ADCARE HEALTH SYSTEMS, INC
Form 10-Q/A
July 08, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 on

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended June 30, 2012

o 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.

(Exact name of registrant as specified in its charter)

Ohio	**31-1332119**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification Number)

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 x No o

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 x No o

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

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.

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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.

- 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.

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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);

• 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.

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AdCare Health Systems, Inc.

Form 10-Q/A

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Part I. Financial Information

Item 1. Financial Statements

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in 000 s)

	June 30, 2012 Restated (Note 2) (Unaudited)	December 31, 2011
ASSETS		
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
LIABILITIES AND STOCKHOLDERS EQUITY		
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

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

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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 Restated (Note 2)	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012 Restated (Note 2)	Six Months Ended June 30, 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

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Amounts in 000 s)

(Unaudited)

	Common Stock Shares		Common Stock and Additional Paid-in Capital Restated (Note 2)		Accumulated Deficit Restated (Note 2)		Noncontrolling Interests Restated (Note 2)		Total Restated (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

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in 000 s)

(Unaudited)

	Six Months Ended June 30, 2012 Restated (Note 2)	2011
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

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

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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, 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.

	Three Months Ended June 30,					
	2012			2011		
(Amounts in 000 s, except per share data)	**Income (loss) Restated (Note 2)**	**Shares (1)**	**Per Share**	**Loss**	**Shares (1)**	**Per Share**
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)

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited) (Continued)

	Six Months Ended June 30,									
	2012					2011				
(Amounts in 000 s, except per share data)		**Loss Restated (Note 2)**	**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**

		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

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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

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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

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.

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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.

- *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.

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- *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

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

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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)
Income (Loss) from Continuing Operations	443	288	(906)	(175)
Loss from discontinued operations, net of tax	(160)		(10)	(170)
Net Income (Loss)	283	288	(916)	(345)
Net Income (Loss) Attributable to Noncontrolling Interest	396	(288)	33	141
Net Income (Loss) Attributable to AdCare Health Systems, Inc.	$ 679	$	$ (883)	$ (204)
Net Income (Loss) per Common Share - Basic:				
Continuing Operations	$ 0.06	$ (0.00)	$ (0.06)	$ 0.00
Discontinued Operations	(0.01)			(0.01)
	$ 0.05	$ (0.00)	$ (0.06)	$ (0.01)
Net Income (Loss) per Common Share - Diluted				

Continuing Operations	$	0.06	$	(0.00)	$	(0.06)	$	0.00
Discontinued Operations		(0.01)						(0.01)
	$	0.05	$	(0.00)	$	(0.06)	$	(0.01)

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	Six Months Ended June 30, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
Revenues				
Patient care revenues	$ 104,450	$ (6,464)	$ (413)	$ 97,573
Management revenues	726		323	1,049
Total revenues	105,176	(6,464)	(90)	98,622
Expenses:				
Cost of services (Exclusive of facility rent, depreciation and amortization)	82,350	(6,058)	2,831	79,123
General and administrative	8,860		(522)	8,338
Facility rent expense	4,115			4,115
Depreciation and amortization	3,258	(238)	284	3,304
Total expenses	98,583	(6,296)	2,593	94,880
Income from Operations	6,593	(168)	(2,683)	3,742
Other Income (Expense):				
Interest expense, net	(6,320)	547	(349)	(6,122)
Acquisition costs, net of gains	(817)			(817)
Derivative gain	763			763
Other expense	(29)		2	(27)
Total other expense, net	(6,403)	547	(347)	(6,203)
Income (Loss) from Continuing Operations Before Income Taxes	190	379	(3,030)	(2,461)
Income Tax Benefit (Expense)	(99)		81	(18)
Income (Loss) from Continuing Operations	91	379	(2,949)	(2,479)
Loss from discontinued operations, net of tax	(269)		(10)	(279)
Net Loss	(178)	379	(2,959)	(2,758)
Net Income (Loss) Attributable to Noncontrolling Interest	651	(379)	14	286
Net Income (Loss) Attributable to AdCare Health Systems, Inc.	$ 473	$	$ (2,945)	$ (2,472)
Net Income (Loss) per Common Share - Basic:				
Continuing Operations	$ 0.06	$ (0.00)	$ (0.23)	$ (0.17)
Discontinued Operations	$ (0.02)			$ (0.02)
	$ 0.04	$ (0.00)	$ (0.23)	$ (0.19)
Net Income (Loss) per Common Share - Diluted				
Continuing Operations	$ 0.06	$ (0.00)	$ (0.23)	$ (0.17)
Discontinued Operations	$ (0.02)			$ (0.02)
	$ 0.04	$ (0.00)	$ (0.23)	$ (0.19)

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

The following table presents the Company s previously issued (the As Reported) and restated (the As Restated) consolidated statement of cash flows for the six months ended June 30, 2012 (*in thousands*):

	Six Months Ended June 30, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
Cash flows from operating activities:				
Net loss	$ (178)	$ 380	$ (2,960)	$ (2,758)
Loss from discontinued operations, net of tax	269		10	279
Loss from continuing operations	91	380	(2,950)	(2,479)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:				
Depreciation and amortization	3,258	(238)	284	3,304
Warrants issued for services				
Stock based compensation expense	347		24	371
Lease expense in excess of cash	291			291
Amortization of deferred financing costs	975	(105)	107	977
Amortization of debt discounts	429		(2)	427
Derivative gain	(763)			(763)
Deferred tax expense	1		32	33
Gain on disposal of assets	(2)			(2)
Provision for bad debts	1,233	(52)	495	1,676
Other noncash items	29		(29)	
Changes in certain assets and liabilities, net of acquisitions:				
Accounts receivable	(9,306)	389	97	(8,820)
Prepaid expenses and other	(4)	107	(1)	102
Other assets	50	57	49	156
Accounts payable and accrued expenses	5,081	(953)	980	5,108
Net cash provided by operating activities continuing operations	1,710	(415)	(914)	381
Net cash used in operating activities discontinued operations	(426)		157	(269)
Net cash provided by operating activities	1,284	(415)	(757)	112
Cash flows from investing activities:				
Proceeds from sale of property and equipment	3			3
Change in restricted cash and investments and escrow deposits for acquisitions	(485)		(2,198)	(2,683)
Acquisitions	(8,849)		(27,806)	(36,655)
Purchase of property and equipment	(2,569)	201	692	(1,676)
Net cash used in investing activities continuing operations	(11,900)	201	(29,312)	(41,011)
Net cash used in investing activities discontinued operations				
Net cash used in investing activities	(11,900)	201	(29,312)	(41,011)
Cash flows from financing activities:				
Proceeds from debt	11,515		35,673	47,188
Debt issuance costs	(205)		(1,321)	(1,526)
Change in line of credit	312		1	313
Exercise of warrants and options	95			95

Proceeds from stock issuances, net		3,768						3,768
Repayment of notes payable		(2,763)		94		(4,284)		(6,953)
Net cash provided by financing activities continuing operations		12,722		94		30,069		42,885
Net cash used in financing activities discontinued operations		(97)						(97)
Net cash provided by financing activities		12,625		94		30,069		42,788
Net Change in Cash		2,009		(120)				1,889
Cash, Beginning		7,364						7,364
Cash decrease due to deconsolidation of variable interest entities (Note 2)				(180)				(180)
Cash, Ending	$	9,373	$	(300)	$		$	9,073
Supplemental Disclosure of Cash Flow Information:								
Cash paid during the period for:								
Interest	$	4,630	$		$	1,177	$	5,807
Income taxes	$	46	$		$	(46)	$	
Supplemental Disclosure of Non-cash Activities:								
Acquisitions in exchange for debt and equity instruments	$	32,720	$		$	(27,720)	$	5,000
Warrants issued for financings costs	$	390	$		$	175	$	565
Noncash debt issuance costs	$	3,490	$		$	(3,490)	$	

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NOTE 3. LIQUIDITY AND PROFITABILITY

The Company had net loss of approximately $345,000 and $2,758,000 for the three and six months ended June 30, 2012, respectively, and a net loss of $4,562,000 and $5,503,000 for the three and six months ended June 30, 2011, respectively. The Company had negative working capital of approximately $26,706,000 at June 30, 2012. The Company s ability to sustain profitable operations is dependent on continued growth in revenue and controlling costs.

Management s plans for increasing liquidity and profitability in future years include the following:

- increasing facility occupancy and improving the occupancy mix by increasing Medicare patients;
- acquiring additional long term care facilities with existing cash flowing operations to expand our operations, and
- refinancing debt where possible to obtain more favorable terms.

Management believes that the foregoing actions, if taken by the Company, should provide the opportunity for the Company to improve liquidity and achieve profitability; however, there is no assurance that such actions will occur or, if they do occur, that they will result in improved liquidity or profitability. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 4. DISCONTINUED OPERATIONS

As part of the Company s strategy to focus on the growth of its skilled nursing segment, the Company decided in the fourth quarter of 2011 to exit the home health segment of the business. This segment represented less than 2% of total revenues for the Company over the past year.

As a result of the decision to exit the home health business, the assets and liabilities that are expected to be sold are reflected as assets and liabilities held for sale and are comprised of the following:

(Amounts in 000 s)		**June 30, 2012**		**December 31, 2011**
Property and equipment, net	$	36	$	45
Other assets		2		2
Assets of disposal group held for sale	$	38	$	47
Current portion of debt	$	143	$	197

Notes payable		43
Liabilities of disposal group held for sale	$ 143	$ 240

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited) (Continued)

NOTE 5. SEGMENTS

The Company reports its operations in three segments: Skilled Nursing Facility (SNF), Assisted Living Facility (ALF), and Corporate & Other. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting, and the management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based upon segment operating income (loss). Segment operating results excludes interest expense and other non-operating income and expenses. The table below sets forth our segment information for the three and six months ended June 30, 2012 and 2011.

(Amounts in 000 s)	SNF	ALF	Corporate & Other	Eliminations	Total
Three months ended June 30, 2012 Restated (Note 2)					
Net revenues	$ 47,853	$ 3,413	$ 3,133	$ (2,608)	$ 51,791
Cost of services	40,259	2,606	59	(2,608)	40,316
General and administrative	(36)		4,381		4,345
Facility rent expense	2,000		50		2,050
Depreciation and amortization	1,202	219	173		1,594
Operating income/(loss)	$ 4,428	$ 588	$ (1,530)	$	$ 3,486
Three months ended June 30, 2011					
Net revenues	$ 31,462	$ 2,410	$ 2,585	$ (2,101)	$ 34,356
Cost of services	27,283	1,869	53	(2,101)	27,104
General and administrative			3,167		3,167
Facility rent expense	1,902		45		1,947
Depreciation and amortization	504	161	40		705
Salary retirement and continuation costs			622		622
Operating income/(loss)	$ 1,773	$ 380	$ (1,342)	$	$ 811
Six months ended June 30, 2012 Restated (Note 2)					
Net revenues	$ 90,897	$ 6,676	$ 5,982	$ (4,933)	$ 98,622
Cost of services	79,040	4,975	41	(4,933)	79,123
General and administrative			8,338		8,338
Facility rent expense	4,026		89		4,115
Depreciation and amortization	2,532	429	343		3,304
Operating income/(loss)	$ 5,299	$ 1,272	$ (2,829)	$	$ 3,742
Total assets, June 30, 2012	$ 139,963	$ 29,403	$ 29,749	$	$ 199,115
Six months ended June 30, 2011					
Net revenues	$ 59,653	$ 4,751	$ 5,297	$ (4,315)	$ 65,386

Cost of services		52,607		3,854		133		(4,315)		52,279
General and administrative						6,091				6,091
Facility rent expense		3,805				45				3,850
Depreciation and amortization		963		313		76				1,352
Salary retirement and continuation costs						622				622
Operating income/(loss)	$	2,278	$	584	$	(1,670)	$		$	1,192
Total assets, December 31, 2011	$	110,532	$	22,328	$	35,792	$	(9,548)	$	159,104

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited) (Continued)

NOTE 6. PROPERTY AND EQUIPMENT

(Amounts in 000 s)	Estimated Useful Lives (Years)		June 30, 2012 Restate (Note 2)		December 31, 2011
Buildings and improvements	5-40	$	121,648	$	93,371
Equipment	2-10		10,060		7,108
Land			9,206		7,636
Computer related	2-10		2,487		2,414
Construction in process			187		77
			143,588		110,606
Less: accumulated depreciation expense			9,868		7,624
Less: accumulated amortization expense			796		533
Property and equipment, net		$	132,924	$	102,449

For the six months ended June 30, 2012 and 2011, depreciation and amortization expense was approximately $3,304,000 and $1,352,000, respectively.

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

During the quarter ended March 31, 2012, the Company recognized a $389,000 impairment charge to write down the carrying value of an office building located in Rogers, Arkansas. The office building was acquired in a 2011 acquisition. The purchase price allocation for that acquisition was deemed to be final as of December 31, 2011. Subsequent to December 31, 2011, it was determined that the acquired office building would not be utilized and the building was not in use as of March 31, 2012. The impairment charge represents a change in fair value from value recognized in the purchase price allocation. The impairment charge is classified as depreciation expense in the consolidated statement of operations and is included in the Company s Skilled Nursing Facility segment.

NOTE 7. RESTRICTED CASH AND INVESTMENTS

The following table sets forth the Company s various restricted cash, escrow deposits and investments:

(Amounts in 000 s)	**June 30, 2012**	**December 31, 2011**
HUD escrow deposits	$ 249	$ 326
Funds held in trust for residents	21	45
Refundable escrow deposit		500
Collateral certificates of deposit	3,354	1,012
Total current portion	3,624	1,883
HUD reserve replacements	1,111	1,130
Reserves for capital improvements	2,429	1,767
Restricted investments for other debt obligations	2,272	1,973
Total noncurrent portion	5,812	4,870
Total restricted cash and investments	$ 9,436	$ 6,753

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NOTE 8. ACCRUED EXPENSES

Accrued expenses consist of the following:

(Amounts in 000 s)		June 30, 2012 Restated (Note 2)		December 31, 2011
Accrued payroll related	$	4,914	$	5,040
Accrued employee benefits		2,985		2,023
Real estate and other taxes		1,244		982
Other accrued expenses		2,650		1,836
Total accrued expenses	$	11,793	$	9,881

NOTE 9. NOTES PAYABLE AND OTHER DEBT

Notes payable and other debt consist of the following:

(Amounts in 000 s)	June 30, 2012 Restated (Note 2)