loan costs, net decreased \$0.5 million, current portion of notes payable and other debt increased \$21.1 million, accounts payable decreased by \$1.0 million, accrued expenses increased by \$0.4 million, senior debt, net of discounts decreased \$33.6 million, common stock and additional paid-in capital increased by \$0.2 million, accumulated deficit increased by \$3.0 million, and noncontrolling interest in subsidiaries decreased by \$1.0 million.

On June 15, 2012, certain wholly owned subsidiaries of AdCare entered into a modification agreement with Private Bank to modify the terms of the loan agreement. The loan modification agreement, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company anticipates that it will re-finance the Little Rock, Northridge and Woodland Hills facilities later this year with long-term financing. However, the Company does not have a formal noncancelable agreement with Private Bank. As such, the entire balance is reflected as a current obligation at June 30, 2012, in the amount of \$21.3 million.

On September 20, 2012, AdCare terminated and paid off all amounts outstanding under that certain Credit Agreement, dated October 29, 2010, between Gemino Healthcare Finance, LLC (Gemino) and AdCare (the Gemino Credit Facility). The Gemino Credit Facility was a secured credit facility for borrowings up to \$7.5 million, which was to mature on October 29, 2013. As such, the entire balance is reflected as a current obligation at June 30, 2012, in the amount of \$7.0 million.

This Amendment No. 1 on Form 10-Q/A (this Amended Report) amends the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 (the Original Report) of AdCare. The effects of the restatements are more fully described in Note 2 to the unaudited consolidated financial statements included in this Amended Report.

The following sections have been amended from the Original Report as a result of the restatements described above:

- Part I - Item 1. Financial Statements (including the footnotes thereto);

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

- Part I - Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations; and
- Part I - Item 4. Controls and Procedures

The Amended Report also includes as exhibits certifications from the Company's Chief Executive Officer and Chief Financial Officer dated as of the date of the filing of the this Amended Report. Except as described above, no other sections have been amended from the Original Report.

This Form 10-Q/A continues to speak as of the date of the original filing, and the Company has not updated the disclosure contained herein to reflect information or events that have occurred since the August 7, 2012 filing date of the original filing, or modify or update disclosures set forth in the original filing, except to reflect the corrections discussed above and except as otherwise expressly stated herein. Accordingly, this Form 10-Q/A should be read in conjunction with the Company's other filings made with the SEC subsequent to the filing of the original filing, including any amendments to those filings.

Table of Contents

AdCare Health Systems, Inc.

Form 10-Q/A

Table of Contents

	Page Number
<u>Part I.</u>	
<u>Financial Information</u>	
<u>Item 1.</u>	
<u>Financial Statements (Unaudited)</u>	5
<u>Consolidated Balance Sheets as of June 30, 2012 (unaudited) and December 31, 2011</u>	5
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2012 and 2011 (unaudited)</u>	6
<u>Consolidated Statements of Stockholders' Equity for the six months ended June 30, 2012 (unaudited)</u>	7
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011 (unaudited)</u>	8
<u>Notes to Consolidated Financial Statements (unaudited)</u>	9
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
<u>Item 4.</u>	
<u>Controls and Procedures</u>	42
<u>Part II.</u>	
<u>Other Information</u>	
<u>Item 6.</u>	
<u>Exhibits</u>	44
<u>Signatures</u>	51

Table of Contents**Part I. Financial Information**

Item 1. Financial Statements

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in 000 \$)

	June 30, 2012 Restated (Note 2) (Unaudited)	December 31, 2011
<u>ASSETS</u>		
Current Assets:		
Cash and cash equivalents	\$ 9,073	\$ 7,364
Restricted cash and investments	3,624	1,883
Accounts receivable, net of allowance of \$2,820 and \$1,346	25,127	18,782
Prepaid expenses and other	525	663
Assets of disposal group held for sale	38	47
Total current assets	38,387	28,739
Restricted cash and investments	5,812	4,870
Property and equipment, net	132,924	102,449
Intangible assets – bed licenses	2,377	1,189
Intangible assets – lease rights, net	7,925	8,460
Goodwill	3,112	3,600
Escrow deposits for acquisitions	1,513	3,172
Lease deposits	1,725	1,685
Deferred loan costs, net	5,269	4,818
Other assets	71	122
Total assets	\$ 199,115	\$ 159,104
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current Liabilities:		
Current portion of notes payable and other debt	\$ 30,485	\$ 4,567
Revolving credit facilities and lines of credit	7,064	7,343
Accounts payable	15,609	12,075
Accrued expenses	11,793	9,881
Liabilities of disposal group held for sale	143	240
Total current liabilities	65,094	34,106
Notes payable and other debt, net of current portion:		
Senior debt, net of discounts	83,038	87,771
Convertible debt, net of discounts	15,035	14,614
Revolving credit facilities	1,900	1,308
Other debt	12,880	1,400
Derivative liability	1,127	1,889
Other liabilities	1,729	2,437
Deferred tax liability	119	86
Total liabilities	180,922	143,611

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

Commitments and contingencies (Note 15)

Stockholders' equity:

Preferred stock, no par value; 1,000 shares authorized; no shares issued or outstanding		
Common stock and additional paid-in capital, no par value; 29,000 shares authorized; 13,697 and 12,193 shares issued and outstanding	39,846	35,047
Accumulated deficit	(21,185)	(18,713)
Total stockholders' equity	18,661	16,334
Noncontrolling interest in subsidiaries	(468)	(841)
Total equity	18,193	15,493
Total liabilities and equity	\$ 199,115	\$ 159,104

See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS***(Amounts in 000 s, except per share data)*

(Unaudited)

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Restated (Note 2)	2011	Restated (Note 2)	2011
Revenues:				
Patient care revenues	\$ 51,266	\$ 33,872	\$ 97,573	\$ 64,404
Management revenues	525	484	1,049	982
Total revenues	51,791	34,356	98,622	65,386
Expenses:				
Cost of services (exclusive of facility rent, depreciation and amortization)	40,316	27,104	79,123	52,279
General and administrative	4,345	3,167	8,338	6,091
Facility rent expense	2,050	1,947	4,115	3,850
Depreciation and amortization	1,594	705	3,304	1,352
Salary retirement and continuation costs		622		622
Total expenses	48,305	33,545	94,880	64,194
Income from Operations	3,486	811	3,742	1,192
Other Income (Expense):				
Interest expense, net	(3,444)	(1,852)	(6,122)	(3,288)
Acquisition costs, net of gains	(524)	(622)	(817)	357
Derivative gain (loss)	353	(2,588)	763	(3,938)
Loss on extinguishment of debt		(77)		(77)
Other income (expense)	(13)	(19)	(27)	587
Total other income (expense), net	(3,628)	(5,158)	(6,203)	(6,359)
Loss from Continuing Operations Before Income Taxes	(142)	(4,347)	(2,461)	(5,167)
Income Tax Expense	(33)	(124)	(18)	(210)
Loss from Continuing Operations	(175)	(4,471)	(2,479)	(5,377)
Loss from Discontinued Operations, Net of Tax	(170)	(91)	(279)	(126)
Net Loss	(345)	(4,562)	(2,758)	(5,503)
Net Loss Attributable to Noncontrolling Interests	141	165	286	341
Net Loss Attributable to AdCare Health Systems, Inc.	\$ (204)	\$ (4,397)	\$ (2,472)	\$ (5,162)
Net (Loss) per Common Share Basic:				
Continuing Operations	\$ 0.00	\$ (0.49)	\$ (0.17)	\$ (0.57)
Discontinued Operations	(0.01)	(0.01)	(0.02)	(0.01)
	\$ (0.01)	\$ (0.50)	\$ (0.19)	\$ (0.58)
Net (Loss) per Common Share Diluted:				
Continuing Operations	\$ 0.00	\$ (0.49)	\$ (0.17)	\$ (0.57)
Discontinued Operations	(0.01)	(0.01)	(0.02)	(0.01)
	\$ (0.01)	\$ (0.50)	\$ (0.19)	\$ (0.58)

See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY***(Amounts in 000 \$)*

(Unaudited)

	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Noncontrolling Interests	Total	
	Restated	Restated	Restated	Restated	
	Common Stock Shares	(Note 2)	(Note 2)	(Note 2)	
Balance, January 1, 2012	12,193	\$ 35,047	\$ (18,713)	\$ (841)	\$ 15,493
Deconsolidation of variable interest entity				660	660
Nonemployee warrants for services		565			565
Stock based compensation expense		346			346
Public stock offering, net	1,165	3,768			3,768
Exercises of options and warrants	69	95			95
Issuance of restricted stock	270	25			25
Net loss			(2,472)	(286)	(2,758)
Balance, June 30, 2012	13,697	\$ 39,846	\$ (21,185)	\$ (468)	\$ 18,193

See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in 000 \$)

(Unaudited)

	Six Months Ended June 30,	
	2012	
	Restated	2011
	(Note 2)	
Cash flows from operating activities:		
Net loss	\$ (2,758)	\$ (5,503)
Loss from discontinued operations, net of tax	279	126
Loss from continuing operations	(2,479)	(5,377)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,304	1,352
Warrants issued for services		297
Stock based compensation expense	371	467
Lease expense in excess of cash	291	379
Amortization of deferred financing costs	977	407
Amortization of debt discounts	427	445
Derivative (gain) loss	(763)	3,938
Loss on debt extinguishment		77
Deferred tax expense	33	95
(Gain) loss on disposal of assets	(2)	126
Gain on acquisitions		(1,104)
Provision for bad debts	1,676	351
Other noncash expenses		45
Changes in certain assets and liabilities, net of acquisitions:		
Accounts receivable	(8,820)	(3,538)
Prepaid expenses and other	102	278
Other assets	156	(29)
Accounts payable and other liabilities	5,108	3,010
Net cash provided by operating activities continuing operations	381	1,219
Net cash (used in) provided by operating activities discontinued operations	(269)	14
Net cash provided by operating activities	112	1,233
Cash flows from investing activities:		
Proceeds from sale of property and equipment	3	
Change in restricted cash and investments and escrow deposits for acquisitions	(2,683)	(110)
Acquisitions	(36,655)	(32,636)
Purchase of property and equipment	(1,676)	(1,943)
Net cash used in investing activities continuing operations	(41,011)	(34,689)
Net cash used in investing activities discontinued operations		
Net cash used in investing activities	(41,011)	(34,689)
Cash flows from financing activities:		
Proceeds from debt	47,188	31,673
Debt issuance costs	(1,526)	(175)
Change in lines of credit	313	4,287
Exercise of warrants and options	95	219

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

Proceeds from stock issuances, net	3,768	
Repayment of notes payable	(6,953)	(709)
Net cash provided by financing activities – continuing operations	42,885	35,295
Net cash used in financing activities – discontinued operations	(97)	(89)
Net cash provided by financing activities	42,788	35,206
Net Change in Cash	1,889	1,750
Cash, Beginning	7,364	3,911
Cash decrease due to deconsolidation of variable interest entities (Note 2)	(180)	
Cash, Ending	\$ 9,073	\$ 5,661
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 5,807	\$ 2,438
Income taxes	\$	\$
Supplemental Disclosure of Non-cash Activities:		
Acquisitions in exchange for debt and equity instruments	\$ 5,000	\$
Warrants issued for financings costs	\$ 565	\$ 330
Other assets acquired in exchange for debt	\$	\$ 3,427

See accompanying notes to consolidated financial statements

Table of Contents

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States. These statements include the accounts of AdCare Health Systems, Inc. and its controlled subsidiaries (collectively, AdCare, the Company or we). Controlled subsidiaries include AdCare's majority owned subsidiaries and variable interest entities (VIE) in which AdCare has control as primary beneficiary. A primary beneficiary is the party in a VIE that has both of the following characteristics: (a) The power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (b) The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The Company delivers skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. All inter-company accounts and transactions were eliminated in the consolidation. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report). In the opinion of the Company's management, all adjustments considered for a fair presentation are included and are of a normal recurring nature. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. Certain prior year amounts have been reclassified to conform to the current year presentation.

As described in the Explanatory Note to this Form 10-Q/A herein and in Note 2, the interim consolidated financial statements for 2012 presented herein have been restated from those previously issued.

Earnings per Share

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is similar to basic earnings per share except net income or loss is adjusted by the impact of the assumed issuance of common shares upon conversion or exercise of convertible securities and the weighted-average number of common shares outstanding includes potentially dilutive securities, such as options, warrants, non-vested shares, and additional shares issuable under convertible notes outstanding during the period when such potentially dilutive securities are not anti-dilutive. Potentially dilutive securities from options,

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

warrants and non-vested shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all options and warrants with exercise prices exceeding the average market value are used to repurchase common stock at market value. The incremental shares remaining after the proceeds are exhausted represent the potentially dilutive effect of the securities. Potentially dilutive securities from convertible debt are calculated based on the assumed issuance at the beginning of the period, as well as any adjustment to income that would result from their assumed issuance.

(Amounts in 000 s, except per share data)	Income (loss) Restated (Note 2)	Three Months Ended June 30,				2011	
		2012	Per Share	Loss	Shares (1)	Per Share	
	Shares (1)						
Continuing Operations:							
Loss from continuing operations	\$ (175)			\$ (4,471)			
Net loss attributable to noncontrolling interests	141			165			
Basic income (loss) from continuing operations	\$ (34)	13,463	\$ 0.00	\$ (4,306)	8,847	\$ (0.49)	
Effect from options, warrants and non-vested shares							
Effect from assumed issuance of convertible shares (2)							
Diluted net income (loss) from continuing operations	\$ (34)	13,463	\$ 0.00	\$ (4,306)	8,847	\$ (0.49)	
Discontinued Operations:							
Basic loss from discontinued operations	\$ (170)	13,463	\$ (0.01)	\$ (91)	8,847	\$ (0.01)	
Diluted loss from discontinued operations	\$ (170)	13,463	\$ (0.01)	\$ (91)	8,847	\$ (0.01)	
Net Loss Attributable to AdCare:							
Basic net loss	\$ (204)	13,463	\$ (0.01)	\$ (4,397)	8,847	\$ (0.50)	
Diluted net loss	\$ (204)	13,463	\$ (0.01)	\$ (4,397)	8,847	\$ (0.50)	

Table of Contents

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited) (Continued)

(Amounts in 000 s, except per share data)	Loss Restated (Note 2)	Six Months Ended June 30,				2011	
		2012 Shares (1)	Per Share	Loss	Shares (1)	Per Share	
Continuing Operations:							
Loss from continuing operations	\$ (2,479)			\$ (5,377)			
Net loss attributable to noncontrolling interests	286			341			
Basic loss from continuing operations	\$ (2,193)	12,844	\$ (0.17)	\$ (5,036)	8,806	\$ (0.58)	
Effect from options, warrants and non-vested shares							
Effect from assumed issuance of convertible shares (2)							
Diluted net loss from continuing operations	\$ (2,193)	12,844	\$ (0.17)	\$ (5,036)	8,806	\$ (0.58)	
Discontinued Operations:							
Basic loss from discontinued operations	\$ (279)	12,844	\$ (0.02)	\$ (126)	8,806	\$ (0.01)	
Diluted loss from discontinued operations	\$ (279)	12,844	\$ (0.02)	\$ (126)	8,806	\$ (0.01)	
Net Loss Attributable to AdCare:							
Basic net loss	\$ (2,472)	12,844	\$ (0.19)	\$ (5,162)	8,806	\$ (0.59)	
Diluted net loss	\$ (2,472)	12,844	\$ (0.19)	\$ (5,162)	8,806	\$ (0.59)	

(1) The weighted average shares outstanding includes retroactive adjustments for the stock dividend issued on October 1, 2011 (see Note 10).

(2) The impact of the conversion of the 2010 and 2011 convertible notes were excluded as the impact would be anti-dilutive.

Intangible Assets and Goodwill

There have been no required impairment adjustments to intangible assets and goodwill during the six months ended June 30, 2012.

Intangible assets consist of the following:

Amounts in (000 s)	Lease Rights	Bed Licenses (included in	Bed Licenses - Separable	Total
--------------------	--------------	---------------------------	--------------------------	-------

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

			property and equipment) Restated (Note 2)					
Balances, December 31, 2011, net	\$	8,460	\$	22,922	\$	1,189	\$	32,571
Deconsolidation of Oklahoma								
Owners				(3,458)				(3,458)
Acquisitions				7,297		1,188		8,485
Amortization expense		(535)		(355)				(890)
Balances, June 30, 2012, net	\$	7,925	\$	26,406	\$	2,377	\$	36,708

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(Unaudited) (Continued)

Intangible Assets and Goodwill (cont.)

For the six months ended June 30, 2012, amortization expense was approximately \$355,000 for bed licenses included in property and equipment. There was no amortization of bed licenses for the six months ended June 30, 2011. For the six months ended June 30, 2012 and 2011, amortization expense was \$535,000 and \$442,000, respectively, for lease rights. Estimated amortization expense for each of the following years ending December 31 is as follows:

(Amounts in 000 s)	Bed Licenses Restated (Note 2)		Lease Rights	
2012 (remainder)	\$	354	\$	534
2013		709		1,069
2014		709		1,010
2015		709		885
2016		709		885
Thereafter		23,216		3,542
Total	\$	26,406	\$	7,925

The following table summarizes the changes in the carrying amount of goodwill at June 30, 2012 as compared with December 31, 2011:

Amounts in (000 s)	June 30, 2012	
	Restated	
	(Note 2)	
Balance, December 31, 2011	\$	3,600
Deconsolidation of variable interest entities		(1,123)
Acquired in acquisitions		635
Impairment charge		
Balance, June 30, 2012	\$	3,112

Goodwill as previously reported in the 2011 consolidated financial statements was \$0.9 million. In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize \$2.7 million of goodwill from 2011 acquisitions that was previously reported as bed licenses in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

Compensated Absences

In 2012, the Company removed the ability for employees to accumulate earned but unused vacation beyond the current calendar year. As a result, vacation time previously accumulated must be used by the employee by December 31, 2012 or it will be forfeited. Management has estimated the potential forfeitures and has adjusted the vacation accrual accordingly.

NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

In this Amendment No.1 on Form 10-Q/A to the Company's Quarterly Report on Form 10-Q for the three and six months ended June 30, 2012, we are restating the consolidated financial statements for the second quarter of 2012. Concurrent with the filing of this Form 10-Q/A, we are also filing amended quarterly reports on Form 10-Q/A for each of the first and third quarters of 2012 to restate our consolidated financial statements therein. The effects of these restatements, to the extent applicable, are reflected in the items revised herein. The restatements relate to the following:

- Correction in the application of the Company's accounting for certain variable interest entities further described as follows:

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report), effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company) acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company

Table of Contents

entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 810-10, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements, the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

- Accounting errors and certain accounting estimates that were identified in the process of finalizing our consolidated financial statements for the year ended December 31, 2012. These matters include the following for the six months ended June 30, 2012:

- *Patient care revenues* - Adjustments totaling \$136,000 and \$413,000 for the three and six months ended June 30, 2012, respectively, related primarily to the following items:

The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period with in the 2012 year. Adjustments totaling \$136,000 for the three months ended June 30, 2012 related to the overstatement of \$81,000 in managed care revenue due to billing errors and a \$56,000 reclassification to reduce managed care revenue due to the improper recognition of bad debt expense subsequently identified by the Company. Adjustments totaling \$413,000 for the six months ended June 30, 2012 relating to the overstatement of \$221,000 in managed care revenue due to billing errors and a \$192,000 reclassification to reduce managed care revenue due to the improper recognition of bad debt expense subsequently identified by the Company.

- *Management revenues* Adjustments totaling \$162,000 and \$323,000 for the three and six months ended June 30, 2012, respectively, related primarily to the reversal of the eliminated management fee expense associated with the correction in the application of the Company's accounting for certain variable interest entities which also has been recorded in costs of services for each period.

- *Accounts receivable, net* - Adjustments totaling \$699,000 related primarily to the following:

The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period with in the 2012 year. Adjustments totaling \$220,000 related to the overstatement in managed care revenue due to billing errors, the timing of the correction of certain operating and other costs incurred within the 2012 year that were deferred or capitalized to the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred related to approximately \$119,000, the issues primarily related to required adjustments resulting from the timing of recognition for state recoupments for Medicaid overpayments for certain facilities totaling \$403,000, the delays in collection efforts and lack of timely follow-up on open patient accounts in 2012 for certain facilities totaling \$284,000, offset by the reversal of the eliminated management fee expense and other receivables associated with the correction in the application of the

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

Company's accounting for certain variable interest entities in the amount of \$327,000.

- *Costs of services* Adjustments totaling \$1,215,000 and \$2,831,000 for the three and six months ended June 30, 2012, respectively, related primarily to the following items:

The timing of expense recognition related to direct care compensation obligations incurred for the facilities located in Arkansas to reflect proper recognition in the appropriate interim reporting period within the 2012 year. For the six months ended June 30, 2012 the adjustment totaled approximately \$918,000 offset by the reversal of the overstated direct care compensation expense of \$258,000 for the three months ended June 30, 2012 resulting in a \$660,000 expense restatement for the six months ended June 30, 2012. The related expense and obligation was being recognized over the period until the respective payment date. However, the obligations should have been expensed immediately in the period incurred as the obligation related to prior services rendered.

Table of Contents

The timing of recognition of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily relate to insufficient processes related to accounting for accrued vacation of \$643,000 and \$803,000 for the three and six months ended June 30, 2012, respectively and the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments of \$41,000 and \$82,000 for the three and six months ended June 30, 2012, respectively.

The timing of the correction of certain operating and other costs incurred within the 2012 year that were deferred or capitalized to the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred related to approximately \$468,000 for the three months and the six months ended June 30, 2012.

The timing of certain adjustments to the provision for bad debts in the appropriate interim reporting period within the 2012 year. The issues primarily related to required adjustments resulting from the timing of recognition for state recoupments for Medicaid overpayments for certain facilities totaling \$403,000 for the six months ended June 30, 2012, the delays in collection efforts and lack of timely follow-up on open patient accounts in 2012 for certain facilities totaling \$221,000 and \$284,000 for the three and six months ended June 30, 2012, respectively, offset by the improper recognition of bad debt expense relating to managed care revenue discussed above in the amount of \$56,000 and \$192,000 for the three and six months ended June 30, 2012, respectively.

- *General and administrative* - Adjustments totaling \$584,000 and \$522,000 for the three and six months ended June 30, 2012, respectively, resulted primarily due to the following items:

The timing of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The timing of the reversal of \$700,000 expense relating to changes to the accrued performance-based incentive obligation during the three months ended June 30, 2012 offset by \$25,000 of expense recognition related to an adjustment to the fair value of warrants granted to non-employees for the six months ended June 30, 2012.

The timing of the expense incorrectly capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period of \$53,000 and \$74,000 for the three and six months ended June 30, 2012, respectively.

The insufficient processes related to accounting for accrued vacation of \$62,000 and \$77,000 for the three and six months ended June 30, 2012, respectively, and the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments of \$2,000 for the six months ended June 30, 2012.

- *Depreciation and amortization* Adjustments totaling a decrease of \$37,000 and an increase \$284,000 for the three and six months ended June 30, 2012, respectively related primarily to the impairment of an office building of \$389,000 acquired through a 2011 acquisition that was vacated and abandoned in first quarter of 2012 to market value less cost to sell offset by \$5,000 decrease in depreciation expense during the three months ended June 30, 2012 related to the office building impairment in first quarter of 2012 and \$32,000 and \$100,000 for the three and six months ended June 30, 2012, respectively, resulted from a decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill resulting from the respective acquisitions.

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

- *Property and equipment, net* Adjustments of \$1,523,000 related primarily to the \$389,000 impairment of an office building acquired in 2011 acquisition offset by a \$5,000 decrease in depreciation expense during the three months ended June 30, 2012 related to the office building impairment in first quarter of 2012; \$100,000 decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill resulted from the respective acquisitions of \$547,000 and \$692,000 of expense inadvertently capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period.

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

Table of Contents

- *Goodwill and Intangible assets bed licenses* - Adjustments of \$635,000 related to an acquisition reclassification to goodwill from the capitalized intangible assets bed licenses of \$87,000 and \$547,000 from property and equipment during the 2012 period.

- *Deferred loan costs, net* Adjustment of \$94,000 related to an adjustment to the fair value of warrants granted to non-employees which related to the costs incurred in connection with loan costs.

- *Current portion of notes payable and other debt* Reclassification of the PrivateBank loan from long-term debt to current as a result of a loan modification agreement with PrivateBank that, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company anticipates that it will re-finance the PrivateBank loan later this year with long-term financing; however, the Company does not have a formal noncancelable agreement with PrivateBank. As such, the entire balance is reflected as a current obligation at June 30, 2012 in the amount of \$21.3 million.

- *Revolving credit facilities and lines of credit* Reclassification of the Gemino Credit Facility from long-term Revolving credit facilities as a result of the Company's termination and pay off of the amounts outstanding under that certain Credit Agreement, dated October 29, 2010, between Gemino and the Company on September 20, 2012. As such, the entire balance is reflected as a current obligation at June 30, 2012, in the amount of \$7.0 million.

- *Statement of cash flows* Adjustments to the statement of cash flows result primarily from the adjustments related to the Oklahoma Owners as discussed above; changes in net loss and the related adjustments to the various working capital related balance sheet accounts resulting from the other adjustments described above; and adjustments to show \$31.4 million of debt incurred in conjunction with certain acquisitions as cash provided by financing activities and cash used in investing activities.

The following table presents the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated balance sheet as of June 30, 2012 (*in thousands*):

	At June 30, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
ASSETS				
Cash and cash equivalents	\$ 9,373	\$ (300)	\$	\$ 9,073
Restricted cash and investments	3,624			3,624
Accounts receivable, net	26,964	(1,138)	(699)	25,127
Prepaid expenses and other	668	(143)		525
Assets of disposal group held for sale	38			38
Total current assets	40,667	(1,581)	(699)	38,387
Restricted cash and investments	5,812			5,812
Property and equipment, net (net of reclassification of \$2,694) (Note 1)	144,399	(9,952)	(1,523)	132,924
Intangible assets bed licenses	2,464		(87)	2,377
Intangible assets lease rights, net	7,925			7,925

Edgar Filing: ADCARE HEALTH SYSTEMS, INC - Form 10-Q/A

Goodwill (reclassification of \$2,694) (Note 1)	3,600	(1,123)	635	3,112
Escrow deposits for acquisitions	1,513			1,513
Lease deposits	1,725			1,725
Deferred loan costs, net	5,733	(558)	94	5,269
Other assets	71			71
Total assets	\$ 213,909	\$ (13,214)	\$ (1,580)	\$ 199,115

LIABILITIES AND STOCKHOLDERS EQUITY

Current portion of notes payable and other debt	\$ 9,401	\$ (196)	\$ 21,280	\$ 30,485
Revolving credit facilities and lines of credit	1,900		5,164	7,064
Accounts payable	16,601	(1,320)	328	15,609
Accrued expenses	11,424	(449)	818	11,793
Liabilities of disposal group held for sale	143			143
Total current liabilities	39,469	(1,965)	27,590	65,094
Senior debt, net of discounts	116,603	(12,288)	(21,277)	83,038
Convertible debt, net of discounts	15,035			15,035
Revolving credit facilities	7,064		(5,164)	1,900
Other debt	12,880			12,880
Derivative liability	1,127			1,127
Other liabilities	1,729			1,729
Deferred tax liability	87		32	119
Total liabilities	193,994	(14,253)	1,181	180,922
Common stock and additional paid-in capital	39,647		199	39,846
Accumulated deficit	(18,240)		(2,945)	(21,185)
Total stockholders equity	21,407		(2,746)	18,661
Noncontrolling interest in subsidiaries	(1,492)	1,039	(15)	(468)
Total equity	19,915	1,039	(2,761)	18,193
Total liabilities and equity	\$ 213,909	\$ (13,214)	\$ (1,580)	\$ 199,115

Table of Contents**NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

The following tables present the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated statement of operations for the three and six months ended June 30, 2012 *(in thousands, except per share information)*:

	Three Months Ended June 30, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
Revenues				
Patient care revenues	\$ 54,642	\$ (3,240)	\$ (136)	\$ 51,266
Management revenues	363		162	525
Total revenues	55,005	(3,240)	26	51,791
Expenses:				
Cost of services (Exclusive of facility rent, depreciation and amortization)	42,227	(3,126)	1,215	40,316
General and administrative	4,929		(584)	4,345
Facility rent expense	2,050			2,050
Depreciation and amortization	1,761	(130)	(37)	1,594
Total expenses	50,967	(3,256)	594	48,305
Income from Operations	4,038	16	(568)	3,486
Other Income (Expense):				
Interest expense, net	(3,366)	272	(350)	(3,444)
Acquisition costs, net of gains	(524)			(524)
Derivative gain	353			353
Other expense	(13)			(13)
Total other expense, net	(3,550)	272	(350)	(3,628)
Income (Loss) from Continuing Operations Before Income Taxes	488	288	(918)	(142)
Income Tax Benefit (Expense)	(45)		12	(33)