ADCARE HEALTH SYSTEMS INC
Form 10-K
March 31, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

þ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2009

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from __________ to __________

Commission file number 333-131542

AdCare Health Systems, Inc.

(Exact name of small business issuer in its charter)

Ohio	**31-1332119**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
5057 Troy Rd, Springfield, OH	**45502-9032**
(Address of principal executive offices)	*(Zip Code)*

Issuer s telephone number (937) 964-8974

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered

Common Stock, no par value	**NYSE Amex**

Securities registered under Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes¨ Noþ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes¨ Noþ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 þ No¨

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check one):

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company þ

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes¨ Noþ

The aggregate market value of AdCare Health Systems, Inc., Common Stock held by non-affiliates of AdCare Health Systems, Inc., as of June 30, 2009, the last business day of our most recently completed second fiscal quarter, was $7,431,309. The number of shares of AdCare Health Systems, Inc., Common Stock, no par value, outstanding as of December 31, 2009 was 5,360,007.

Documents of Which Portions Are Incorporated by Reference	**Parts of Form 10-K into Which Portion of Documents Are Incorporated**
Proxy Statement for AdCare Health Systems, Inc. s June 4, 2010 Annual Meeting of Shareholders	III

AdCare Health Systems, Inc.

Form 10-K

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EX-32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act
EX-32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act
EX-99.3	Press Release dated March 31, 2010

Special Note Regarding Forward Looking Statements

Certain statements in this report constitute forward-looking statements. These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance, or achievements of AdCare to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Specifically, the actions of competitors and customers and our ability to execute our business plan, and our ability to increase revenues is dependent upon our ability to continue to expand our current business and to expand into new markets, general economic conditions, and other factors. You can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipate estimates, predicts, potential, continues, or the negative of these terms or other comparable terminology. Although believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or review any forward-looking statements, whether as a result of new information, future developments or otherwise.

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PART I

Item 1. Business

Business Development

We are a Springfield, Ohio based developer, owner and manager of retirement communities, assisted living facilities, nursing homes, and provide home health care services in the state of Ohio. We currently manage fourteen facilities, comprised of six skilled nursing centers, six assisted living residences and two independent living/senior housing facilities, totaling over 824 units.

We were organized in 1989 by Gary Wade and J. Michael Williams. Mr. Wade remains active in the management of the business, as President and CEO. Passport Retirement, founded by David A. Tenwick, our Chairman, acquired AdCare Health Systems in 1995. We have a seasoned senior management team with substantial senior living, healthcare and real estate industry experience. Our senior management team is incentivized to continue to grow our business through their combined ownership of approximately 31.3% of our common stock.

Description of Business

We have an ownership interest in eight of the facilities we manage, comprised of 100% ownership of two of the skilled nursing centers and three assisted living facilities, as well as a 50% ownership of three of the assisted living facilities. The assisted living facilities that we own operate under the name Hearth & Home, with the tag line Home is where the hearth is We also maintain a development/consulting initiative which is strategic in providing potential management opportunities to our core long-term care business. AdCare Health Systems, Inc. and Hearth & Home are registered trademarks. All of our properties are located within the State of Ohio.

On May 15, 2008, we completed our acquisition of the New Lincoln Lodge. This acquisition was effective April 1, 2008. Consequently, many of the expense areas in our income statement have increased. The New Lincoln Lodge is a senior living facility located in Columbus, Ohio. For further information on this acquisition, please review our 8-K filed on May 19, 2008 and amended on July 29, 2008.

Additionally, in November, 2008, we acquired the remaining 50.8% ownership interest in Hearth & Home of Van Wert, LLC as required by our forward purchase contract. Through October 2008, we owned 49.2% of the limited liability company with the remaining 50.8% owned by individual investors, located primarily in Van Wert.

Our business operates in two segments: (1) management and facility-based care and (2) home-based care. In our management and facility-based care segment, we derive revenues from three primary sources. We operate and have ownership interests in eight facilities for which we collect fees from the residents of those facilities. Profits/losses are generated to the extent that the monthly patient fees exceed the costs associated with operating those facilities. We also manage assisted living facilities and nursing homes owned by third parties. With respect to these facilities, we receive a management fee based on the revenue generated by the facilities. Within our management facility-based care segment, we provide development, consulting and accounting services to third parties. In these instances, we receive a fee for providing those services. These fees vary from project to project, with the development fee in most cases being based on a percentage of the total cost to develop the project.

Our home-based care segment provides home health care services to patients while they are living in their own homes. We use our own employees and independent contractors to provide the in-home health care and home care services at a fixed rate. Our profits/losses are based upon the spread between the amount we receive for providing the services and the cost incurred by us in providing those services. Our costs to provide services include the personnel cost which we have paid to the employees and independent contractors as well as our overhead and management expenses. Our management and support staff are more than adequate to support the number of employees and independent contractors in the field. Therefore, the profitability of our home-based care segment will improve with increased patient volume and visits provided to the extent that we can increase the number of independent contractors and employees in the field.

Because our overhead costs are relatively fixed, our management team believes that the keys to profitable operations of our business are achieving higher occupancy in the long-term care facilities that we own and/or manage, and increasing the number of home health care providers that we have in the field.

We entered the home healthcare field with the acquisition of Assured Health Care in January, 2005. Our management team believes that we have an infrastructure in place to support more offices and a larger number of home health care professionals which will allow us to increase the number of patients served. During 2008, we began providing home health services to residents in assisted living facilities that we own and manage. This cross-selling initiative has proven beneficial to Assured Health Care by increasing our revenue and beneficial to the residents of assisted living by providing them skilled services that otherwise are not available in the assisted living setting. These actions along with continued marketing efforts to expand our market share within the region we serve have improved the profitability of Assured Health Care.

In addition to improving our existing operations, our management team believes that there are significant opportunities to continue the growth of our business. Our nursing homes, assisted living facilities and independent living facilities operate in the senior living facilities market. Our management believes that this market is one of the most dynamic and rapidly growing sectors within the healthcare space. We believe the trends are encouraging as a result of two key industry drivers: positive demographics, due to the aging of America, coupled with the limited supply of senior living facilities. Our strategy is to be opportunistic by exploiting these trends and growing both internally and through strategic acquisitions.

Our principal executive offices are located at 5057 Troy Road, Springfield, Ohio 45502, and our telephone number is (937) 964-8974. We maintain a website at www.adcarehealth.com.

Employees

As of December 31, 2009, we had approximately 846 total employees of which 538 were full time employees.

Item 1A. Risk Factors

The following are certain risk factors that could affect our business, operations and financial condition. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report of Form 10-K because these factors could cause the actual results and conditions to differ materially from those projected in forward-looking statements. This section does not describe all risks applicable to our business, and we intend it only as a summary of certain material factors. If any of the following risks actually occur, our business, financial condition or results of operations could be negatively affected. In that case, the trading price of our stock could decline.

We intend to expand our business into new areas of operation.

Our business model calls for seeking to acquire existing cash flowing operations and to expand our operations and branch out into other related areas of business. While we intend to retain our focus on the health care industry, our success will largely depend on our ability to expand geographically into new areas of business within our general industry. As a result, we expect to experience all of the risks that generally occur with expansion into new areas.

Many of these risks are out of our control, including risks such as:

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adapting our management systems and personnel into new areas of business;

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integrating new businesses into our structure;

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obtaining adequate financing under acceptable terms;

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where applicable, securing joint venture arrangements with local hospitals, churches, universities, and other entities;

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retention of key personnel, customers and vendors of the acquired business;

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impairments of goodwill and other intangible assets; and

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contingent and latent risks associated with the past operations of, and other unanticipated costs and problems arising in, an acquired business.

If we are unable to successfully integrate the operations of an acquired business into our operations, we could be required to undertake unanticipated changes. These changes could have a material adverse effect on our business. Since we went public in November, 2006, we have not expanded into new areas of business.

<u>We may need additional financing to complete our long-term acquisition and expansion plans, and we do not have commitments for additional financing.</u>

To achieve our growth objectives, we will need to obtain sufficient financial resources to fund our expansion, development and acquisition activities. We believe we may need to secure debt financing in order to help us leverage our equity resources and make further acquisitions. As of December 31, 2009 we had an accumulated deficit of \$9,805,249 and working capital of approximately \$2,658,000. Our cumulative losses have, in the past, made it difficult for us to borrow adequate funds on what management believed to be commercially reasonable terms. To date, we do not have any commitments for such financing and there can be no assurance that adequate financing will be available on terms that are acceptable to us, if at all. In addition, our Board of Directors may elect to use our stock as currency in acquiring additional businesses. If so, our stockholders may experience dilution.

<u>We currently have a line of credit in place which may be insufficient to satisfy short-term cash needs.</u>

In November 2008, we established a \$100,000 line of credit with Huntington National Bank to assist with cash flow. As of December 31, 2009, the entire line of credit was available for use in operations of the Company. During 2008, we established a \$150,000 line of credit using funds from our non-qualified deferred compensation plan. Members of this plan, which is only available to senior management, authorized the transfer of funds to establish the line of credit with interest accruing at 8%. As of December 31, 2009, the entire line of credit was available for use in operations of the Company. Businesses typically use lines of credit to finance short-term and unexpected cash needs. There can be no assurances that these lines of credit will be sufficient in the event of an acute cash deficit. Therefore, we intend to secure additional lines of credit or increases in our existing lines but we can provide no assurance that it will be available on acceptable terms, if at all, or that the amount of any line of credit obtained will be sufficient to handle future cash needs as they arise.

<u>Our business is concentrated in Ohio, making it subject to increased risks as a result of potential declines in the Ohio economy.</u>

To date, all of our properties are located within the State of Ohio. In recent years, the economy in the State of Ohio has lagged behind the economic growth in other areas of the country. While we intend to explore expansion into other geographic areas, we are, to some extent, dependent upon the economy of the State of Ohio and the surrounding region. To date, we do not believe that the slow growth of the Ohio economy has negatively impacted our business.

We have a history of operating losses and may incur losses in the future as we expand.

For the year ended December 31, 2009, we had a net income of $440,283 compared to a net loss of $1,076,178 for the year ended December 31, 2008. Therefore, we have only recently had profitable operations. There can be no assurance that we will be able maintain profitable operations as we expand. As of December 31, 2009, we have working capital of approximately $2,658,000.

Management s plans with the objective of improving liquidity and profitability in future years encompass the following:

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refinancing debt where possible to obtain more favorable terms.

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increase facility occupancy.

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add additional management contracts.

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acquire existing cash flowing operations to expand our operations and branch out into other related areas of business.

Management believes that the actions that will be taken by the Company provide the opportunity for the Company to improve liquidity and maintian profitability. However, there can be no assurance that such events will occur.

Assisted living and skilled nursing facility financial stability could be negatively impacted by the current economic conditions.

Approximately 19% of our skilled nursing occupants and nearly all the occupants of our assisted living facilities rely on their personal investments and wealth to pay for their stay in our facilities. Recent declines in market values of investments could limit their ability to pay for services or shorten the period of time for which they can pay privately for their stay. The declining market for the sale of homes could limit their ability to sell their personal assets further reducing their ability to remain in our facilities. Furthermore, adult children who have recently become unemployed may decide to care for their parent at home so that their parent s income may help offset some of their own financial burdens. While we have not found these circumstances to have a material effect on financial results to date, the length of the economic downturn and eventual recovery could begin to manifest in these areas reducing facility occupancy, financial performance and cash flow.

We are engaged in an evolving and highly-regulated industry, which increases the cost of doing business and may require us to change the way our business is conducted.

Health care is an area of extensive and frequent regulatory change. Changes in the laws or new interpretations of existing laws can have a significant effect on methods of doing business, cost of doing business, and amounts of reimbursements from the government and other payers. Our assisted living residences and nursing homes are subject to regulation and licensing by state and local health and social service agencies and other regulatory authorities. We are and will continue to be subject to varying degrees of regulation and licensing by health or social service agencies. A failure to comply with applicable requirements could cause us to be fined or could cause the cessation of our business, which would have a material adverse effect on our company.

The manner and the extent to which assisted living is regulated at the federal and state level is evolving. Changes in the laws or new interpretations of existing laws may have a significant effect on our methods and costs of doing business. Our success will depend partially on our ability to satisfy the applicable regulations and requirements and to procure and maintain required licenses. Our operations could also be adversely affected by, among other things, regulatory developments such as mandatory increases in the scope and quality of care given to the residents and revisions in licensing and certification standards. We believe that our operations do not presently violate any existing federal or state laws. But there can be no assurance that federal, state, or local laws or regulatory procedures which might adversely affect our business, financial condition, and results of operations for prospects will not be expanded or imposed.

Changes in the methods of payment from Medicare and Medicaid or the reimbursement rates may adversely affect our revenues and operating margins.

For the year ended December 31, 2009, Medicare and Medicaid constituted 30% and 51%, respectively, of our total patient care revenues. For the year ended December 31, 2008, Medicare and Medicaid constituted 25% and 53%, respectively, of our total patient care revenues. The health care industry is experiencing a strong trend towards cost containment. In general, the government has sought to impose lower reimbursement and resource utilization group rates, limit the scope of covered services, and negotiate reduced payment schedules with providers. These cost containment measures have generally resulted in reduced rates of reimbursement for the services provided by companies such as ours.

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Changes to Medicare and Medicaid reimbursement programs have limited, and are expected to continue to limit, payment increases under these programs. Also, the timing of Medicare and Medicaid program payments is subject to regulatory action and governmental budgetary constraints. In addition, federal and state government agencies may reduce the funds available under those programs in the future or require more stringent utilization and quality review of service providers such as us.

State regulatory changes also affect our business.

In the budget passed by the Ohio General Assembly effective July 1, 2005, significant changes were made to the Medicaid reimbursement formula for nursing homes. Under this new law, the cost reimbursement system, which had been in place since the early 1990 s, will be phased out and replaced with a pricing system that will reward both quality of care and efficiency in management operations. In July 2006, Medicaid began the transition to the new reimbursement system. Beginning in July 2010, the State of Ohio has proposed completing the transition to the new reimbursement system which would have the effect of reducing reimbursement at some of our nursing homes if approved. Additionally, the State of Ohio has stopped paying co-pays on dually eligible residents. For the time being, the Federal Government has picked up the costs of the co-pays no longer provided by the State of Ohio. We are not certain whether the Federal Government will continue this program in the long run. As a result, should Ohio continue to refuse co-pays on dually eligible residents and the Federal Government should stop such payments; a substantial amount of our co-pays could become uncollectible.

An expanded Federal program is underway to recover Medicare overpayments.

The Medicare Modernization Act of 2003 established a three year demonstration project to recover overpayments and identify underpayments on Medicare claims from hospitals, skilled nursing facilities and home health agencies through a review of claims previously paid by Medicare beginning in October, 2007. Medicare contracted nationwide with third parties known as Recovery Audit Contractors (RAC) to conduct these reviews commonly referred to as RAC Audits. Due to the success of the program, the Tax Relief and Healthcare Act of 2006 made the program permanent and mandated its expansion to all 50 states by 2010. As of March 31, 2010, we have not received notification that any of our claims are subject to RAC Audits however, we can make no assurances that our claims will not be selected for RAC Audits in the future and if they are the extent to which these audits may reduce our revenue or otherwise hinder cash flow. For the year ended December 31, 2009, approximately 30% of our patient care revenue was from Medicare.

State Certificate of Need laws and other regulations could negatively impact our ability to grow our nursing home business.

The State of Ohio, and other states in which we could expand, have adopted Certificate of Need or similar laws that generally require that a state agency approve certain nursing home acquisitions and determine the need for certain nursing home bed additions, new services, capital expenditures, or other changes prior to the acquisition or addition of beds or services, the implementation of other changes, or expenditure of capital. State approvals are generally issued for specified maximum expenditures and require implementation of the proposal within a specified period of time. Failure to obtain the necessary state approval can result in the inability to provide the service, to operate the centers, to complete the acquisition, addition, or other change, and can also result in sanctions or adverse action on the center s license and adverse reimbursement action. There can be no assurance that we will be able to obtain Certificate of Need approval for all future projects requiring the approval, or that approvals will be timely.

Due to the high-risk circumstances in which we conduct business, we may encounter liability claims in excess of insurance coverage.

The provision of health care services entails an inherent risk of liability. In recent years, participants in the long-term care industry have become subject to an increasing number of lawsuits alleging malpractice or related legal theories, many of which involve large claims and significant defense costs. We currently maintain $1,000,000 in liability insurance for any one exposure. This insurance is intended to cover malpractice and other lawsuits. Although we believe that it is in keeping with industry standards, there can be no assurance that claims in excess of our limits will not arise. Any such successful claims could have a material adverse effect upon our financial condition and results of operations. Claims against us, regardless of their merit or eventual outcome, may also have a material adverse effect upon our ability to attract and retain business. In addition, our insurance policies must be renewed annually and there can be no assurance that we will be able to retain coverage in the future or, if coverage is available, that it will be available on acceptable terms.

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We encounter intense competition from competitors, many of whom have greater resources than AdCare.

The long-term care industry is highly competitive and we believe that it will become even more competitive in the future. Our assisted living facilities and nursing homes compete with numerous companies providing similar long-term care alternatives, such as home health care agencies, community-based service programs, retirement communities and convalescent centers, and other assisted living providers. We compete with national companies such as HCR Manor Care, Alterra and Extended Care with respect to both our nursing home and assisted living facilities. We also compete with locally owned entities such as Health Care Facilities-HCF on a regional basis. Historically, we have found that the entry of one or more of these competitors into one of our established markets can reduce both our occupancy and the rates we are able to charge to our customers. In the past, we have found national publicly traded competitors who are willing to enter into a market already served by us. When these competitors experienced lower than expected occupancies, they relied on their greater financial resources to reduce their rates in order to increase occupancy. This resulted in our occupancies decreasing below expected levels. Eventually, demographics improved and rates stabilized. However, there can be no assurance that similar events will not occur in the future which could limit our ability to attract residents or expand our business and that could have a negative effect on our financial condition, results of operations, and prospects. We can provide no assurance that competitive pressures will not have a material adverse effect on us.

The home health care business is also highly competitive. Since we first acquired Assured Health Care in 2005, its operations remain relatively centralized in the Dayton, Ohio area. However, in that area, Assured faces competition from several sources including, without limitation, Fidelity Nursing Home Systems, Kettering Network Home Care, GEM City Home Care, Greene Memorial Hospital Home Care, and Community Springfield.

Our business is very labor intensive, we operate in smaller markets with limited personnel resources, and our success is tied to our ability to attract and retain qualified employees.

We compete with other providers of home health care, nursing home care, and assisted living with respect to attracting and retaining qualified personnel. We depend on the availability of Registered Nurses and Licensed Practical Nurses to provide skilled care to our nursing home residents. According to the Ohio Hospital Association, the supply of nurses nationwide is predicted to be 800,000 short of demand by 2020. Another study conducted by Dr. David I. Auerbach for the journal *Health Affairs* estimated the shortage to increase to 340,000 by 2020. According to the Bureau of Labor Statistics, employment of registered nurses is expected to grow 23 percent [or 587,000 jobs] from 2006 to 2016, much faster than the average for all occupations . The Bureau of Labor Statistics also reports employment of LPNs is expected to grow 14 percent [or 105,000 jobs] between 2006 and 2016, faster than the average for all occupations, in response to the long-term care needs of an increasing elderly population and the general increase in demand for health care services . While the experts may not agree on the size of the shortage, they all appear to agree that there is and will continue to be a shortage. Because of the small markets in which we operate, shortages of nurses and/or trained personnel may require us to enhance our wage and benefit package in order to compete and lure qualified employees from more metropolitan areas. To date, we have been able to adequately staff all of our operations. However, we can provide no assurance that our labor costs will not increase, or that, if they do increase, they can be matched by corresponding increases in revenues.

We are dependent on our management team and the loss of any of these individuals would harm our business.

Our future success depends largely upon the management experience, skill, and contacts of our officers and directors, in particular, David A. Tenwick, our Chairman, Gary L. Wade, our President and CEO, Christopher Brogdon our Vice Chairman and Chief Acquisitions Officer and Scott Cunningham, our Chief Financial Officer. Mr. Tenwick, Mr.

Wade and Mr. Cunningham, have each signed employment contracts that are effective through September 2011. Mr. Brogdon does not currently have an employment agreement. Loss of the services of any or all of these officers could be materially detrimental to our operations. In addition, due to the location of our corporate headquarters in a smaller urban region, we may experience difficulty attracting senior managers in the future.

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Our business is largely dependent on short-term management contracts that may not be renewed from year to year.

For the years ended December 31, 2009 and 2008, approximately 7.0% and 7.2%, respectively, of our total revenues were generated from management contracts to manage senior living and long-term care facilities. These contracts generally have terms of three years with options to renew at the end of the term. Each contract can be terminated without cause by either party on nine months notice and may be terminated earlier for cause. There can be no assurance that the contracts will be renewed at the end of the present terms, or that our customers will not exercise their ability to terminate the contracts earlier. Our home healthcare business enters into one year contracts with various agencies to provide home care services to clients and members of those agencies. There can be no assurance that existing contracts will be renewed in 2010 or later.

We own multiple parcels of real estate and could be subject to environmental liability for hazardous substances found on any of those parcels, whether or not we caused the contamination.

While we are not aware of any potential problems at this time, we own multiple parcels of real estate, each of which is subject to various federal, state, and local environmental laws, ordinances, and regulations. Many of these laws and regulations provide that a current or previous owner of real property may be held liable for the cost of removing hazardous or toxic substances, including materials containing asbestos that would be located on, in, or under the property. These laws and regulations often impose liability whether or not the owner or operator knew, or was responsible for, the presence of the hazardous or toxic substances. The cost of the removal is generally not limited under the laws and regulations and could exceed the property's value and the aggregate assets of the owner or operator. The presence of these substances or failure to remediate such substances properly may also adversely affect the owner's ability to sell or rent the property or to borrow using the property as collateral. If any of our properties were found to have environmental issues, we may be required to expend significant amounts to rehabilitate the property and we may be subject to significant liability.

The price of our securities may be subject to fluctuation.

The market price of our common stock and warrants will likely be highly volatile and subject to wide fluctuations in response to various factors, many of which are beyond our control. These factors include:

- variations in our operating results;
- changes in the general economy, and more specifically the Ohio economy or in the local economies in which we operate;
- the financial markets; the state and length of the present bear market and when the market may recover;
- the departure of any of our key executive officers and directors;

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the level and quality of securities analysts coverage for our common stock;

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announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

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changes in the federal, state, and local health-care regulations to which we are subject; and

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future sales of our common stock.

For these reasons, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on past results as an indication of future performance.

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Our management substantially controls all major decisions.

Our directors and officers beneficially own approximately 34.1% of our outstanding common shares. Therefore, our directors and officers will be able to influence major corporate actions required to be voted on by stockholders, such as the election of directors, the amendment of our charter documents, and the approval of significant corporate transactions such as mergers, reorganizations, sales of substantially all of our assets, and liquidation. Furthermore, our directors will be able to make decisions affecting our capital structure, including decisions to issue additional capital stock, implement stock repurchase programs and incur indebtedness. This control may have the effect of deterring hostile takeovers, delaying or preventing changes in control or changes in management, or limiting the ability of our other stockholders to approve transactions that they may deem to be in their best interest.

As we expand our operations, we may open or manage facilities that are geographically near other facilities that we operate or manage.

While the facilities that we own and manage are sufficiently well-spaced so that they do not currently compete for business, there can be no assurance in the future, as we grow, that circumstances will not arise where facilities which we own and/or manage will compete with each other for patients. If this were to occur, it may damage our relationships with facilities that we manage that could result in the termination of our management agreements.

The requirements of being a public company may strain our resources and distract our management.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act. These requirements may place a strain on our systems and resources. The Exchange Act requires that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires that we maintain effective disclosure controls and procedures and internal controls for financial reporting. We are required to document and test our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and, although not currently required, a report by our independent registered public accountants addressing these assessments. During the course of our testing, we may identify deficiencies which we may not be able to remediate in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. In addition, if we fail to achieve and maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act.

In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, significant resources and management oversight is required. This may divert management's attention from other business concerns, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge, and we cannot assure you that we will be able to do so in a timely fashion.

Takeover defense provisions may adversely affect the market price of our common stock.

Various provisions of Ohio corporation law and of our corporate governance documents may inhibit changes in control not approved by our Board of Directors and may have the effect of depriving our investors of an opportunity to receive a premium over the prevailing market price of our common stock in the event of an attempted hostile takeover. In addition, the existence of these provisions may adversely affect the market price of our common stock and warrants. These provisions include:

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a requirement that special meetings of stockholders be called by our Board of Directors, the Chairman, the President, or the holders of shares with voting power of at least 25%;

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staggered terms among our directors with these classes of directors and only one class to be elected each year;

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advance notice requirements for stockholder proposals and nominations; and

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availability of "blank check" preferred stock.

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Provisions in our bylaws provide for indemnification of officers and directors, which could require us to direct funds away from our business and future products.

Our Articles of Incorporation and Code of Regulations provide for the indemnification of our officers and directors. We may be required to advance costs incurred by an officer or director and to pay judgments, fines and expenses incurred by an officer or director, including reasonable attorneys' fees, as a result of actions or proceedings in which our officers and directors are involved by reason of being or having been an officer or director of our company. Funds paid in satisfaction of judgments, fines and expenses may be funds we need for the operation of our business and the development of our product candidates, thereby affecting our ability to attain or maintain profitability.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate office is located in Springfield, Ohio. We own the office building, which contains approximately 7,200 square feet of office space. We believe that we will need additional office space in the near future and that suitable office space is available in the Springfield area. We own additional land on which we could expand our office facilities. This property is subject to debt in the amount of approximately $269,000 (as of December 31, 2009) which matures on February 1, 2017.

In order to qualify for HUD financing, one of three assisted living properties owned by Community s Hearth & Home, LLC., was transferred into a separate entity. Two properties located in Clark County were retained by Community s Hearth & Home LLC while the third property located in Champaign County was transferred to Hearth & Home of Urbana. The ownership of the three properties remains the same. We own 50% of Community s Hearth & Home and Hearth & Home of Urbana and our partner, Community Mercy Health Partners, a hospital group, owns the remaining 50%. In June 2008, refinancing of these properties was completed.

Community s Hearth & Home, LLC., is an Ohio limited liability company that owns two assisted living properties. The two properties owned by this entity are each subject to a United States Department of Housing and Urban Development insured mortgage of approximately $1,844,000 (as of December 31, 2009) which matures July, 2043.

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Hearth & Home at Harding is a free standing, single story assisted living facility, comprised of 11,711 square feet of space. The central core of common living area of the home includes a living room, family room, dining room, kitchen, activity room, and laundry room with 10 separate bedrooms with baths on each side of the central core for a total of 20 bedrooms (including 8 one bedroom units). The facility is located on 1.25 acres in Springfield, Ohio. Springfield is a community in southwestern Ohio.

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Hearth & Home at El Camino is a duplicate copy of Hearth & Home at Harding also located in Springfield, Ohio. The facility is dedicated to providing Alzheimer s care for its residents.

Hearth & Home of Urbana, LLC, owns one assisted living property. This property is subject to a United States Department of Housing and Urban Development insured mortgage of approximately $2,120,000 (as of December 31, 2009) which matures July, 2043.

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Hearth & Home of Urbana was a duplicated copy of Hearth & Home at Harding and El Camino. However, the facility was expanded in 2003 to add 12 more units, public area and parking spaces now totaling 20,180 square feet of space. In order to meet growing market demand, during 2007, a portion of the building was retrofitted to provide specialized Alzheimer s care. The assisted living facility is located on 2 acres in Urbana, Ohio. Urbana is a community located in southwestern Ohio.

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Hearth & Home of Van Wert is a free standing single story assisted living facility, comprised of 25,571 square feet of space and is owned by Hearth & Home of Van Wert, LLC., an Ohio limited liability company. The facility is designed with 15 residential bedrooms (30 total bedrooms) grouped into two clusters around community living spaces, including family kitchen, dining, laundry and a hearth room. There is a main kitchen and the living clusters are connected by a large interior atrium. The assisted living facility is located on 3 acres in Van Wert, Ohio. Van Wert is a community in northwestern Ohio. Through October 2008, we owned 49.2% of the limited liability company with the remaining 50.8% owned by individual investors, located primarily in Van Wert. In November, 2008, we acquired the remaining 50.8% ownership interest. In November 2009, this property was refinanced with a United States Department of Housing and Urban Development insured mortgage of approximately $2,181,200 (as of December 31, 2009) which matures December, 2044.

Hearth & Home of Vandalia, Inc. is an Ohio corporation that owns a free standing single story assisted living facility, comprised of 29,431 square feet of space. The facility is designed with 15 residential bedrooms (45 total bedrooms) grouped into three clusters around community living spaces, including family kitchen, dining, laundry and hearth room. There is a main kitchen and the living clusters are connected by a large interior atrium. The assisted living facility is located on 4 acres in Vandalia, Ohio. Vandalia is a community located on the north side of the city of Dayton, Ohio. This property is subject to a United States Department of Housing and Urban Development insured mortgage of approximately $3,586,000 (as of December 31, 2009) which matures on May, 2041.

The Pavilion, LLC, is an Ohio limited liability company that owns a 62 bed skilled nursing facility located on 4 acres of land in Sidney, Ohio. The skilled nursing facility is a single story building that is licensed for 62 beds and has a gross building area of 16,151 square feet. The 62 beds are dually certified for Medicaid and Medicare. The building is constructed in the form of a cross, with resident rooms in three of the wings and the nurses station at the center of the cross. The fourth wing of the building contains the dining room and activity area, kitchen, laundry and other staff operations areas. During 2007, several semi-private rooms were converted to private suites consequently reducing the number of beds in service to 50. Sidney is a community located in northwestern Ohio. This property is subject to a United States Department of Housing and Urban Development insured mortgage of approximately $1,992,000 (as of December 31, 2009) which matures on December, 2027.

Hearth & Care of Greenfield, LLC is an Ohio limited liability company that owns a 50-bed single story skilled nursing facility, located on approximately one half acre, in Greenfield, Ohio. The property is a residential home that was converted and expanded into 40-nursing beds all located on the first floor. During 2007, renovations were completed which added 10 private bedrooms, new kitchen, laundry, activity and therapy rooms and a new front entrance and nurses station totaling 10,550 square feet. The total square footage after renovations is approximately 29,000 square feet of space. The 50 beds are dually certified for Medicaid and Medicare. Greenfield is a community located in southern Ohio. This property was refinanced during 2008 and is now subject to a United States Department of Housing and Urban Development insured mortgage of approximately $2,487,000 (as of December 31, 2009) maturing in August, 2038.

In April, 2008, we acquired the New Lincoln Lodge Retirement Residence located in Columbus, Ohio. The facility is a 49 unit building containing approximately 34,500 square feet and is located on approximately three acres. The building is two stories with resident units on both floors. There is a central kitchen and dining area providing meals to the residents. We also provide light housekeeping and activity areas including a library. During 2008, we obtained a residential care facility license for the purpose of providing assisted living services. Currently, services are provided to primarily independent residents but during 2009 we began providing services to residents requiring an assisted living level of care. The property is subject to a United States Department of Housing and Urban Development insured mortgage of approximately $1,940,000 (as of December 31, 2009) which matures July, 2036.

Pursuant to a ten-year lease which began March 1, 2003, we lease 100% of The Covington Care Center, a 106-bed single story skilled nursing facility located in Covington, Ohio, a community in western Ohio. This is a net lease in which we lease the entire facility including the building and equipment. We also manage this facility and all revenues collected in excess of the lease costs and operating expenses represent our profits with respect to this facility. The building is a long, rectangular building containing 31,048 square feet of space. It has several nurses stations, dining, laundry, kitchen, activity, therapy, and several other rooms along with administrative offices. The 106 resident beds are dually certified for Medicaid and Medicare. During 2007 and 2009, several semi-private rooms were converted to private suites and expanded therapy areas consequently reducing the number of beds in service to 94.

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In April, 2008, the lease was extended by one year and the lessor agreed to spend $600,000 for improvements. In addition, after annual base rents are paid, we agreed to share any excess cash flow with the lessor after we receive a 6% management fee. Moreover, at the end of the lease, we have a right of first refusal to acquire the property and an option to renew the lease for five years at a rental to be determined.

We believe that all of our properties are well maintained and suitable for the services we provide in them and that they are adequately covered by insurance.

Portfolio of Owned and Managed Facilities

SKILLED NURSING FACILITIES (SNF)	**BEDS**	**FACILITIES DEVELOPED BY ADCARE**	**% OWNED**	**MANAGE**	**2008 OCCUPANCY** [3]	**2009 OCCUPANCY** [3]
Covington Care Center, Covington, OH[2][4]	94			X	81%	85%
Koester Pavilion, Troy, OH	150			X	98%	95%
The Pavilion Care Center, Sidney, OH[10]	50		100%	X	89%	92%
Health Center at SpringMeade, Tipp City, OH[1]	99	X		X	99%	99%
Valley View Alzheimer s Center, Frankfort, OH [7]	50			(7)	89%	(7)
Hearth & Care of Greenfield, Greenfield, OH	50		100%	X	92%	94%
West Toledo Nursing and Rehabilitation Center[9]	80			X	(9)	62%

ASSISTED LIVING FACILITIES (ALF)	**BEDS**	**FACILITIES DEVELOPED BY ADCARE**	**% OWNED**	**MANAGE**	**2008 OCCUPANCY** [3]	**2009 OCCUPANCY** [3]
Hearth & Home at Harding, Springfield, OH [1]	20	X	50%	X	87%	83%
Hearth & Home at Urbana, Urbana, OH [1]	32	X	50%	X	79%	71%
Hearth & Home at Friedman Village, Tiffin OH[1][8]	20	X		(8)	86%	(8)
Hearth & Home at El Camino, Springfield, OH [1]	20	X	50%	X	100%	100%
Hearth & Home at Van Wert, Van Wert, OH [1]	30	X	100% [6]	X	94%	87%
	45	X	100%	X	97%	100%

Hearth & Home at Vandalia, Vandalia, OH (1)						
Legacy Assisted Living Xenia, OH (1)	22	X		X	97%	90%

INDEPENDENT LIVING FACILITIES (ILF)	BEDS	FACILITIES DEVELOPED BY ADCARE	% OWNED	MANAGE	2008 OCCUPANCY (3)	2009 OCCUPANCY (3)
SpringMeade Residence, Tipp City, OH (1)	83	X		X	98%	97%
Friedman Village, Tiffin, OH (1)(8)	31	X		(8)	95%	(8)
Lincoln Lodge Retirement Residence (5)	49		99%	X	73%	69%

(1) *These represent facilities in which we acted in the traditional capacity of a real estate developer overseeing the entire project from acquisition of the land through construction and operation of the facility.*

(2) *Net Lease in which we pay rent plus taxes, insurance and maintenance on the property.*

(3) *Average occupancy for the year ended December 31, 2008 and December 31, 2009.*

(4) *Covington Care Center reduced the number of beds in service to 94 from 98 effective April 1, 2009. Covington Care Center is licensed for 106 beds.*

(5) *The Lincoln Lodge Retirement Residence was acquired effective April 1, 2008. Although currently operating primarily as an independent living facility, portions of the facility are providing assisted living services.*

(6) *We acquired our partner s 50.8% interest in Hearth & Home of Van Wert in November 2008.*

(7) *Management of this facility was discontinued effective May 31, 2009.*

(8) *Management of this facility was discontinued effective March 31, 2009.*

(9) *A wholly owned subsidiary of AdCare was appointed receiver for West Toledo Nursing and Rehabilitation Center effective August 6, 2009. Subsequently, AdCare was hired to manage West Toledo Nursing and Rehabilitation Center.*

(10) *The Pavilion Care Center is licensed for 62 beds but has 50 in service.*

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Item 3. Legal Proceedings

We are not currently involved in any material litigation. We may from time to time become a party to various legal proceedings arising in the ordinary course of our business.

PART II

Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our units began trading on the American Stock Exchange on November 10, 2006, under the symbol ADK.U . Each unit consisted of two shares of common stock and two five year warrants for two shares of common stock. The units stopped trading and the common stock and the warrants began to trade separately on December 21, 2006, with the common stock under the symbol ADK and the warrants under the symbol ADK.WS .

In October 2008, NYSE Euronext acquired the American Stock Exchange. Consequently, our stock is now traded on the NYSE Amex exchange. The high, low and closing prices of our stock and dividends declared and paid during 2009 and 2008 were as follows:

ADK		**High**	**Low**	**Close**	**Cash Dividends**
2009	First Quarter	$1.37	$0.70	$0.94	None
	Second Quarter	$2.45	$0.94	$2.25	None
	Third Quarter	$2.95	$2.32	$2.84	None
	Fourth Quarter	$4.15	$2.10	$3.94	None

ADK.WS		**High**	**Low**	**Close**	**Cash Dividends**
2009	First Quarter	$0.17	$0.02	$0.05	None
	Second Quarter	$0.70	$0.05	$0.36	None
	Third Quarter	$0.85	$0.25	$0.60	None
	Fourth Quarter	$2.60	$0.20	$2.60	None

ADK		**High**	**Low**	**Close**	**Cash Dividends**
2008	First Quarter	$1.40	$0.63	$1.20	None
	Second Quarter	$3.09	$1.20	$2.61	None
	Third Quarter	$2.75	$1.71	$1.87	None
	Fourth Quarter	$2.02	$1.06	$1.06	None

ADK.WS		**High**	**Low**	**Close**	**Cash Dividends**
2008	First Quarter	$0.17	$0.01	$0.15	None
	Second Quarter	$0.70	$0.10	$0.40	None

Third Quarter	$0.60	$0.30	$0.37	None
Fourth Quarter	$0.52	$0.11	$.016	None

On December 31, 2009, we had approximately 760 share owner accounts of record.

We have never paid cash dividends on our common shares. Holders of common shares are entitled to receive dividends. Our ability to pay dividends will depend upon our future earnings and net worth. We are restricted by Ohio law from paying dividends on any of our outstanding shares while insolvent or if such payment would result in a reduction of our stated capital below the required amount.

It is the intention of our Board periodically to consider the payment of dividends, based on future earnings, operating and financial condition, capital requirements and other factors deemed relevant by the Board. There is no assurance that we will be able or will desire to pay dividends in the near future or, if dividends are paid, in what amount. Our Board may decide not to pay dividends in the near future, even if funds are legally available, in order to provide us with more funds for operations.

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On December 8, 2009, at a special shareholder meeting, shareholders approved the sale of 1,400,000 shares of stock and warrants in a private placement. The offering consisted of Units with each Unit containing one share of the Company s common stock and one five-year warrant to purchase an additional share of common stock at $2.50 per share. Each Unit was valued at $2.00. The offering is not registered under the Securities Act of 1933 and was only sold in the United States pursuant to applicable exemptions from registration. As a result the Company raised approximately $2,439,000 after commissions and expenses.

Equity Compensation Plan Information

The following table sets forth additional information as of December 31, 2009, concerning shares of our common stock that may be issued upon the exercise of options and other rights under our existing equity compensation plans and arrangements, divided between plans approved by our shareholders and plans or arrangements not submitted to the shareholders for approval. The information includes the number of shares covered by and the weighted average exercise price of, outstanding options and other rights and the number of shares remaining available for future grants excluding the shares to be issued upon exercise of outstanding options, warrants, and other rights.

	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	1,456,228	$1.69	100,920
Equity compensation plan not approved by security holders	0	$0.00	0

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Item 6. Selected Financial Data

Not Applicable.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a Springfield, Ohio based developer, owner and manager of retirement communities, assisted living facilities, nursing homes, and provide home health care services in the state of Ohio. We currently manage fourteen facilities, comprised of six skilled nursing centers, six assisted living residences and two independent living/senior housing facilities, totaling approximately 824 beds.

We have an ownership interest in eight of the facilities we manage, comprised of 100% ownership of two skilled nursing facilities and two assisted living facilities, 99% ownership in one independent living facility as well as a 50% ownership in three assisted living facilities. We lease one additional skilled nursing facility. The assisted living facilities that we own operate under the name Hearth & Home, with the tag line Home is where the hearth is... We also maintain a development/consulting initiative which is strategic in providing potential management opportunities to our core long-term care business. AdCare Health Systems, Inc.® and Hearth & Home® are registered trademarks. All of our properties are located within the State of Ohio.

We believe that the assisted living industry is the preferred residential alternative for seniors who cannot live independently due to physical or cognitive frailties but who do not require the more intensive medical attention provided by a skilled nursing facility. Generally, assisted living provides housing and 24-hour personal support services designed to assist seniors with activities of daily living such as bathing and dressing. Our unique approach to assisted living presents individuals with choices, passively encouraging socialization and advancing each resident with dignity and hospitality. Our facilities are designed to passively encourage socialization by providing smaller bedrooms compared to our competition while providing larger common areas. This encourages our residents to spend less time alone in their rooms and more time with family and other residents in the common areas. On the continuum of social to medical model, we remain as close to the social end of the spectrum as possible.

We believe that assisted living services will continue to increase as an attractive alternative to nursing home care because a variety of supportive services and supervision can be obtained in a more independent and less institutional setting. Generally, basic care and support services can be offered more economically in an assisted living facility than in a skilled nursing facility. Assisted living facility services are most commonly paid for from patients private funds. There is also limited coverage by Medicaid and some long term care insurances.

Our skilled nursing facilities provide skilled nursing health care services, including room and board, nutrition services, recreational therapy, social services, housekeeping and laundry services. Skilled nursing facilities dispense medications prescribed by the patients physicians. We also provide for the delivery of ancillary medical services. These specialty services include rehabilitation therapy services such as audiology, speech, occupational and physical therapies, which are provided through licensed therapists and registered nurses and the provision of medical supplies, nutritional support, infusion therapies and related clinical services. Skilled nursing facility services are most commonly paid for by Medicare, Medicaid, and various commercial insurances or from patients private funds.

In recent years, we observed the trend that more seniors were staying in their homes for a longer period of time prior to moving into a long-term care setting. We have also observed that more seniors are using nursing and assisted living facilities for short rehabilitation stays and then moving back to their homes. We have taken advantage of this opportunity and expanded our operations to provide personal care and health care services in the home. Accordingly, in January, 2005, we acquired Assured Health Care, a home health care service provider located in Dayton, Ohio. Assured has been providing home health care services in the greater Dayton area since 1995. Home health care services include four broad categories: 1) home health nursing services, 2) infusion therapy (intravenous delivery and administration of nutrients, fluids, antibiotics and other medications to patients), 3) respiratory therapy, and 4) home medical equipment. These services are all provided within the patient s home. These services are paid for by Medicare and various state Medicaid programs as well as commercial insurance carriers.

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Segments

Our business operates in two segments: (1) management and facility-based care and (2) home-based care. In our management and facility-based care segment, we derive revenues from three primary sources. We operate and have ownership interests in eight facilities for which we collect fees from the residents of those facilities. Profits/losses are generated to the extent that the monthly patient fees exceed the costs associated with operating those facilities. We also manage assisted living facilities and nursing homes owned by third parties. With respect to these facilities, we receive a management fee based on the revenue generated by the facilities. Within our management facility-based care segment, we provide development, consulting and accounting services to third parties. In these instances, we receive a fee for providing those services. These fees vary from project to project, with the development fee in most cases being based on a percentage of the total cost to develop the project.

Management and Facility Based Care Segment

We focus on two primary indicators in evaluating the financial performance of our business. Those indicators are facility occupancy and staffing. Facility staffing is important because payroll and related payroll costs represent approximately 62% of our total operating costs. Staffing levels and the quality of staff are closely monitored by management to make sure costs are maintained within expected levels and to assure a high level of quality services. Facility occupancy is important as higher occupancy generally leads to higher revenue. According to the Ohio Health Care Association, average nursing home occupancy within Ohio was 87.6% for 2008. Over the past 10 years, occupancy has averaged 87.8% statewide according to the State of Ohio. According to the American Health Care Association, median nursing facility occupancy rates were 87.5% nationally for certified beds. Our skilled nursing facilities averaged 88.8% for 2009 and assisted living facilities averaged 85.6%. For 2008, our skilled nursing facilities averaged 85% and assisted living facilities averaged 87.9%. Statewide averages are not published for assisted living facilities.

On May 15, 2008, we completed our acquisition of the Lincoln Lodge. The Lincoln Lodge is a 49 unit senior living facility located in Columbus, Ohio. This acquisition was effective April 1, 2008. Consequently, many of the expense areas in our income statement increased. When acquired, the facility focused on providing independent living services to seniors and was approximately 80% occupied. Since our acquisition, we have obtained a license to provide assisted living services and have started admitting assisted living residents. It s our goal to fill the remaining vacant units with assisted living and begin replacing the current independent residents with assisted living residents through attrition. During this transitional phase, our average assisted living occupancy may appear somewhat lower than in the past. For the year ended December 31, 2009, compared to the year ended December 31, 2008, overall occupancy in our assisted living centers decreased .8%.

We have implemented changes at our skilled nursing facilities to improve occupancy and revenue and these changes appear to be working as occupancy rates have been increasing. We own two of our skilled nursing facilities and lease a third. We have recently completed renovations at all three facilities with additional renovations in process. We continue our work towards maximizing the number of patients covered by Medicare where our profit margins are typically higher. For the year ended December 31, 2009, compared to the year ended December 31, 2008, overall occupancy in our skilled nursing centers increased approximately 3.3%.

In July 2009, the Governor of the State of Ohio signed into law the state Biennial Budget 2009-2010. Certain provisions of this budget contain modifications to Medicaid reimbursement that affect our reimbursement beginning July 1, 2009. We have implemented operating changes in our skilled nursing facilities to help offset some of the negative impacts of the state budget changes. However, we are receiving limited positive adjustments in our reimbursement while our costs of providing services continue to rise. For the year ended December 31, 2009, Medicaid covered residents of our skilled nursing facilities comprised approximately 67% of our total skilled nursing facility residents.

The Federal Centers for Medicare and Medicaid Services, or CMS, has recently adopted rules that it estimates will decrease aggregate Medicare payments to skilled nursing facilities by approximately 1.1% in federal fiscal year 2010. Effective as of October 1, 2008, CMS increased Medicare rates for skilled nursing facilities by approximately 3.5% for the federal fiscal year ending September 30, 2009, under a rule adding an annual update to account for inflation in the cost of goods and services. CMS has recently adopted rules recalibrating the Medicare prospective payment categories for skilled nursing facilities for federal fiscal year 2010. The recalibration will result in a decrease of approximately 3.3% in projected skilled nursing facility payments, offset by a proposed increase of approximately 2.2% to account for inflation. As a result, CMS estimates that aggregate Medicare payments will be reduced by approximately 1.1% in fiscal year 2010, on or after October 1, 2009. For the

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year ended December 31, 2009, Medicare covered residents of our skilled nursing facilities comprised approximately 15% of our total residents.

Home Based Care Segment

In addition to providing home health care services to patients in their homes, we are utilizing our home health services in our assisted living and independent living properties creating cross selling opportunities thereby further enhancing our revenue. The percentage of our home health patients covered by Medicare has increased from 16% for the year ended December 31, 2008, to 26.4% for the year ended December 31, 2009.

The Center for Medicare and Medicaid Services (CMS) has made a 2.75% across-the-board rate reduction for home health care services for 2010, as well as a 2.71% cut for 2011. Additionally, CMS has other initiatives directed towards reducing payment for home health care services. Medicare covered services comprise approximately 26% of our home health total visits. Effective January 1, 2010, Ohio Job and Family Services (Medicaid) made a 3% reduction in reimbursement for home health services. Medicaid covered services comprise approximately 62% of our home health total visits.

The table below shows the net income (loss) from both our management and facility-based care operation and our home based care operation for the years ended December 31, 2009 and 2008.

	(Amounts in 000 s)				
	Manage- ment and Facility Based Care	Home Based Care	Total Segments	Cor- porate	Total
Year ended December 31, 2009:					
Net Revenue	$25,545	$3,055	$28,600	$(1,909)	$26,691
Net Profit	19	421	440	-	440
Total Assets	27,451	2,653	30,104	-	30,104
Capital Spending	573	-	573	-	573
Year Ended December 31, 2008:					
Net Revenue	$23,782	$2,804	$26,586	$(1,793)	$24,793
Net Profit (Loss)	(1,252)	176	(1,076)	-	(1,076)
Total Assets	24,294	2,545	26,839	-	26,839

Capital Spending	468	9	477	-	477

Revenue in our management and facility based care segment increased approximately $1,763,000 or 7.4% primarily as result of a 3.3% increase in occupancy in our skilled nursing facilities partially offset by a decrease in our assisted living facility occupancy of .8%. Additionally, the acquisition of the Lincoln Lodge along with increases in rates charged to our privately paying residents contributed to our increased revenue. As a result, Net Profit for the year ended December 31, 2009, was approximately $19,000, an improvement of $1,271,000 over 2008. Total assets increased primarily as a result of capital raised in a private offering of our stock along with routine fixed asset additions.

Revenue in our home based care segment increased approximately $251,000 or 9%. This is primarily the result of services provided to assisted living residents as well as an increase in the number of patients covered by Medicare. As a result, net profit increased approximately $245,000.

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Consolidated Results of Operations

Year Ended December 31, 2009 and December 31, 2008

Revenue

Approximately 93% of our revenue is derived from patient care services provided by our skilled nursing facilities, assisted living facilities and home health agency. The following table compares revenue for the years ended December 31, 2009 and 2008:

	December 31, 2009	December 31, 2008	Increase	% Change
Patient care revenue	$24,834,831	$23,008,754	$1,826,077	7.9%
Management, consulting and development fee revenue	1,856,269	1,784,540	71,729	4.0%
	$26,691,100	$24,793,294	$1,897,806	7.7%

For the periods compared, patient care revenue increased $1,826,077 or 7.9%. Skilled nursing facility revenue increased approximately $1,218,000 due to an increase in average occupancy in our skilled nursing centers by 3.3%. Occupancy in our assisted living centers decreased by approximately .8%; however, revenue increased by approximately $357,000 as a result of higher fees charged to residents that required more intensive care which more than offset our lower occupancy. We attribute the decrease in occupancy to potential residents choosing lower cost alternatives and delaying their decision to enter assisted living during these difficult economic times. Charges for private paying residents at our assisted living and skilled nursing facilities increased approximately 5% beginning January 1, 2009 adding to our revenue growth. Additionally, patient care revenue increased due to the acquisition of the New Lincoln Lodge effective April 1, 2008. Home health revenue increased approximately $251,000 as a result of services provided to assisted living residents as well as an increase in the number of patients covered by Medicare. Management, consulting and development fee revenue increased approximately $72,000 or 4.0% as a result of higher management fees charged to properties we manage but do not own. The higher fees were a result of negotiated increases.

Operating Expenses

	December 31, 2009	December 31, 2008	(Decrease)/ Increase	% Change
Payroll and related payroll costs	$15,371,150	$15,649,862	$(278,712)	(1.8)%
Other operating expenses	8,626,987	8,248,157	378,830	4.6%
Depreciation and amortization	918,851	882,900	35,951	4.1%
	$24,916,988	$24,780,919	$136,069	.5%

Operating expenses for the year ended December 31, 2009 increased approximately $136,000 or .5%. Payroll and related payroll costs for the year ended December 31, 2009 decreased by approximately $279,000 or 1.8%. For the year ended December 31, 2008, payroll and related payroll costs included approximately $162,000 in payroll expense related to the retirement benefits of our previous Chief Operating Officer and approximately $640,000 in non-cash expenses primarily related to the warrants approved by shareholders at our August 15, 2008, shareholder meeting compared to approximately $320,000 in stock option compensation expense for the year ended December 31, 2009. These savings were partially offset by employee wages which have increased approximately 3% as a result of annual wage increases. The acquisition of New Lincoln Lodge contributed approximately $79,000 in additional payroll and related costs. Payroll expense at our home health agency increased as a result of an increase in the number of patients served.

Other operating expenses increased approximately $379,000 or 4.6% due primarily to increased occupancy at our skilled nursing facilities resulting in increased supplies and services usage required to provide care for the additional residents.

Depreciation and amortization increased approximately $36,000 or 4.1% primarily due to routine additions of fixed assets and their related depreciation expense.

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Income from Operations

Income from continuing operations for the year ended December 31, 2009 was approximately $1,774,000 compared to approximately $12,000 for the year ended December 31, 2008. As described above, total revenue grew by 7.7% from 2008 to 2009 ahead of operating expenses which remained relatively unchanged.

Other Income and Expense

	December 31, 2009	December 31, 2008	(Decrease)/ Increase	% Change
Interest income	$5,472	$23,287	$(17,815)	(76.5)%
Interest expense, others	(1,207,749)	(1,265,622)	57,873	(4.6)%
Interest expense, related parties	(2,177)	(36,446)	34,269	(94.0)%
Other income (expense)	(46,745)	4,200	(50,945)	(1213.0)%
	$(1,251,199)	$(1,274,581)	$23,382	(1.8)%

Interest income decreased approximately $18,000 or 76.5% for the year ended December 31, 2009, as a result of less interest earned on bank accounts. Interest expense for the year ended December 31, 2009 decreased approximately $58,000 or 4.6%. Interest expense for the year ended December 31, 2008 included the recognition of the balance of unamortized financing costs of approximately $210,000 in contrast to the year ended December 31, 2009 which included approximately $48,000 in expense for unamortized financing costs. The expense in both years is the result of refinancing loans.

Other expense was approximately $47,000 for the year ended December 31, 2009. This is a result of approximately $64,000 in expenses associated with due diligence activity for a potential acquisition. The expenses have been recognized in accordance with ASC Topic 805, *Business Combinations*. These expenses were somewhat offset by rental income of approximately $16,800 for commercial space at the Lincoln Lodge.

Summary

Income before income taxes for the year ended December 31, 2009 was approximately $523,000 compared to a net loss of approximately $848,000 for the year ended December 31, 2008, an increase of approximately $1,371,000 primarily as a result of increased revenue. The net loss for the year ended December 31, 2008, included the gain we recognized upon our acquisition of the New Lincoln Lodge of approximately $414,000.

Income tax expense of approximately $43,000 and $170,000 for years ended December 31, 2009 and 2008, respectively, is related to the amortization of purchased goodwill under Internal Revenue Code section 197. However, as a result of existing loss carry forwards no tax will actually be paid by the Company.

Net income for the year ended December 31, 2009, was approximately $440,000 compared to a net loss for the year ended December 31, 2008, of approximately $1,076,000, an increase of $1,516,000.

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Changes in Balance Sheet

The following table contains selected balance sheet items where the fluctuation from 2008 to 2009 was greater than 10%. For a complete balance sheet, please refer to page 30 of this 10-K.

	December 31, 2009	December 31, 2008	Increase/ (Decrease)	% Change
Cash and cash equivalents	$4,481,100	$1,266,315	$3,214,785	253.9%
Management, consulting and development receivables, net	$124,761	$258,811	$(134,050)	(51.8)%
Prepaid expenses and other	$541,958	$478,534	$63,424	13.3%
Restricted cash	$1,430,674	$1,155,596	$275,078	23.8%
Other assets	$1,357,160	$1,012,340	$344,820	34.1%
Notes payable to stockholders, net of current portion	$24,444	$34,626	$(10,182)	(29.4%)
Other liabilities	$746,074	$299,314	$446,760	149.3%
Income tax payable	$212,574	$170,007	$42,567	25.0%
Common stock and additional paid-in capital	$17,571,801	$14,766,967	$2,804,834	19.0%

Cash increased approximately $3,215,000 primarily due to cash generated by operations of approximately $1,892,000 as well as cash raised in a private sale of our stock in December 2009 which generated approximately $2,439,000 in additional cash net of offering costs. Please refer to the Cash Flow section of the Liquidity and Capital Resources section of this management discussion and analysis for a more thorough discussion of cash.

Management, consulting and development receivables decreased approximately $134,000 primarily due to additional reserves for potentially uncollectible accounts.

Prepaid expenses and other increased approximately $63,000 primarily due to primarily due to prepaid health insurance premiums.

Restricted cash increased approximately $275,000 due to additional deposits made as a result of refinancing one of our properties with HUD during in November 2009 as well as interest earned and additional deposits to HUD reserves for replacements.

Other assets increased approximately $345,000 as a result of reserves for future health insurance expenses as part of the self funded portion of our health insurance plan as well as cash reserved for our non-qualified deferred compensation plan. We maintain an equal liability for these assets. Capitalized financing costs associated with our HUD loans also are maintained as other assets and are being amortized over the life of the loans.

Notes payable, stockholder, net of current portion, decreased approximately $10,000 as a result of repayments of principal on the loan.

Other liabilities increased approximately $447,000 primarily as a result of reserves for future health insurance expenses as part of the self funded portion of our health insurance plan as well as cash reserved for our non-qualified deferred compensation plan. We maintain equal assets for these liabilities.

Income tax payable increased approximately $43,000 during 2009 in relation to the amortization of purchased goodwill under Internal Revenue Code section 197.

Common stock and additional paid-in capital increased approximately $2,805,000 as a result of capital raised during the private sale of our stock during December, 2009, and due to stock option and warrant compensation expense. Please refer to the Consolidated Statement of Stockholders Equity on page 32 of this 10-K for additional detail.

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Liquidity and Capital Resources

Our sources of cash consist primarily of cash provided by operations supplemented by small lines of credit when necessary. These sources have been sufficient to fund our continuing operations but have been historically insufficient to fund our acquisition growth strategy. Additionally, we incur significant legal, auditing and Sarbanes-Oxley Section 404 compliance costs necessary to continue as a public company. Although we have successfully integrated these costs into the cash flow from our operations, these costs have further limited our ability to grow through acquisitions.

We plan to improve liquidity by 1) refinancing debt where possible to obtain more favorable terms, 2) increasing facility occupancy, add additional management contracts and expand our home health operations and 3) engage financial advisors to assist the Company in identifying, evaluating and securing alternative capital, financing and investment sources to fund the Company s strategic business plan.

On December 7, 2009, at a special shareholder meeting, shareholders approved the sale of 1,400,000 shares of stock and warrants in a private placement. The offering consisted of Units with each Unit containing one share of the Company s common stock and one five-year warrant to purchase an additional share of common stock at $2.50 per share. Each Unit was priced at $2.00. The offering was not registered under the Securities Act of 1933 and was only sold in the United States pursuant to applicable exemptions from registration. As a result the Company raised approximately $2,439,000 after commissions and expenses. We plan to use the proceeds primarily for growth through acquisitions.

Overview

We had net working capital as of December 31, 2009 of approximately $2,658,000 as compared to negative net working capital of approximately $540,000 for the year ended December 31, 2008, an improvement of approximately $3,198,000. The improvement is a result of cash generated by operations and cash raised in our private offering.

On November 14, 2008, we established a $100,000 line of credit with Huntington National Bank to assist with cash flow. As of December 31, 2009, the entire line of credit was available for use in operations of the Company. We are currently working with our primary lender to increase our line of credit but there are no assurances we will be successful or that the increase can be obtained at favorable terms.

We have established a $191,000 line of credit using funds from our non-qualified deferred compensation plan. Members of this plan, which is only available to senior management, authorized the transfer of funds to establish the line of credit with interest accruing at 8%. We withdrew $191,000 from the deferred employee compensation plan (see note 15 to the consolidated financial statements) and deposited the funds into an interest bearing savings account. We intend to use the savings to fund temporary operating cash short falls. We repaid the withdrawn funds to the plan at the end of 2009 with interest that accrued at 8%. In January, 2010, we reestablished the line of credit from the non-qualified deferred compensation plan with same terms as 2009. The funds are presently used in the operations of the company.

Our properties are financed with loans secured by the Department of Housing and Urban Development (HUD). These loans restrict our use of the cash generated by the properties for purposes other than to fund the operations of the HUD financed property. In January and July each year, we are permitted to withdraw cash from these properties if a calculation of cash flow determines that the properties have generated cash in excess of what is needed to fund the expenses of the property in the short term. When the calculation indicates there is available cash, we withdraw the funds from the property and deposit them in an interest bearing checking account and hold them for future use in operations. There was approximately $928,000 of cash that was subject to these requirements representing approximately 20% of our total cash balance as of December 31, 2009.

In November 2008, we completed the acquisition of Hearth & Home of Van Wert as required by our forward purchase contract to acquire the outstanding partnership interest in Hearth & Home of Van Wert by October 2008. The cost of acquiring the partners interest was approximately $950,000 and was primarily satisfied with cash received at the closing of financing for Hearth & Care of Greenfield and with a note payable to the sellers of approximately $28,500 bearing interest of 5% due in November, 2010 a note payable to a seller of $112,500 that bears no interest but for which interest has been imputed at 5% resulting in a discount of approximately $8,400. Total notes payable to sellers are approximately $141,000.

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Notes Payable and Other Debt

For the year ended December 31, 2009 and the year ended December 31, 2008, we had notes payable and other debt outstanding of $17,433,408 and $17,732,169, respectively with weighted average interest rates of 6.7%. Approximately 5% of our debt is now at a variable interest rate compared to approximately 7% in 2008 as a result of refinancing loans that were previously at a variable interest rate to fixed interest rate loans. We project a change of 1% in interest rates could result in a change in interest expense of approximately $9,000 annually.

On June 26, 2008 we completed the refinancing of three assisted living properties known as Community s Hearth & Home. This refinancing replaced our adjustable rate demand taxable notes, series 2002 Bonds in the original principal amount of $4,200,000 obtained in 2002. Interest on the note was indexed at the LIBOR rate. We refinanced this debt with two HUD insured loans at a fixed interest rate of 6.65% with a 35 year amortization. The new financing consists of two loans, one for the two Springfield, Ohio properties and one for the Urbana, Ohio property. The new loans are in the amount of $1,863,800 and $2,142,700, respectively, and total $4,006,500. As a result of this refinancing, in June 2008, we recognized the balance of the unamortized financing costs of approximately $106,000 from the 2002 Bond financing.

On July 24, 2008, we completed refinancing our Assured Health Care loan in the original amount of approximately $820,000. This refinancing replaced $760,000 of our note payable to a stockholder leaving $60,000 still payable to the stockholder. Interest on the loan accrues at the Lender s Prime Commercial Rate plus 1.5% or 6.5% at the time of the loan closing and the monthly payments are $17,000 per month. The loan matures in 2013.

On July 29, 2008, we completed refinancing our Hearth & Care of Greenfield skilled nursing facility located in Greenfield, Ohio. This refinancing replaced our existing note payable in the amount of $1,412,000 and returned over $800,000 to the Company for cash utilized to complete the room additions and renovations of the property. Our new financing is a HUD insured loan at a fixed interest rate of 6.5% with a 30 year amortization. As a result of this refinancing, in July, 2008, we recognized approximately $51,000 in expenses related to financing costs of the refinanced debt. As a result of this refinancing, the restricted certificate of deposit in the amount of approximately $217,000 was released and liquidated. Proceeds were used to repay a loan in the amount of $190,000 with the balance of the proceeds being used to supplement operating cash flow.

On October 17, 2008, we completed refinancing our corporate office building located in Springfield, Ohio. This refinancing replaces two loans totaling approximately $230,000 at the time of the refinancing. Our new financing is traditional bank mortgage debt in the amount of $300,000. Repayment terms include level principal payments with a nine year amortization and variable interest indexed to the LIBOR rate plus 3% or approximately 7.4% at the time of the loan closing. Approximately $70,000 in loan proceeds was used for renovations to the office building.

On November 9, 2009, we completed refinancing our Hearth & Home of Van Wert assisted living facility located in Van Wert, Ohio. This refinancing replaced our existing note payable in the initial amount of $2,041,000. Our new financing is a HUD insured loan at a fixed interest rate of 5.1% with a 35 year amortization in the amount of $2,181,200. As a result of this refinancing, in November, 2009, we recognized approximately $48,000 in expenses related to financing costs of the refinanced debt.

Note Payable to Stockholder

For the year ended December 31, 2009 and the year ended December 31, 2008 note payable to stockholder was \$33,876 and \$44,058, respectively, with interest rates of approximately 5.0%. The loan originally matured in May 2007 but was extended to May 2009. However, in July, 2008, we completed refinancing \$760,000 of this loan with a bank loan leaving a balance due on our note payable to stockholder of \$33,876 as of December 31, 2009. In August 2009, the loan was extended to December 2010.

Cash Flow

Activities that affect our cash flows from operations are numerous. For instance, the acuity of our assisted living residents affects the monthly fees we charge them and the fees increase in relation to the level of services required to take care of them. In the skilled nursing facilities, patients who are covered under Medicare are paid higher reimbursement rates than patients who are covered under Medicaid. Also, the length of stay in our nursing homes affects cash flow.

Our cash requirements are satisfied primarily with cash generated from operating activities and debt. Our cash flow is dependent on our ability to collect accounts receivable in a timely manner. Accounts receivable collections in the health care industry can be very complex processes. At December 31, 2009, approximately 81% of our skilled nursing facility residents were covered by the Medicaid and Medicare programs. These are reliable payment sources which make our likelihood of collection very high. However, the time it takes to receive payment on a claim from these sources can be long. On average, accounts receivable were outstanding nearly 27 days before collection as of December 31, 2009 which is lower than December 31, 2008 days of 33. The status of collection efforts is monitored very closely by our senior management. (See additional discussion under Patient Care Receivables in the Critical Accounting Policies and Use of Estimates on page 24.)

December 31, 2009 as compared to December 31, 2008

During 2009, we satisfied our cash requirements primarily with cash generated from operating activities. Our cash was used principally for the operations of our properties. Cash provided by operating activities was approximately $1,892,000 as a result of decreased accounts receivable and increased other liabilities offset by increased prepaid expenses, other assets and decreased accounts payable and accrued expenses.

Net cash used in investing activities for the years ended December 31, 2009 and December 31, 2008 was approximately $847,000 and $1,419,000, respectively. For the year ended December 31, 2009, cash used in investing activities was primarily the result of increasing restricted cash to satisfy HUD s requirement for reserves for replacement of fixed assets and the purchase of property, plant and equipment for approximately $573,000. For the year ended December 31, 2008, cash used in investing activities was primarily the result of satisfying the forward purchase contract for approximately $941,000 and the purchase of property, plant and equipment for approximately $477,000.

For the year ended December 31, 2009, net cash provided by financing activities was approximately $2,170,000 and was primarily the result of raising approximately $2,439,000 in a private sale of our stock offset by routine principal payment on our loans. Other activity included proceeds from notes payable generated through refinancing one of our properties with HUD in November 2009. The proceeds were used to repay the principal on the former loan.

For the year ended December 31, 2008, net cash provided by financing activities was approximately $1,319,000 and was the result of cash received upon refinancing certain loans offset by repayments on the original loans. Repayments on note payable to stockholder were the result of refinancing the loan with traditional bank debt. Repayments on notes payable were the result of refinancing existing debt as well as routine debt repayments.

Inflation

The resident fees that we receive from the properties that we own or lease and the management fees we receive from the facilities we manage for third parties are our primary sources of income at this time. This source of income is affected by the monthly rental rates and the occupancy rates. The monthly rental rates are dependent on various factors including competition, market conditions and the locations of the properties. We evaluate and prepare budgets for our properties on an annual basis. At that time, we assess the impact of inflation on the operations of the properties, including but not limited to, budgeting increases for real estate taxes, utilities, employee expenses, food and supplies. However, some factors are difficult to quantify, such as potential increases in employee expenses as a result of the current shortage of qualified nurses, and there can be no assurance that the resident rental rates will increase or that costs will not increase due to inflation or other causes. We strive to be the provider of choice in each of our markets and to charge market or better than market rates.

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Critical Accounting Policies and Use of Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We base our estimates on historical experience, business knowledge and on various other assumptions that we believe to be reasonable under the circumstances at the time. Actual results may vary from our estimates. These estimates are evaluated by management and revised as circumstances change. We believe that the following are critical accounting policies:

Our financial statements reflect consolidation with entities in which we have determined to have a controlling financial interest

Arrangements with other business enterprises are evaluated, and those in which AdCare is determined to have controlling financial interest are consolidated. ASC Topic 810, Consolidation addresses the consolidation of business enterprises to which the usual condition of consolidation (ownership of a majority voting interest) does not apply. This interpretation focuses on controlling financial interests that may be achieved through arrangements that do not involve voting interests. It concludes that, in absences of clear control through voting interests, a company s exposure (variable interest) to the economic risks and potential rewards from the variable interest entity s assets and activities are the best evidence of control. If an enterprise holds a majority of the variable interests of an entity, it would be considered the primary beneficiary. The primary beneficiary is required to consolidate the assets, liabilities and results of operations of the variable interest entity in its financial statements.

AdCare has evaluated its relationship with Community s Hearth & Home and Hearth & Home of Urbana and has determined that these entities are variable interest entities and that AdCare holds variable interests in these entities. Furthermore, the Company determined that it is the primary beneficiary of these variable interests and that the entities are required to be consolidated in accordance with ASC Topic 810, Consolidation.

Patient Care Receivables

Patient care receivables are reported net of allowances for doubtful accounts. The administrators and managers of our properties evaluate the adequacy of the allowance for doubtful accounts on a monthly basis, and adjustments are made if necessary. On an ongoing basis, we have experienced very few collection problems and do not anticipate significant increases unless the economy where our properties are located encounters a severe down trend. Approximately 80% of our revenue in our nursing facilities is derived from Medicare and Medicaid qualifying residents. Charges to these payers are evaluated monthly to insure that revenue is recorded properly and that any adjustments necessitated by our contractual arrangement with these payers are recorded in the month incurred.

Long-lived Assets and Goodwill

We account for our long-lived assets of property, plant and equipment other than goodwill by applying the provisions of Codification topic 350 *Intangibles Goodwill and Other*. We review the value of our long-lived assets on an annual basis or sooner if required for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The determination and measurement of an impairment loss under these accounting standards requires the significant use of judgment and estimates based on many factors which can be subject to changing circumstances. Some of the changing circumstances could be market conditions, interest rates, competition and the economy.

Beginning January 1, 2002, we accounted for goodwill under the provisions of Codification topic 350 *Intangibles Goodwill and Other*, which requires us to no longer amortize goodwill. We now test goodwill on an annual basis for the purpose of assessing the potential of its impairment and making the appropriate adjustments if required. We no longer amortize costs associated with the acquisition of certificates of need required in Ohio for nursing homes.

Incentive Stock Option Plan

Through December 31, 2005, we accounted for our employees stock option plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. No stock based employee compensation is reflected in net income, as all options granted under our plans are at an exercise price equal to the market value of the underlying common stock as of the date of grant. There had been no market for our common stock; accordingly, the exercise price established at time of grant was based on the judgment of the option committee.

Effective January 1, 2006, we began accounting for options by applying the fair value recognition provisions of Codification topic 718, *Stock Compensation*, the effects of which are included in our financial statements for the year ended December 31, 2008 and 2009.

Recent Accounting Pronouncements

Accounting Standards Codification

During 2009, we adopted Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (as codified in the ASC Topic 105, *Generally Accepted Accounting Principles*). SFAS 168 makes the FASB Accounting Standards Codification (ASC) the single source of authoritative accounting principles generally accepted in the United States (GAAP). The ASC does not change GAAP, but introduces a new structure, organized by accounting topics, designed to simplify user access to all authoritative literature related to a particular topic. All prior authoritative documents were superseded and all other accounting literature not included in the ASC is considered nonauthoritative. As a result, prior GAAP references are no longer applicable. Where applicable, the Company has replaced prior GAAP references with the new ASC references.

Revenue Recognition

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition Multiple-Deliverable Revenue Arrangements*, which amends ASC Topic 605, *Revenue Recognition*. This ASU requires companies to allocate revenue in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of value is not available. This ASU is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Postretirement Benefit Plans

During 2009, the Company adopted the FASB Staff Position (FSP) No. FAS 132(R)-1 *Employers Disclosures about Postretirement Benefit Plan Assets* (as codified in the ASC Topic 715, *Compensation - Retirement Benefits*). This FSP requires more detailed disclosures about employers plan assets in a defined benefit pension or other postretirement plan, including employers investment strategies, major categories of plan assets, and concentrations of credit risk within plan assets and inputs and valuation techniques used to measure the fair value of plan assets. This FSP also requires disclosure of the effects of measurements on changes in plan assets for the period for fair value measurements using significant unobservable inputs. As this FSP is only disclosure-related, the adoption does not impact the Company s results of operations, financial position, or cash flows. In addition, AdCare does not offer this type of plan at this time.

Business Combinations

Effective January 1, 2009, we adopted ASC Topic 805, *Business Combinations* . These new standards significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. This standard requires companies to recognize, with certain exceptions, all assets acquired and liabilities assumed and noncontrolling interests in acquisitions of less than a 100 percent controlling interest at their acquisition-date fair value; recognize contingent consideration at the acquisition-date fair value, with subsequent changes in fair value recorded in earnings; recognize preacquisition loss and gain contingencies at their acquisition-date fair values; capitalize in-process research and development acquired at fair value; expense as incurred, acquisition-related transaction costs; generally expense acquisition-related restructuring costs; and recognize changes in existing income tax valuation allowances and tax uncertainty accruals that result from a business combination transaction as adjustments to income tax expense.

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We did not enter into any business combination transactions during 2009; and therefore, the effect of implementing these standards will be dependent upon the nature and extent of future business combination transactions.

ASC Topic 810, *Consolidation* establishes new accounting and disclosure reporting requirements for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The new standard requires that a noncontrolling interest in a consolidated subsidiary be recorded as a separate component of equity. Gains or losses are not recognized on sales; they are recorded as increases or decreases in paid-in-capital, unless there is a loss of control. The adoption of this standard does not have a material effect on our consolidated results of operations, financial position, or cash flows.

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, *Accounting for Transfers of Financial Assets* (as codified in the ASC Topic 860, *Transfers and Servicing*). SFAS 166 eliminates the exceptions for qualifying special-purpose entities (QSPE) from the consolidation guidance and clarifies the requirements for isolation and limitations on portions of financial assets eligible for sale accounting. In addition, SFAS 166 requires enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. SFAS 166 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact that adoption will have on its consolidated financial statements. The adoption of SFAS 166 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

n June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)* (as codified in the ASC Topic 810, *Consolidation*). SFAS 167 revises guidance on when a variable interest entity (VIE) should be included in consolidated financial statements. SFAS 167 replaces the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a VIE with an approach focused on indentifying which reporting entity has the power to direct the activities of the VIE that most significantly impact the entity s economic performance. SFAS 167 also requires additional disclosures about a reporting entity s involvement in VIEs. SFAS 167 is effective for interim and annual reporting periods beginning after November 15, 2009. The adoption of SFAS 167 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Fair Value Measurements and Disclosures

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (as codified in the ASC Topic 820, *Fair Value Measurements and Disclosures*). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. SFAS 157 also requires fair value measurements to be disclosed by level within that hierarchy.

The Company has adopted the provisions of ASC Topic 820, *Fair Value Measurements and Disclosures*. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The topic provides guidance on various methods used to measure fair value including market, income and cost approaches. These approaches require the Company to utilize certain assumptions about risk. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company attempts to utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the inputs used in the valuation techniques, the Company is required to classify the inputs under a fair value hierarchy that ranks the inputs based on their quality and reliability. Financial instruments carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 Quoted market prices in active markets for identical assets or liabilities.

Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 Unobservable inputs that are not corroborated by market data.

The estimated fair values of the Company s short-term financial instruments, including cash and cash equivalents, receivables and payables arising in the ordinary course of business, and current portions of debt, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. The Company does not have any other financial instruments measured at fair value on a recurring basis that require further disclosure. On January 1, 2009, we adopted the remaining provisions of ASC 820 as it relates to non-financial assets and liabilities that are not recognized

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or disclosed at fair value on a recurring basis. The adoption of ASC 820 did not materially impact our consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, *Fair Value Measurements and Disclosures Measuring Liabilities at Fair Value*, which amends ASC Topic 820, *Fair Value Measurements and Disclosure*. ASU 2009-05 clarifies the measurement of liabilities at fair value in the absence of observable market information. ASU 2009-05 is effective for the Company s first reporting period beginning January 1, 2010. The Company is currently evaluating the impact that adoption will have on its financial statements.

Subsequent Events

During 2009, we adopted SFAS No. 165, Subsequent Events, (as codified in ASC Topic 855, *Subsequent Events*). SFAS 165 clarifies the accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 165 also requires management to disclose the date through which subsequent events were evaluated and whether that date represents the date the financial statements were issued or were available to be issued. The adoption of SFAS 165 did not have a material effect on our consolidated results of operations, financial position, or cash flows.

In February 2010, the FASB issued Accounting Standards Update (ASU) 2010-09, *Subsequent Events* which amends ASC Topic 855, *Subsequent Events*. The purpose of the amendment is to alleviate potential conflicts between Subtopic 855-10 requirements to disclose the date that the financial statements are issued which potentially conflicts with some of the Securities and Exchange Commission s guidance. The adoption of ASU 2010-09 did not have a material effect on our consolidated results of operations, financial position, or cash flows.

Financial Instruments Disclosures

Effective for the quarterly period ended June 30, 2009; we adopted ASC Topic 825, *Financial Instruments* . The topic requires disclosures about the fair value of financial instruments for interim reporting periods in addition to annual financial statements. The adoption of this standard does not have a material effect on our consolidated results of operations, financial position, or cash flows.

SEC requirement for Interactive Data to Improve Financial Reporting

In January 2009, the Securities and Exchange Commission (SEC) issued Release No. 33-9002, Interactive Data to Improve Financial Reporting. The final rule requires us to provide our financial statements and schedules to the SEC and our website in interactive data format using the eXtensible Business Reporting Language (XBRL). The rule was adopted to improve the ability of financial statement users to access and analyze financial data. The SEC adopted a phase-in schedule under which we will be required to submit filings using XBRL beginning with our quarterly report for the second quarter of 2011. Compliance with this rule will have no impact upon our consolidated results of operation, financial position, or cash flows.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not Required

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Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED

PUBLIC ACCOUNTING FIRM

To the Stockholders

AdCare Health Systems, Inc.

and Subsidiaries

Springfield, Ohio

We have audited the accompanying consolidated balance sheet of AdCare Health Systems, Inc and Subsidiaries as of December 31, and 2008, and the related consolidated statements of operations, stockholders   equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AdCare Health Systems, Inc and Subsidiaries as of December 31, and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted as of January 1, 2009 Statement of Financial Accounting Standards (FASB) No. 160, *Noncontrolling Interests in Consolidated Financial Statements*

(as codified in ASC Topic 810, *Consolidation*.)

As discussed in Note 2 to the consolidated financial statements, the Company is subject to certain risks and uncertainties.

/s/BATTELLE & BATTELLE LLP

Dayton, Ohio

March 31, 2010

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	December 31, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash	$ 4,481,100	$ 1,266,315
Accounts receivable:		
Long-term care resident receivables, net	1,838,560	2,008,847
Management, consulting and development receivables, net	124,761	258,811
Advances and receivables from affiliates	16,407	17,635
Prepaid expenses and other	541,958	478,534
Total current assets	7,002,786	4,030,142
Restricted cash	1,430,674	1,155,596
Property and equipment, net	16,445,028	16,772,660
License, net	1,189,307	1,189,307
Goodwill	2,679,482	2,679,482
Other assets	1,357,160	1,012,340
Total assets	$ 30,104,437	$ 26,839,527
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of notes payable and other debt	$ 698,504	$ 713,323
Current portion of notes payable to stockholder	9,432	9,432
Accounts payable	1,039,422	1,009,002
Accrued expenses	2,597,151	2,838,407
Total current liabilities	4,344,509	4,570,164
Notes payable and other debt, net of current portion	16,701,028	16,974,788
Notes payable to stockholder, net of current portion	24,444	34,626
Other liabilities	746,074	299,314
Income tax payable	212,574	170,007
Total liabilities	22,028,629	22,048,899

Stockholders' equity:		
Preferred stock, no par value; 500,000 shares authorized;		
no shares issued or outstanding	-	-
Common stock and additional paid-in capital, no par value;		
14,500,000 shares authorized; 5,360,007 shares issued and outstanding	17,571,801	14,766,967
Accumulated deficit	(9,805,249)	(10,245,532)
Total stockholders' equity	7,766,552	4,521,435
Noncontrolling interest in subsidiaries	309,256	269,193
Total equity	8,075,808	4,790,628
Total liabilities and stockholders' equity	$ 30,104,437	$ 26,839,527

See notes to consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 2009	2008
Revenues:		
Patient care revenues	$24,834,831	$23,008,754
Management, consulting and development fee revenue	1,856,269	1,784,540
Total revenue	26,691,100	24,793,294
Expenses:		
Payroll and related payroll costs	15,371,150	15,649,862
Other operating expenses	8,626,987	8,248,157
Depreciation and amortization	918,851	882,900
Total expenses	24,916,988	24,780,919
Income from Operations	1,774,112	12,375
Other Income (Expense):		
Interest income	5,472	23,287
Interest expense, others	(1,207,749)	(1,265,622)
Interest expense, related parties	(2,177)	(36,446)
Other (expense) income	(46,745)	4,200
Total other (expenses)	(1,251,199)	(1,274,581)
Gain on Acquisition	-	413,954
Income (Loss) Before Income Taxes	522,913	(848,252)
Income Tax (Expense)	(42,567)	(170,007)
Net Income (Loss)	480,346	(1,018,259)
Net (Income) Attributable to Noncontrolling Interests	(40,063)	(57,919)
Net Income (Loss) Attributable to AdCare Health Systems	$ 440,283	$(1,076,178)
Net Income (Loss) Income Per Share, Basic:	0.11	$ (0.28)
Net Income (Loss) Income Per Share, Diluted:	0.10	$ (0.28)
Weighted Average Common Shares Outstanding,		

Basic	3,917,286	3,786,129
Diluted	4,425,631	3,786,129

See notes to consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

	Total	Accumulated Deficit	Common Stock and Additional Paid-in Capital	Noncontrolling Interest
Balance, January 1, 2008:	$5,149,672	$(9,169,354)	$14,063,956	$255,070
Warrants issued in connection with consulting agreement	61,559	-	61,559	-
Stock option compensation expense	641,004	-	641,004	-
Purchase of minority interest investment	448	-	448	-
Net loss	(1,076,178)	(1,076,178)	-	-
Distribution from noncontrolling interest	(43,796)	-	-	(43,796)
Net income attributable to noncontrolling interest	57,919	-	-	57,919
Balance, December 31, 2008	$4,790,628	$(10,245,532)	$14,766,967	$269,193
Warrants issued in connection with consulting agreement	15,908	-	15,908	-
Stock option compensation expense	320,414	-	320,414	-
Stock issuance	30,000	-	30,000	-
Stock issued in private stock offering	2,765,000	-	2,765,000	-
Private stock offering costs, net	(326,488)	-	(326,488)	-
Net income	440,283	440,283	-	-

Net income attributable to noncontrolling interest	40,063	-	-	40,063
Balance, December 31, 2009	$8,075,808	$(9,805,249)	$17,571,801	$309,256

See notes to consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2009	2008
Cash flows from operating activities:		
Net Income (Loss) inclusive of noncontrolling interests	$ 480,346	$ (1,018,259)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	918,851	882,900
Warrants issued for services	43,693	150,831
Stock option compensation expense	320,414	641,004
Note receivable forgiveness exchanged for rent	-	9,000
Gain on acquisition	-	(413,952)
Changes in certain assets and liabilities:		
Accounts receivable	305,565	111,805
Prepaid expenses and other	(110,546)	(90,851)
Other assets	(344,820)	(24,982)
Accounts payable and accrued expenses	(210,836)	300,635
Income tax liability	42,567	170,007
Other liabilities	446,760	(278,696)
Net cash provided by operating activities	1,891,994	439,442
Cash flow from investing activities:		
(Increase) decrease in restricted cash	(275,078)	47,829
Forward purchase contract buyout	-	(941,289)
Distribution to minority shareholders	-	(50,000)
Purchase of minority interest investment	-	(448)
Proceeds from sale of assets, net	1,286	2,500
Purchase of property plant and equipment	(573,168)	(477,092)
Net cash used in investing activities	(846,960)	(1,418,500)

See notes to consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

	Year Ended December 31, 2009	2008
Cash flows from financing activities:		
Proceeds from notes payable	$ 2,088,000	$ 6,469,171
Stock issued	30,000	-
Stock issued in private stock offering	2,765,000	-
Private stock offering costs	(326,488)	-
Prepaid financing costs	108,338	159,130
Repayment of note payable to stockholder	(10,182)	(760,000)
Repayment on notes payable	(2,484,917)	(4,549,553)
Net cash provided by financing activities	2,169,751	1,318,748
Net Increase in Cash	3,214,785	339,690
Cash, Beginning	1,266,315	926,625
Cash, Ending	$ 4,481,100	$ 1,266,315
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest	$ 1,122,385	$ 1,012,813
Supplemental Disclosure of Non-Cash Activities:		
Rent in exchange of note receivable repayment	$ -	$ 9,000
Acquisition of assets in exchange for note forgiveness	$ -	$ 2,740,584
Purchase of business assets in exchange for debt	$ -	$ 266,300

See notes to consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

AdCare Health Systems, Inc. and Subsidiaries (AdCare or the Company), formerly Passport Retirement, Inc., is a developer, owner and manager of retirement communities, assisted living facilities, skilled nursing facilities and home health care services in the state of Ohio. The Company manages fourteen facilities, comprised of six skilled nursing facilities, six assisted living facilities and two independent living/senior housing facilities, totaling approximately 824 units. The Company also acquired a home health care business in 2005 and provides consulting and management services to various long-term care providers.

During December 1995, AdCare entered into a joint venture agreement with a hospital to build assisted living facilities in Ohio. AdCare subsequently formed Hearth & Home of Ohio, Inc. (Hearth & Home) to hold AdCare s 50% interest in this joint venture. Hearth & Home and the hospital then formed Community s Hearth & Home, Ltd. (Community s Hearth & Home), a limited liability company. This joint venture currently operates three Hearth & Home assisted living facilities.

In 1999, AdCare formed Hearth & Care of Greenfield, LLC (Greenfield), which owns and operates a 50-bed nursing facility. Greenfield is a wholly-owned subsidiary of AdCare.

In 1999, AdCare formed Hearth & Home of Van Wert LLC. (Van Wert), which owns and operates an assisted living facility. In, July 2007, AdCare acquired an additional .4% of Van Wert for a total interest of 49.2% through October 2008. AdCare had agreed to offer to purchase the remaining 50.8% interests. In October of 2008, AdCare purchased the minority interest in Van Wert to obtain 100% ownership, as set forth in the forward purchase agreement (see Note 6).

In 2001, AdCare formed Hearth & Home of Vandalia, Inc. (Vandalia), which owns and operates an assisted-living facility. AdCare holds a 100% interest in Vandalia.

In 2002, AdCare formed The Pavilion Care Center, LLC (The Pavilion), which owns and operates a 50-bed nursing facility. The Pavilion is a wholly-owned subsidiary of Hearth & Home of Ohio, Inc.

In March 2003, AdCare entered into a lease agreement with Covington Realty, LLC to lease the Covington Care Center (Covington), a 94-bed nursing facility.

In January 2005, AdCare acquired Assured Health Care, Inc. (Assured), which is a home healthcare agency.

Effective April 1, 2008, AdCare acquired 99% of The New Lincoln, Ltd. The sole asset of The New Lincoln, Ltd. is the New Lincoln Lodge Retirement Residence which is a 49 unit senior living residence located in Columbus, Ohio (see Note 16).

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation

The accompanying financial statements are prepared in conformity with accounting principles generally accepted in the United States (GAAP) in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 105, Generally Accepted Accounting Principles.

Principles of Consolidation

During 2009, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (as codified in the ASC Topic 810, *Consolidation*). ASC Topic 810 establishes accounting and reporting standards for a noncontrolling interest in a subsidiary in consolidated financial statements and for the deconsolidation of a subsidiary. ASC Topic 810 clarifies that a controlling interest in a subsidiary is an ownership interest in the consolidated entity and must be reported as equity in the consolidated financial statements, rather than in the liability or mezzanine section between liabilities and equity. ASC Topic 810 also requires consolidated net income be reported at amounts that include both the parent and the noncontrolling interest. The adoption of ASC Topic 810 did not have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, *Accounting for Transfers of Financial Assets* (as codified in the ASC Topic 860, *Transfers and Servicing*). SFAS 166 eliminates the exceptions for qualifying special-purpose entities (QSPE) from the consolidation guidance and clarifies the requirements for isolation and limitations on portions of financial assets eligible for sale accounting. In addition, SFAS 166 requires enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. SFAS 166 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact that adoption will have on its consolidated financial statements. The adoption of SFAS 166 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)* (as codified in the ASC Topic 810, *Consolidation*). SFAS 167 revises guidance on when a variable interest entity (VIE) should be included in consolidated financial statements. SFAS 167 replaces the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a VIE with an approach focused on indentifying which reporting entity has the power to direct the activities of the VIE that most significantly impact the entity s economic performance. SFAS 167 also requires additional disclosures about a reporting entity s involvement in VIEs. SFAS 167 is effective for interim and annual reporting periods beginning after November 15, 2009. The adoption of SFAS 167 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of Consolidation *(continued)*

Presented below are the carrying amount and classification of the assets and liabilities of our variable interest entities as of December 31, 2009.

	December 31, 2009
Current assets	$ 487,164
Other Assets	526,556
Property and equipment, net	3,797,700
Total assets	$ 4,811,420
Current liabilities	$ 278,383
Notes payable, net of current portion	3,933,822
Other Liabilities	37,505
Total liabilities	$ 4,249,710
Owner s equity	561,710
Total liabilities and equity	$ 4,811,420

The assets of the variable interest entities are pledged as security towards a Department of Housing and Urban Development secured loan and consequently restricted as to use. The Department of Housing and Urban Development secured loan is a non-recourse loan. As the primary beneficiary of the variable interest entities, the Company could be required to provide financial support by providing additional operating cash for example if the need arises as a result of a significant downturn in performance.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported results of operations during the reporting period. Examples include allowance for doubtful accounts, contractual allowances for Medicare and Medicaid, deferred taxes, tax valuation allowance and impairment of intangibles. Actual results could differ materially from those estimates.

Statement of Cash Flows

For the purposes of reporting cash flows, the Company considers all short-term investments with original maturities less than three months, which are readily convertible into cash, to be cash equivalents.

Patient Care Receivables and Revenues

Patient care accounts receivable and revenues for the Company are recorded in the month that services are provided. For private patients, accounts receivable with invoice dates greater than 30 days are considered delinquent and are charged interest of 1.5% per month.

The Company provides services to certain patients under contractual arrangements with the Medicare and Medicaid programs. Amounts paid under these contractual arrangements are subject to review and final determination by the appropriate government authority or its agent. In the opinion of management, adequate provision was made in the consolidated financial statements for any adjustments resulting from the respective government authorities review.

NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Patient Care Receivables and Revenues (continued)

Contractual adjustments for the Medicare and Medicaid programs are recognized in the month that the related revenues are recorded. These contractual adjustments represent the difference between established rates and the amounts estimated to be reimbursable by Medicare and Medicaid. Differences between these estimates and amounts subsequently determined are recorded as additions to or deductions from contractual adjustments in the period such determination is made. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

Potentially uncollectible patient accounts are provided for on the allowance method based on management s evaluation of outstanding accounts receivable at year-end and historical experience. For the years ended December 31, 2009 and 2008, management recorded an allowance for uncollectible accounts estimated at approximately $156,000 and $79,000, respectively.

Management, Consulting and Development Fee Receivables and Revenue

Management, consulting and development fee receivables and revenue are recorded in the month that services are provided. For the years ended December 31, 2009 and 2008, management recorded an allowance for uncollectible accounts estimated at approximately $120,000 and $27,500 respectively.

Property and Equipment

Property and equipment are stated at cost. Expenditures for major improvements are capitalized. Depreciation commences when the assets are placed in service. Maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to expense as incurred. Upon disposal of assets, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in income. Depreciation is recorded on a straight-line basis over the estimated useful lives of the respective assets.

Licenses

The Company has capitalized the cost of acquiring operating licenses in connection with the acquisitions of its two skilled nursing facilities The Pavilion and Hearth & Care of Greenfield. In accordance with Codification Topic 350 *Intangibles Goodwill and Other*, the licenses are tested for impairment annually. The fair value of the operating licenses for the years ended December 31, 2009 and 2008 exceeded the carrying amount; therefore, no impairment loss was recognized. The fair value of the operating licenses was estimated using the present value of future cash flows. For the years ended December 31, 2009 and 2008, the total carrying amount of the operating licenses was approximately $1,200,000. The operating licenses are tested for impairment in December of each year.

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. The provision for income taxes included in the accompanying consolidated statements of income was computed by applying statutory rates to income before income taxes. Income taxes are allocated to each company based on earnings of each company.

Deferred income taxes are recognized for the tax consequences in future years of temporary differences between the financial reporting and tax basis of assets and liabilities of each period-end based on enacted tax laws and statutory tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense represents the taxes currently payable and the net change during the period in deferred tax assets and liabilities.

During 2007, the Company adopted new authoritative guidance related to the accounting for uncertain tax positions. The new guidance prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. The adoption of this new guidance did not have a material impact on the Company s results of operations, financial position, or cash flows.

Segments

For the years ended December 31, 2009 and 2008, the Company operated in two segments: management and facility based care and home based care. The management and facility based care segment provides services to individuals needing long term care in a nursing home or assisted living setting and management of those facilities. The home based care segment provides home health care services to patients while they are living in their own homes. All the Company s revenues and assets are within the State of Ohio.

	Manage- ment and	Home	(Amounts in 000s)

	Facility Based Care	Based Care	Total Segments	Cor-porate	Total
Year ended December 31, 2009:					
Net Revenue	$25,545	$3,055	$28,600	$(1,909)	$26,691
Net Profit	19	421	440	-	440
Total Assets	27,451	2,653	30,104	-	30,104
Capital Spending	573	-	573	-	573
Year ended December 31, 2008:					
Net Revenue	$23,782	$2,804	$26,586	$(1,793)	$24,793
Net Profit	(1,252)	176	(1,076)	-	(1,076)
Total Assets	24,294	2,545	26,839	-	26,839
Capital Spending	468	9	477	-	477

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentrations of Credit Risk

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and notes and accounts receivable.

Cash and cash equivalents

The Company maintains its cash with financial institutions. From time to time, these balances exceed the federally insured limits. These balances are maintained with high quality financial institutions which management believes limits the risk. On October 3, 2008 the Emergency Economic Stabilization Act was passed raising the covered limit to $250,000 per depositor. In addition, our primary financial institution participated in the FDIC Transaction Account Guarantee Program, which provides unlimited coverage. As a result, for the years ended December 31, 2009 and 2008 no bank account balances were in excess of the federal depository insurance coverage limit.

Notes and Accounts Receivable

Notes and accounts receivable are recorded at net realizable value. The Company records interest income on interest-bearing loans using an appropriate rate of interest over the life of the loan.

Interest income accruals are suspended for interest-bearing loans receivable that are in default during the period of time that collection is uncertain. Payments received on non-accrual loans are first applied against any accrued interest balance outstanding. Once collection is considered to be certain, interest income accruals are resumed.

The Company performs ongoing evaluations of its residents and significant third party payers with which they contract, generally not requiring collateral. Management believes that credit risk with respect to accounts receivable is limited based on the stature and diversity of the third party payers with which they contract. The Company maintains an allowance for doubtful accounts which management believes is sufficient to cover potential losses.

Delinquent notes and account receivable are charged against the allowance for doubtful accounts once likelihood of collection has been determined. Notes and accounts receivable are considered to be past due and placed on delinquent status based on contractual terms, as well as how frequently payments are received, on an individual account basis.

Restricted Cash

The Regulatory Agreement established with the financing secured through the Department of Housing and Urban Development (HUD) for The Pavilion, Hearth & Home of Vandalia, Community s Hearth & Home, Hearth & Home of Urbana, Lincoln Lodge, Hearth & Care of Greenfield and Hearth & Home of Van Wert requires monthly escrow deposits for taxes, insurance and replacement of project assets. For the years ended December 31, 2009 and 2008, these deposits were $1,234,640 and $926,700 respectively. These facilities also agreed to Fair Housing Administration (FHA) restrictions as to rental charges, operation policies and expenditures, and distributions to its member.

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Restricted Cash (continued)

In 2008, the Company agreed to deposit $60,000 in an interest bearing CD with The Huntington National Bank as collateral for a loan associated with Assured Home Health. The CD was released from restriction and converted to cash in July 2009.

In the State of Ohio, Nursing Homes are required to maintain a savings account for the use of the residents to deposit their personal funds. The Company maintains such accounts for their nursing home residents with an offsetting liability as these funds are payable to the residents on demand. For the years ended December 31, 2009 and 2008, the balance in these accounts was approximately $63,800 and $53,300 respectively.

Lincoln Lodge collects security deposits on their units. This cash is held in a separate account as required. For the years ended December 31, 2009 and 2008, the balance in this account was approximately $38,700 and $28,200 respectively.

Goodwill

Effective January 1, 2003, the Company adopted Codification Topic 350, *Intangibles Goodwill and Other*. Codification topic 350, *Intangibles Goodwill and Other* requires, among other things that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition Codification Topic 350, *Intangibles Goodwill and Other* requires that the Company identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life will be tested for impairment in accordance with the guidance in Codification Topic 350, *Intangibles Goodwill and Other*. The principal effect of the adoption of Codification Topic 350, *Intangibles Goodwill and Other* was to eliminate amortization of the Company s indefinite lived intangibles. Goodwill is tested for impairment in accordance with Codification Topic 350, *Intangibles Goodwill and Other* in the fourth quarter of each year. Based on the Company s impairment test, the Company determined that no impairment of goodwill existed at December 31, 2009. Goodwill is part of our Management and Facility Based Care segment.

In November, 2008, the Company completed a forward purchase contract to acquire the outstanding partnership interest in Hearth & Home of Van Wert. The value of the forward purchase contract was approximately $900,000. The Company paid approximately $941,000 to satisfy the contract resulting in the acquisition of an additional $41,000 in goodwill.

Impairment of Long-Lived Assets

The Company accounts for long-lived assets in accordance with the provisions of Codification Topic 360, *Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

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NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Advertising

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2009 and 2008 were approximately $319,100 and $284,000, respectively.

Fair Value of Financial Instruments

The respective carrying value of certain on-balance sheet financial instruments approximated their fair value. These instruments include cash and cash equivalents, accounts receivable, notes and loans receivable, notes and loans payable, lines of credit, accounts payable and accrued expenses. Fair values were assumed to approximate carrying values for these financial instruments since they are short-term in nature and their carrying amounts approximate fair values, they are receivable or payable on demand, or the interest rates earned and/or paid approximate current market rates.

Earnings per Share

Codification Topic 260, *Earnings Per Share* requires the presentation of basic and diluted earnings per share. Basic earnings per share exclude any dilutive effects of options, warrants and convertible securities and is computed using the weighted average number of common shares outstanding. Earnings available to common stockholders include preferential distributions to Members in a manner similar to the treatment of dividends to preferred stockholders. Diluted earnings per share reflects the potential dilution if securities or other contracts to issue common units were exercised or converted into common units.

Accounting Standards Codification

During 2009, we adopted Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (as codified in the ASC Topic 105, *Generally Accepted Accounting Principles*). SFAS 168 makes the FASB Accounting Standards Codification (ASC) the single source of authoritative accounting principles generally accepted in the United States (GAAP). The ASC does not change GAAP, but introduces a new structure, organized by accounting topics, designed to simplify user access to all authoritative literature related to a particular topic. All prior authoritative documents were superseded and all other accounting literature not included in the ASC is considered nonauthoritative. As a result, prior GAAP references are no longer applicable. Where applicable, the Company has replaced prior GAAP references with the new ASC references.

Revenue Recognition

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition Multiple-Deliverable Revenue Arrangements*, which amends ASC Topic 605, *Revenue Recognition*. This ASU requires companies to allocate revenue in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of value is not available. This ASU is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements *(Continued)*

Postretirement Benefit Plans

During 2009, the Company adopted the FASB Staff Position (FSP) No. FAS 132(R)-1 *Employers Disclosures about Postretirement Benefit Plan Assets* (as codified in the ASC Topic 715, *Compensation - Retirement Benefits*). This FSP requires more detailed disclosures about employers plan assets in a defined benefit pension or other postretirement plan, including employers investment strategies, major categories of plan assets, and concentrations of credit risk within plan assets and inputs and valuation techniques used to measure the fair value of plan assets. This FSP also requires disclosure of the effects of measurements on changes in plan assets for the period for fair value measurements using significant unobservable inputs. As this FSP is only disclosure-related, the adoption does not impact the Company s results of operations, financial position, or cash flows. In addition, AdCare does not offer this type of plan at this time.

Business Combinations

Effective January 1, 2009, we adopted ASC Topic 805, *Business Combinations* . These new standards significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. This standard requires companies to recognize, with certain exceptions, all assets acquired and liabilities assumed and noncontrolling interests in acquisitions of less than a 100 percent controlling interest at their acquisition-date fair value; recognize contingent consideration at the acquisition-date fair value, with subsequent changes in fair value recorded in earnings; recognize preacquisition loss and gain contingencies at their acquisition-date fair values; capitalize in-process research and development acquired at fair value; expense as incurred, acquisition-related transaction costs; generally expense acquisition-related restructuring costs; and recognize changes in existing income tax valuation allowances and tax uncertainty accruals that result from a business combination transaction as adjustments to income tax expense.

We have not entered into any business combination transactions during 2009; and therefore, the effect of implementing these standards will be dependent upon the nature and extent of future business combination transactions.

Consolidation

ASC Topic 810, *Consolidation* establishes new accounting and disclosure reporting requirements for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The new standard requires that a noncontrolling interest in a consolidated subsidiary be recorded as a separate component of equity. Gains or losses are not recognized on sales; they are recorded as increases or decreases in paid-in-capital, unless there is a loss of control. The adoption of this standard does not have a material effect on our consolidated results of operations, financial position, or cash flows.

Fair Value Measurements and Disclosures

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (as codified in the ASC Topic 820, *Fair Value Measurements and Disclosures*). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. SFAS 157 also requires fair value measurements to be disclosed by level within that hierarchy.

NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recently Adopted or Issued Accounting Pronouncements *(continued)*

Fair Value Measurements and Disclosures *(continued)*

The Company has adopted the provisions of ASC Topic 820, Fair Value Measurements and Disclosures . Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The topic provides guidance on various methods used to measure fair value including market, income and cost approaches. These approaches require the Company to utilize certain assumptions about risk. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company attempts to utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the inputs used in the valuation techniques, the Company is required to classify the inputs under a fair value hierarchy that ranks the inputs based on their quality and reliability. Financial instruments carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 Quoted market prices in active markets for identical assets or liabilities.

Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 Unobservable inputs that are not corroborated by market data.

The estimated fair values of the Company s short-term financial instruments, including cash and cash equivalents, receivables and payables arising in the ordinary course of business, and current portions of debt, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. The Company does not have any other financial instruments measured at fair value on a recurring basis that require further disclosure. On January 1, 2009, we adopted the remaining provisions of ASC 820 as it relates to non-financial assets and liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of ASC 820 did not materially impact our consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, *Fair Value Measurements and Disclosures Measuring Liabilities at Fair Value*, which amends ASC Topic 820, *Fair Value Measurements and Disclosure*. ASU 2009-05 clarifies the measurement of liabilities at fair value in the absence of observable market information. ASU 2009-05 is effective for the Company s first reporting period beginning January 1, 2010. The Company is currently evaluating the impact that adoption will have on its financial statements.

Subsequent Events

During 2009, we adopted Statement of Financial Accounting Standard (SFAS) No. 165, *Subsequent Events* (as codified in the ASC Topic 855, *Subsequent Events*). SFAS 165 clarifies the accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 165 also requires management to disclose the date through which subsequent events were evaluated and whether that date represents the date the financial statements were issued or were available to be issued. The adoption of SFAS 165 did not have a material effect on our consolidated results of operations, financial position, or cash flows. Refer to NOTE 18 SUBSEQUENT EVENTS for additional information.

Reclassification

Certain reclassifications have been made to the 2008 financial information to conform to the 2009 presentation.

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NOTE 2.

LIQUIDITY AND PROFITABILITY

The Company achieved a net income of approximately $440,000 and incurred a net loss of $1,076,000 for the years ended December 31, 2009 and 2008, respectively. The company has working capital of approximately $2,658,000 at December 31, 2009. The Company s ability to sustain profitable operations is dependent on continued growth in revenue and controlling costs.

Management s plans for sustaining liquidity and profitability in future years encompass the following:

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increase facility occupancy.

.

add additional management contracts.

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acquire existing cash flowing operations to expand our operations and branch out into other related areas of business.

Management believes that the actions that will be taken by the Company provide the opportunity for the Company to improve liquidity and sustain profitability. However, there can be no assurance that such events will occur.

NOTE 3.

PROPERTY AND EQUIPMENT

	Estimated Useful Lives (Years)	December 31, 2009	2008
Buildings and improvements	5 to 40	$15,989,300	$15,729,206
Equipment	2-10	3,084,940	2,776,999
Land	-	2,945,928	2,922,712
Furniture and fixtures	2-5	689,090	642,195
Construction in process	-	66,773	143,863
		22,776,031	22,214,975
Less: accumulated depreciation		6,331,003	5,442,315
		$16,445,028	$16,772,660

For the years ended December 31, 2009 and 2008 depreciation expense was approximately $899,500 and $868,000, respectively.

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NOTE 4.

NOTES PAYABLE AND OTHER DEBT

	December 31, 2009	December 31, 2008
Promissory note payable to a financial institution in the original principal amount of $2,041,000, executed on December 22, 2003. The note bears interest indexed to the Wall Street Journal Prime Rate plus 1.00% per annum (4.25% at November 30, 2009 and December 31, 2008) with monthly principal and interest payments of approximately $11,590. The note matures on January 1, 2026. The note is secured by inventory, accounts, equipment, general intangibles and fixtures. The note is subject to various financial and restrictive covenants. The note was refinanced in November 2009.	$ -	$ 1,878,794
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $3,721,500 executed on February 17, 2000. The note bears interest at the rate of 8.50% per annum with monthly principal and interest payments of approximately $27,309. The note matures on May 1, 2041. The note has various restrictive covenants imposed by HUD.	3,586,038	3,607,918
On January 26, 2005, AdCare issued a promissory note to the major stockholder of Assured Home Health, Inc. The face value of the note is $450,000 and accrues interest during 2005 which adds to the note balance. The note then bears interest of 5% and is payable in 36 monthly payments of $14,161 beginning February 2006 and maturing February 2009.	-	28,173
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $2,108,800 executed on November 27, 2007. The note bears interest at the rate of 5.95% per annum with monthly principal and interest payments of approximately $15,047. The note matures on December 1, 2027. The note is subject to various covenants and is collateralized by real estate and rental income.	1,992,094	2,052,178
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $2,524,800 executed on September 1, 2008 to refinance a construction loan at Greenfield. The note bears interest at the rate of 6.50% per annum with monthly principal and interest payments of approximately $15,960. The note matures on August 1, 2038. The	2,486,759	2,515,596

note has various restrictive covenants imposed by HUD.		
Lease payable to a financial institution executed on February 15, 2008. The note bears interest of 8.616%. The note matures on February 15, 2012. The note is secured by computer equipment.	140,869	200,043
Mortgage note payable to a financial institution in the principal amount of $300,000 executed on October 17, 2008. The note bears interest indexed to the Daily Fluctuating LIBOR rate plus 3% per annum (approximately 3.23% at December 31, 2009) with monthly principal and interest payments of approximately $4,144. The note matures on February 1, 2017. The note is collateralized by real estate.	268,750	300,000
Notes payable to unrelated third parties executed on November 15, 2008 related to the purchase of Hearth & Home of Van Wert. The notes mature in November 2010 and bear interest of 5%. The notes are unsecured.	103,835	134,400

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NOTE 4.

NOTES PAYABLE AND OTHER DEBT (Continued)

	December 31, 2009	2008
Line of credit payable to a financial institution with a maximum limit of $100,000. The note bears interest at 4.45% and is revolving.	$ -	$96,700
Line of credit payable to a financial institution with a maximum limit of $50,000. The note bears interest at 4.25% and is revolving.	49,687	49,687
Assumed mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $2,162,500 executed on June 1, 1995. The note bears interest at the rate of 7.25% per annum with monthly principal and interest payments of approximately $13,800. The note matures on July 1, 2036. The note has various restrictive covenants imposed by HUD.	1,940,031	1,963,225
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $1,863,800 executed on August 1, 2008 to refinance bonds. The note bears interest at the rate of 6.65% per annum with monthly principal and interest payments of approximately $11,450. The note matures on July 1, 2043. The note has various restrictive covenants imposed by HUD.	1,843,816	1,858,116
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $2,142,700 executed on August 1, 2008 to refinance bonds. The note bears interest at the rate of 6.65% per annum with monthly principal and interest payments of approximately $13,170. The note matures on July 1, 2043. The note has various restrictive covenants imposed by HUD.	2,119,725	2,136,165
Note payable to a financial institution executed on July 24, 2008. The note bears interest indexed to the Wall Street Journal Prime Rate plus 1.50% per annum (4.75% at December 31, 2009) and is interest only payments until March 2009. The note matures on May 1, 2013. The note is secured with receivables from Assured.	601,339	748,372
Mortgage note payable, insured by HUD, to a financial institution in the original principal amount of $2,181,200 executed on November 9, 2009	2,181,200	-

to refinance previous mortgage. The note bears interest at the rate of 5.10% per annum with monthly principal and interest payments of approximately $11,148. The note matures on December 1, 2044. The note has various restrictive covenants imposed by HUD.		
Other	85,389	118,744
	17,399,532	17,688,111
Less current portion of long term debt	698,504	713,323
Total long-term debt	$16,701,028	$16,974,788

NOTE 4.

NOTES PAYABLE AND OTHER DEBT (Continued)

Maturities on the Company s debt obligations for each of the next five years and thereafter are as follows:

2010	$ 698,504
2011	522,857
2012	475,131
2013	319,395
2014	297,205
Thereafter	15,086,440
	$ 17,399,532

NOTE 5.

NOTES PAYABLE STOCKHOLDERS

	December 31,	
	2009	2008
Promissory note payable to a stockholder in the original principal amount of $835,000 executed on April 27, 2006. The note bears interest equal to the prime rate (3.25% at December 31, 2009 and 2008) per annum and requires interest only payments monthly. The note originally matured on May 1, 2007, but was extended to December 31, 2010. A portion of this note was refinanced in July 2008 and $760,000 of the note was repaid.	$33,876	$44,058
Less current portion of shareholder debt	9,432	9,432
Total long-term shareholder debt	$24,444	$34,626

NOTE 6. FORWARD PURCHASE CONTRACT

In October 2003, the Company amended a purchase agreement with certain minority interest holders in one of its subsidiaries. As a result of that amendment, the Company became subject to the accounting pursuant to Codification topic 480 *Distinguishing Liabilities from Equity* which was effective for agreements entered into or amended after May 31, 2003. The amendment contained a forward purchase contract which was accounted for as a liability. The amount of the liability, at the date of the amendment, measured as set forth in SFAS 150, was approximately $985,000, which has been recorded using purchase accounting as required by SFAS 150, EITF 00-6, *Accounting for Freestanding Derivative Financial Instruments Indexed to and Potentially Settled in the Stock of a Consolidated Subsidiary* and FASB 141, *Business Combinations*. This resulted in an increase to the carrying value of the real property of $250,000 and the recording of goodwill of approximately $865,000. This purchase accounting adjustment was related to the minority interest being reduced by previously incurred net losses attributable to those minority interests prior to the date of adoption of SFAS 150. The resulting goodwill has been tested for impairment annually. No impairment charge has been recognized. In periods subsequent to 2003, the liability has been reduced for payments made to the minority interests as a result of the forward purchase contract and adjusted by changes in the present value of the amount to be paid under the forward purchase contract as required by SFAS 150. The liability is recorded at the greater of the interest holders cash basis or fair value. There were no payments made to minority interests or adjustments required due to changes in fair value in 2009 and 2008. In November 2008, the Company completed the forward purchase contract to obtain 100% ownership of Hearth & Home of Van Wert at a total cost of $941,289 of which $800,664 was in cash while the remaining $140,625 was issued in the form of notes payable which mature in 2010 (see Note 4).

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NOTE 7.

STOCK BASED COMPENSATION

From time to time, as determined by the Board of Directors, the Company grants stock based compensation awards to officers, directors, employees and certain consultants to the Company. The Board of Directors administers the granting of awards, determines the persons to whom awards will be made, the amount of the awards, and the other terms and conditions of the awards. The Board currently has three separate grants of stock based compensation awards that have provided both incentive and nonqualified stock options and awards to various consultants to the Company.

The Company uses the Black Scholes option pricing model for estimating the fair values of employee share options, warrants and similar instruments as permitted by ASC Topic 718, *Stock Compensation.*

Expected Dividend: The Company has not historically paid dividends and does not expect to pay dividends in the near future. As such, there is no expected dividend yield.

Expected Volatility: Because the Company is a relatively new public company, estimates of expected volatility are based on the weighted-average historical volatility of similar companies within the industry whose stock prices are publicly available.

Risk-Free Interest Rate: The Company bases the risk-free interest rate on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the expected term of the options being valued.

Expected Term: The Company currently uses a simplified method for calculating the expected term based on the vesting and contractual expiration dates.

Employee Stock Options

In August 2004, the Company granted 114,200 options with a weighted-average fair value estimated at $0.36 per share. The options have a term of 5 years and the exercise price per share was equal to the fair market value on the grant date. The stock options vested 40% on the date of grant and 20% for each of the three years from the date of grant. The options began to expire in August 2009.

In May 2007, the Company granted 199,000 options with a weighted-average fair value estimated at $0.58 per share. The options have a term of 5 years and the exercise price per share was equal to the fair market value on the grant date. The stock options vested 20% on the date of grant and 20% for each of the 4 years from the date of grant. The options begin to expire in May 2012.

There were no grants during 2009 or 2008.

Total stock option compensation expense of $20,892 was recognized for each of the periods ending December 31, 2009 and 2008, respectively.

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NOTE 7. STOCK BASED COMPENSATION (Continued)

Employee Stock Options (continued)

The following summarizes the Company s stock option activity for the period ending December 31, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Aggregate Intrinsic Value
Outstanding at January 1, 2009	272,000	$1.85		
Granted	-	-		
Exercised	-	-		
Forfeited	(20,600)	$1.91		
Expired	(32,320)	$2.50		
Outstanding at December 31, 2009	219,080	$1.76	3.6 years	$ -
Exercisable at December 31, 2009	155,640	$1.86	2.7 years	$ -

At December 31, 2009, the Company has approximately $42,000 of unrecognized compensation expense related to outstanding stock options. Assuming no pre-vesting forfeitures, this expense will be recognized as a charge to earnings over a weighted-average remaining service period of 0.85 years.

Employee Common Stock Warrants

In November 2007, the Board recommended a new warrant incentive plan (the Incentive Plan) and, at a special meeting of shareholders held on August 15, 2008, the Company s shareholders approved the issuance of warrants to purchase up to 1,092,305 shares of the Company s common stock to certain officers and directors of the Company. The warrants issued in connection with the incentive plan are exercisable for a period of 10 years and vest equally over a period of five years. The exercise price of the warrants vesting in calendar year 2008 was $1.21 per share. The exercise price of the warrants vesting in calendar year 2009 was $2.25 per share. The exercise price of the warrants vesting in 2010 is $3.00 per share. Thereafter, in calendar years 2011 and 2012, the exercise price of the warrants would float based upon the average closing price of the Company s common stock on NYSE-Amex but not less than

$3.00 per share. As of January 1, 2009, 438,783 warrants have vested with a weighted-average fair value estimated at $1.35 per share. The warrants have a term of 10 years and were at an exercise price per share less than the fair market value on the grant date. The warrants are exercisable until the term expires in August, 2018. An aggregate total of 514,134 warrants issued under the Incentive Plan were originally scheduled to vest in calendar years 2010, 2011, and 2012, at the rate of 171,378 warrants per year (the Unvested Warrants).

In September 2009, the company granted 300,000 warrants to its Vice Chairman and Chief Acquisitions Officer. One third of the warrants vested on the grant date with an exercise price of $3.00 per share and the remaining two thirds vest equally in 2010 and 2011 with exercise prices of $4.00 and $5.00, respectively. The Company estimated the weighted average fair value at $.97 per share. The warrants expire in September, 2017

In December 2009, shareholders approved modifying the incentive plan warrants scheduled to vest in 2011 so that the exercise price is fixed at $4.00 per share. Subsequently, the Company granted 171,378 warrants with a fair value estimated at $1.05 per share. One third of the warrants vested in December 2009 with the remaining scheduled to vest equally in December 2010 and December 2011. The warrants are exercisable until the term expires in August 2018. This modification was accounted for in accordance with provisions in ASC Topic 718, *Stock Compensation.*

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NOTE 7. STOCK BASED COMPENSATION (Continued)

Employee Common Stock Warrants (continued)

In December 2009, shareholders approved eliminating the incentive plan warrants scheduled to vest in 2012 and approved issuing 171,378 shares of the Company s common stock to certain officers and directors with a one year restriction on transfer (restricted shares). See the *Restricted Shares* section of this note.

In December 2009, the Company granted 125,000 warrants to members of senior management with a fair value estimated at $1.05 per share. The warrants have a term of 5 years and an exercise price of $3.00 per share. One third of the warrants vest in December 2009 with the remaining two thirds scheduled to vest equally in December 2010 and December 2011. The warrants are exercisable until the term expires in December, 2014.

The significant assumptions used to estimate the fair value of employee common stock warrants granted using the Black Scholes option-pricing model is as follows:

	2009	2008
Dividend Yield	0.0%	0.0%
Expected Volatility	48.0%	43.0%
Risk-Free Interest Rate	2.53%	3.13%
Expected Term	7 years	4.5 years

The following summarizes the Company s employee common stock warrant activity for the period ending December 31, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Aggregate Intrinsic Value
Outstanding at January 1, 2009	1,084,322	$2.37		

Granted	596,378	$3.79			
Exercised	-	-			
Forfeited	(18,405)	$1.21			
Cancelled or Modified	(342,756)	$3.00			
Expired	(8,000)	$1.00			
Outstanding at December 31, 2009	1,311,539	$2.75	7.5 years	$	-
Exercisable at December 31, 2009	1,028,204	$1.73	7.8 years	$	-

For the years ended December 31, 2009 and 2008, the Company recognized approximately $258,000 and $587,000, respectively, of related compensation expense. The Company has approximately $379,000 of unrecognized compensation expense related to these warrants as of December 31, 2009. Assuming no pre-vesting forfeitures, this expense will be recognized as a charge to earnings over a weighted-average remaining service period of 1.12 years.

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NOTE 7. STOCK BASED COMPENSATION (Continued)

Non-employee Common Stock Warrants

On February 1, 2008, the Company engaged GCC-Prospect Corporation (GCC) for the purposes of providing certain investment banking and advisory services. Among other services, GCC was to assist the Company in identifying, evaluating and securing alternative capital, financing and investment sources for the Company to fund its strategic business plan. In addition, they were to help in identifying acquisition and joint venture transactions to further the expansion plans of the Company. In exchange for their services, the Company paid GCC a total of $10,000 per month and granted 30,000 warrants with a fair value estimated at $.75 per warrant. The warrants have a term of 5 years and were at an exercise price per share less than the fair market value on the grant date. The warrants are exercisable until the term expires in January, 2013.

In November, 2008, the Company extended the agreement with GCC. In exchange for their services, the Company granted 80,000 warrants with 30,000 vesting in the first month of the extension and the remaining 50,000 vesting equally over the remaining five months with 40,000 vesting during 2009. Additionally, the Company agreed to pay GCC $10,000 beginning November 1, 2008, at the successful closing of a transaction. The Company terminated this agreement in August, 2009. The Company estimated the warrants had a grant date weighted average fair market value of $.64 per warrant. The warrants have a term of 5 years and were at an exercise price per share less than the fair market value on the grant date. The warrants are exercisable until their terms begin to expire in January, 2013.

In accordance with the terms and conditions contained in the underwriting agreement for the private offering of the Company s common stock, the Company agreed to pay the placement agent 10% warrant coverage. Therefore, 140,000 warrants were issued. The warrants are exercisable at $2.00 per share. The Company valued the warrants using the Black Scholes option pricing model, at approximately $199,000 or $1.42 per share. The issuance of the warrants and the related expense, which was treated as a cost of the offering, were both offsetting adjustments to additional paid in capital. The warrants expire in December, 2014.

The significant assumptions used to estimate the fair value of non employee common stock warrants granted using the Black Scholes option-pricing model is as follows:

	2009	2008
Dividend Yield	0.0%	0.0%
Expected Volatility	48.0%	38.0%

Risk-Free Interest Rate	2.53%	2.71%
Expected Term	3.4 years	5 years

NOTE 7. STOCK BASED COMPENSATION (Continued)

Non-employee Common Stock Warrants (continued)

The following summarizes the Company s non-employee common stock warrant activity for the period ending December 31, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Aggregate Intrinsic Value
Outstanding at January 1, 2009	334,000	$1.93		
Granted	180,000	$1.78		
Exercised	-	-		
Forfeited	(14,000)	$1.00	-	-
Outstanding at December 31, 2009	500,000	$1.87	3.8 years	$ -
Exercisable at December 31, 2009	500,000	$1.87	3.8 years	$ -

For the years ended December 31, 2009 and 2008, the Company recognized approximately $15,000 and $184,000, respectively, of related compensation expense. At December 31, 2009, the Company has no unrecognized compensation expense related to outstanding non-employee common stock warrants.

Restricted Stock

In December 2009, shareholders approved eliminating the incentive plan warrants scheduled to vest in 2012 and approved issuing 171,378 shares of the Company s common stock with a one year restriction on transfer (restricted stock) to certain directors and members of management. The restricted stock is subject to forfeiture if the recipient is not a director or employed by the Company at the end of the one year restriction. The Company determined the fair value of the restricted stock to be equal to the grant date stock price of $2.90. The related compensation expense is being recognized over the one year restricted period.

The following summarizes the Company s restricted stock activity for the period ending December 31, 2009:

	Number of Shares	Weighted Avg. Grant Date Fair Value
Nonvested at January 1, 2009	-	-
Granted	171,378	$2.90
Vested	-	-
Forfeited	-	-
Nonvested at December 31, 2009	171,378	$2.90

At December 31, 2009, the Company has approximately $456,000 of unrecognized compensation expense related to restricted stock. Assuming no pre-vesting forfeitures, this expense will be recognized as a charge to earnings during 2010.

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NOTE 8.

PRIVATE SALE OF COMMON STOCK

In December, 2009, at a special shareholder meeting, shareholders approved the sale of 1,382,500 shares of stock and warrants in a private offering of the Company s stock. The offering consisted of Units with each Unit containing one share of the Company s common stock and one five-year warrant to purchase an additional share of common stock at $2.50 per share. As a result, 1,382,500 new shares of common stock and 1,382,500 warrants were issued. Gross proceeds of the private sale $2,765,000. Proceeds, net of the underwriter s expenses, were approximately $2,439,000.

NOTE 9.

COMMON STOCK WARRANTS

A summary of the status of the Company s common stock warrants as of December 31, 2009 and December 31, 2008 is presented below:

	December 31,	
	2009	2008
Beginning balance	1,406,000	1,406,000
Issued	1,382,500	-
Exercised	-	-
Expired	-	-
Ending balance	2,788,500	1,406,000

In connection with the Company s private sale of stock and warrants in December 2009, the Company issued 1,382,500 warrants. The warrants have an exercise price of $2.50 per share and expire in December, 2014.

In December 2009, shareholders approved amending the 1,406,000 warrants issued in November 2006 in connection with the Company s initial public offering. The amendments included reducing the exercise price from $5.40 to $2.50, extending the expiration date from November, 2011, to December, 2014, and adding a callable option that will allow the Company to call for repurchase of all, or any portion of, the warrants for $.10 per warrant provided that (i) the common stock underlying the warrants is registered and (ii) the common stock trades at or above $6.00 per share for ten consecutive trading days during which the average daily volume for the ten day period is at least 40,000 shares. The callable feature has been accounted for in accordance with ASC 480-10-25, *Distinguishing Liabilities from Equity*. The Company has determined that since the warrants will be redeemed only upon the occurrence of conditional events, the call option does not meet the definition of a mandatorily redeemable financial instrument in ASC 480-10-25 and, therefore, no liability has been recorded. However, the call option will be assessed at each reporting period to determine whether circumstances have changed such that the instrument now meets the definition of a mandatorily redeemable instrument (that is, the call option is no longer conditional). If conditions have occurred or have become certain to occur, the financial instrument will be reclassified as a liability.

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NOTE 10.

INCOME TAXES

The provision for income taxes attributable to continuing operations for the years ended December 31, 2009 and December 31, 2008 is presented below.

	December 31,	
	2009	2008
Current Tax Expense (Benefit):		
Federal	-	-
State	-	-
Deferred Tax Expense (Benefit):		
Federal	42,567	170,007
State	-	-
	42,567	170,007
Total income tax expense (benefit)	42,567	170,007

At December 31, 2009 and December 31, 2008, the tax effect of significant temporary differences representing deferred tax assets are as follows:

	December 31,	
	2009	2008
Net current deferred tax asset:		
Allowance for doubtful accounts	92,376	33,841
Accrued expenses	130,539	82,293
	222,915	116,134
Net long-term deferred tax asset (liability):		
Net operating loss carry forwards, AdCare	$ 2,700,232	$ 3,096,503
Investment in New Lincoln Lodge	(140,744)	(140,744)
Income tax benefit-New Lincoln Lodge	(71,886)	(211,429)
Depreciation and amortization	(252,103)	(266,375)
Stock based compensation	268,300	187,973

	2,503,799	2,665,928
Total deferred tax assets	2,726,714	2,782,062
Valuation allowance	(2,939,288)	(2,952,069)
Net deferred tax asset	$ (212,574)	$ (170,007)

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NOTE 10.

INCOME TAXES (Continued)

The items accounting for the differences between income taxes computed at the federal statutory rate and the provision for income taxes are as follows:

	December 31,	
	2009	2008
Income tax at statutory rate	34.00%	34.00%
Stock options	4.81%	(0.78)%
Meals and entertainment	0.45%	(0.26)%
Penalties	0.00%	(0.21)%
Officers life insurance	1.94%	(0.96)%
Net taxable flow through income CHH	0.07%	2.67%
Net taxable flow through income HVW	8.19%	(0.11)%
Change in valuation allowance	(39.80)%	(50.62)%
Change in effective tax rate	0.00%	1.37%
Other	0.00%	(3.87)%
Effective tax rate	9.66%	(18.77)%

As of December 31, 2009, AdCare had consolidated federal net operating loss (NOL) carry forwards of approximately $7,942,000. These NOLs begin to expire in 2011 through 2023.

Management determined that the deferred tax assets do not satisfy the recognition criteria set forth in SFAS No. 109. Accordingly, a full valuation allowance has been recorded for this amount.

Under Section 382 of the Internal Revenue Code of 1986, as amended (the Code), the utilization of net operating loss carry forwards may be limited under the change in stock ownership rules of the Code. As a result of ownership changes, which occurred in November 2006 in connection with the Company s public offering, the Company may have substantially limited or eliminated the availability of its net operating loss carry forwards.

NOTE 11.

COMMITMENTS AND CONTINGENCIES

Employment Agreements

Commencing on September 1, 2008, the Company entered into employment agreements with three executive officers. The employment agreements provide for an initial employment term of three years expiring on August 31, 2011 with base salaries ranging from $10,000 to $12,500 per month, a minimum salary increase of five percent per year, fringe benefits such as health and life insurance and inclusion in any option program that the Company may institute in the future. In addition, the employment agreements provide that if the executive is terminated for any reason other than cause (which is defined as dishonest in transactions with the Company, material disloyalty and/or the express refusal to perform services for the Company which may be properly requested), the Company is required to compensate said executive for the remaining term of the respective employment agreement plus one additional year. The employment agreements also include a non-compete agreement restricting said executive from competing with the Company for a period of one year following the termination.

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NOTE 11.

COMMITMENTS AND CONTINGENCIES (Continued)

Operating Leases

The Company has various non-cancelable operating leases for office space, Covington Care Center nursing facility and equipment which expire through August 2013. During 2008, the lease was renegotiated for Covington Care Center resulting in lower lease payments. Rent expense under this agreement for 2009 and 2008 was approximately $629,000 and $528,000 respectively.

Future minimum lease payments as of December 31, 2009 are as follows:

2010	$ 560,000
2011	605,000
2012	620,000
2013	155,000
	$1,940,000

Legal Matters

Certain claims and suits arising in the ordinary course of business in managing certain nursing facilities were filed or are pending against the Company. Management provides for loss contingencies where the possibility of a loss is probable. For the years ended December 31, 2009 and 2008, no estimated loss liabilities due to litigation were recorded. Management believes that the liability, if any, which may result would not have a material adverse effect on the financial position or results of operations of the Company. The Company carries liability insurance that is available to fund certain defined losses, should any arise, net of a deductible amount.

NOTE 12.

THIRD-PARTY REIMBURSEMENT

Medicare

Payments for Medicare resident services are made under a prospective payment system. There is no retroactive adjustment to allowable cost. The Company is paid one of several prospectively set rates that vary depending on the resident s service needs. Payment rates are established on a federal basis by the Centers for Medicare and Medicaid Services (CMS).

The final settlement process is primarily a reconciliation of services provided and rates paid. As a result, no material settlement estimates are expected.

Medicaid

Payments for Medicaid resident services are calculated and made under a prospective reimbursement system. Payment rates are based on actual cost, limited by certain ceilings, adjusted by a resident service needs factor and updated for inflation. The direct care portion of the rate can be adjusted prospectively for changes in residents service needs. While interim rates are subject to reconsideration and appeal, once this process is completed, they are not subject to subsequent retroactive adjustment. However, the Ohio Department of Job and Family Services (ODJFS) has the opportunity to audit the cost report used to establish the prospective rate. If the ODJFS discovers non-allowable or misclassified costs that resulted in overpayments to the Company, then the funds will be recovered by the ODJFS through the final rate recalculation process.

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NOTE 12.

THIRD-PARTY REIMBURSEMENT (Continued)

Medicaid (continued)

For the years ended December 31, 2009 and 2008, management estimated that no amounts are due to the Medicaid program resulting from non-allowable or misclassified costs for any open Medicaid reimbursement years.

Third-Party Overpayments

ODJFS overpaid the Company on certain of its Medicaid residents. Medicaid overpayments were approximately $172,100 and $128,600 for the years ended December 31, 2009 and 2008, respectively, and are included in accrued expense in the accompanying consolidated balance sheet. The Company received Medicaid payments for residents who were previously discharged or for residents who were covered by the Medicare program or other payers. The overpayments are primarily due to the ODJFS lack of processing status changes on a timely basis despite the Company s submission of such changes.

Laws and Regulations

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigation involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

NOTE 13.

RELATED PARTY TRANSACTIONS

On April 27, 2006, a stockholder loaned the Company $835,000 that was used to repay the loan for Assured Health Care. The majority of this note was subsequently refinanced in July 2008 and repaid to the stockholder. The balance as of December 31, 2009 was approximately $34,000. (see Note 5).

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NOTE 14.

CURRENT VULNERABILITY DUE TO CERTAIN CONCENTRATIONS

The Company s operations are concentrated in the long-term care market, which is a heavily regulated environment. The operations of the Company are subject to the administrative directives, rules and regulations of federal and state regulatory agencies, including, but not limited to, CMS, the ODJFS and the Ohio Department of Health and Aging. Such administrative directives, rules and regulations, including budgetary reimbursement funding, are subject to change by an act of Congress, the passage of laws by the Ohio General Assembly or an administrative change mandated by one of the executive branch agencies. Such changes may occur with little notice or inadequate funding to pay for the related costs, including the additional administrative burden, to comply with a change.

The Company has 100% of its 194 nursing facility beds certified under the Medicaid and Medicare programs. A summary of occupancy utilization and net revenues for these nursing facility beds is as follows:

For the Year Ended	Percent of Total Occupancy	Percent of Long-Term Care Receivables	Percent of Patient Care Revenue
Medicaid			
December 31, 2009	67%	38%	50%
December 31, 2008	63%	37%	53%
Medicare			
December 31, 2009	15%	23%	30%
December 31, 2008	14%	24%	25%
Other Payers			
December 31, 2009	18%	39%	20%
December 31, 2008	23%	39%	22%

NOTE 15.

DEFERRED COMPENSATION PLAN

The Company maintains a non-qualified deferred compensation plan available to a select group of management or highly compensated employees. Contributions to the plan are made by the participants. The Company does not provide any matching contributions. The benefits of the plan are payable upon the employee s separation of employment with the Company. As of December 31, 2009, the Company recorded an asset of approximately $292,500 to reflect the amount of investments held in the plan and a corresponding liability acknowledging the Company s obligation to employees participating in the plan (included in other assets and other liabilities in the accompanying balance sheet). The underlying assets are recorded at fair value and primarily represent short term fixed income assets invested at the participants' direction. Contributions to the plan in 2009 were not material.

In February, 2008, the Company withdrew $150,000 from the plan and deposited it in a savings account to use as a line of credit. The Company paid 8% interest on the funds withdrawn until they were repaid in 2009.

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NOTE 16.

SENIOR LIVING FACILITY ACQUISITIONS

On March 7, 2008, the Company entered into an agreement to acquire 100% of The New Lincoln, Ltd. effective April 1, 2008. The sole asset of The New Lincoln, Ltd. is the New Lincoln Lodge Retirement Residence which is a 51 unit senior living residence located in Columbus, Ohio. The Company completed the transaction on May 15, 2008. The Company accounted for the transaction under guidance issued in EITF 04-01, *Accounting for Preexisting Relationships between the Parties to a Business Combination* . The Company s preexisting relationship consisted primarily of a note receivable.

The consideration paid by the Company to NLL was approximately $2,392,000 consisting of $12,500 in cash, the residual value of the Company s note receivable of approximately $218,000, 1% ownership of NLL which the Company has valued at approximately $6,600, liabilities assumed of approximately $2,144,000 and 25,000 warrants to purchase the Company s stock at a price equal to the stock price of $1.21. Preliminarily, the Company has estimated the value of these warrants to be approximately $10,500 using the Black-Scholes option-pricing model.

Additionally, the Company granted an option and right of first refusal to the seller. The terms of the agreement include an option to purchase the NLL for a period of two years ending on April 1, 2010 at a price equal to $2,750,000 plus any capital expenditures, cash loans, and refinancing charges made to refinance the property. The Company also granted a right of first refusal for an additional three years ending on April 1, 2013 in the event the seller does not exercise its option to purchase by April 1, 2010. The right of first refusal grants the seller the opportunity to meet any offer to purchase the property for a period of sixty days from the time the offer is made.

Following is a condensed balance sheet showing assets acquired and liabilities assumed as of the date of acquisition:

	April 1, 2008
Cash	$ 19,813
Prepaid expenses and other	12,246
Restricted cash	36,677
Property, Plant & Equipment	2,740,000
Assets Acquired	2,808,736
Current portion of notes payable and other debt	$(86,499)

Accounts payable and accrued expenses	(88,740)
Notes payable and other debt, net of current portion	(1,968,343)
Liabilities Assumed	$(2,143,582)
Net assets acquired	$ 665,154

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NOTE 16.

SENIOR LIVING FACILITY ACQUISITION (Continued)

The following unaudited pro forma summary presents consolidated financial information for the year ended December 31, 2007 as if the acquisition had occurred on January 1, 2007. The unaudited pro forma summary presents consolidated financial information for the three months ended March 31, 2008 as if the acquisition had occurred on January 1, 2008.

	March 31, 2008	December 31, 2007
Revenue	$ 6,151,710	$ 24,245,000
Expenses	6,304,851	25,200,655
Loss Before Discontinued Operations, Income Taxes and Gain	(153,141)	(955,655)
Income Tax Benefit	-	178,415
Income Tax Expense	(10,642)	-
Gain on Acquisition	413,593	419,552
Income (Loss) from continuing operations	249,810	(357,688)
Discontinued Operations:		
Income from discontinued operations (including gain on disposal)	-	587,039
Provision for income taxes	-	(178,415)
	-	408,624
Net Income	$ 249,810	$ 50,936
Net Income Per Share, Basic and Diluted:		
Continuing operations	$ 0.07	$ (0.09)
Discontinued operations	-	0.11
	$ 0.07	$ 0.02
Weighted Average Common Shares Outstanding,		
Basic	3,786,129	3,786,129
Diluted	3,786,129	3,786,129

In November, 2008, the Company acquired the remaining 50.8% ownership interest in Hearth & Home of Van Wert, LLC as required by our forward purchase contract (see Note 6). Through October 2008, the Company owned 49.2% of the limited liability company with the remaining 50.8% owned by individual investors. The total cost of the acquisition was $941,289 of which $800,664 was satisfied in cash while the remaining $140,625 was satisfied in the form of a sellers notes payable which mature in 2010 (see Note 4). Approximately $41,000 was allocated to goodwill with the balance treated as an additional equity investment by the Company for the purpose of eliminating the liability for the forward purchase contract.

NOTE 17.

BENEFIT PLANS

The Company sponsors a 401(k) plan, which provides retirement benefits to eligible employees. All employees are eligible once they reach age 21. The Company matches employee contributions at 50% up to 2% of the employee s salary. Total matching contributions during 2009 and 2008 were approximately $59,000 and $45,000, respectively.

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NOTE 18. SUBSEQUENT EVENTS

In May 2009, the FASB issued ASC Topic 855, *Subsequent Events*, which is effective for interim or annual financial periods ending after June 15, 2009. Subsequent events are events or transactions that occur after the balance sheet date, but before financial statements are issued. The adoption of this standard did not have a material effect on our results of operations, financial position or cash flows.

On March 7, 2010, Coosa Nursing ADK, LLC, a wholly owned subsidiary of the Company, entered a Purchase Agreement with Coosa Valley Health Care Inc, an Alabama corporation, to acquire the assets of Coosa Valley Health Care, a 124 bed skilled nursing facility located in Gadsden, Alabama. The purchase price is $8,700,000 with an anticipated closing date of June 1, 2010. The Company paid $150,000 upon signing the purchase agreement as earnest money.

On March 7, 2010, Attalla Nursing ADK, LLC, a wholly owned subsidiary of the Company, entered a Purchase Agreement with Attalla Health Care Inc., an Alabama corporation, to acquire the assets of Attalla Health Care, a 182 bed skilled nursing facility located in Attalla, Alabama. The purchase price is $9,800,000 with an anticipated closing date of June 1, 2010. The Company paid $150,000 upon signing the purchase agreement as earnest money.

If the Company terminates the purchase agreement(s) because of seller s failure to satisfy certain conditions of the purchase agreement(s), the earnest money will be returned to the Company. Conversely, if the Company fails to complete the purchase for reasons other than the defined conditions within the purchase agreement(s), then the seller will retain the earnest money. Upon closing of the purchase, the earnest money will be applied against the purchase price.

An estimate of the financial effect of these subsequent transactions can not be made as of March 31, 2010.

On March 31, 2010, the Company acquired its partner s 50% noncontrolling interest ownership in two assisted living facilities located in Springfield Ohio known as Community s Hearth & Home. Also on March 31, 2010, the Company acquired its partner s 50% noncontrolling interest ownership in one assisted living facility located in Urbana Ohio known as Hearth & Home of Urbana. The purchase price was $500,000; however, due to the timing of this transaction, the financial effect of this subsequent transaction has not been determined as of March 31, 2010.

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Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

On May 16, 2008, the Audit Committee of the Board of Directors of AdCare Health Systems, Inc. (the Company) dismissed Rachlin LLP (Rachlin) as the Company s independent registered public accounting firm as previously reported on Form 8-K filed on May 19, 2008 and herein incorporated by reference.

There are no disagreements between the Company and either its current or former accounting firm on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Item 9A(T). Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (SEC) and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs.

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Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, management used the framework set forth in the report entitled *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. The COSO framework summarizes each of the components of a company s internal control system, including (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. Based on our assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2009.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permits us to provide only management's report in this annual report.

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is included under the captions **Election of Directors** , **Executive Officers** and **Section 16(a) Beneficial Ownership Reporting Compliance** in our proxy statement relating to our 2010 Annual Meeting of Shareholders to be held June 4, 2010, and is incorporated herein by reference.

We have a Business Conduct Policy applicable to all employees of AdCare. Additionally, the Chief Executive Officer (CEO) and all senior financial officers, including the principal financial officer, the principal accounting officer or controller, or any person performing a similar function (collectively, the Senior Financial Officers) are bound by the provisions of our code of ethics relating to ethical conduct, conflicts of interest, and compliance with the law.

We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding any amendment to, waiver of, any provision of this code of ethics by posting such information on our website at the address and location specified.

Item 11. Executive Compensation

We incorporate by reference information on executive compensation under the heading Executive Compensation in our Proxy Statement, which we will file with the SEC on or prior to April 21, 2010.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

We incorporate by reference information on security ownership of some beneficial owners under the heading Security Ownership of Certain Management and Beneficial Owners in our Proxy Statement, which we will file with the SEC on or prior to April 21, 2010.

Item 13. Certain Relationships and Related Transactions, and Director Independence

We incorporate by reference information on certain relationships and related transactions under the heading Certain Relationships and Related Transactions in our Proxy Statement, which we will file with the SEC on or prior to April 21, 2010.

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Item 14. Principal Accountant Fees and Services

We incorporate by reference information on principal accountant fees and services under the heading Fees of the Registered Independent Public Accounting Firm for the Year Ended December 31, 2009 in our Proxy Statement, which we will file with the SEC on or prior to April 21, 2010.

PART IV

Item 15. Exhibits and Financial Statement Schedules

Reports on Form 8-K.

The Company filed the following Reports on Form 8-K during 2009:

Date	Description
February 5, 2009	Announcing the termination of a material definitive agreement
April 2, 2009	Press release announcing earnings results for the year ended December 31, 2008, and the departure of a director.
May 18, 2009	Press release announcing earnings results for the quarter ended March 31, 2009.
September 24, 2009	Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers and related press release
December 11, 2009	Unregistered Sales of Equity Securities and related press release
December 23, 2009	Press release announcing shareholder approval of warrant modifications

The Company filed the following Reports on Form 8-K subsequent to December 31, 2009:

Date	Description
January 4, 2010	Election of directors and related press release.
March 11, 2010	Material definitive agreements and press release announcing potential acquisitions

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Exhibits. Exhibits included or incorporated by reference herein: See Exhibit Index below.

Exhibit	Description of Exhibit	Location	
3.1	Amended and Restated Articles of Incorporation of Registrant	Exhibit 3.1	incorporated by reference from Exhibit 3.1 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
3.2	Code of Regulations of the Registrant	Exhibit 3.2	incorporated by reference from Exhibit 3.2 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.1	Specimen Common Share Certificate	Exhibit 4.1	incorporated by reference from Exhibit 4.1 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.2	Specimen Unit Certificate	Exhibit 4.2	incorporated by reference from Exhibit 4.2 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.3	Specimen Warrant Certificate	Exhibit 4.3	incorporated by reference from Exhibit 4.3 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.4	Form of Warrant Agreement, dated ________, 2006	Exhibit 4.4	incorporated by reference from Exhibit 4.4 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.5	2004 Non-Qualified and Incentive Stock Option Plan of Registrant	Exhibit 4.5	incorporated by reference from Exhibit 4.5 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
4.6	Form of Representative s Warrant	Exhibit 4.6	incorporated by reference from Exhibit 4.6 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.1	Employment Agreement between AdCare Health Systems, Inc. and David A. Tenwick, dated September 1, 2008	Exhibit 10.1	incorporated by reference from Exhibit 99 of the Company s Form 8-K filed September 8, 2008
10.2	Employment Agreement between AdCare Health Systems, Inc. and Gary L. Wade, dated September 1, 2008	Exhibit 10.2	incorporated by reference from Exhibit 99 of the Company s Form 8-K filed September 8, 2008
10.3		Exhibit 10.3	

	Employment Agreement between AdCare Health Systems, Inc. and J. Scott Cunningham, dated September 1, 2008		incorporated by reference from Exhibit 99 of the Company s Form 8-K filed September 8, 2008
10.4	Form of Secured Promissory Debenture dated _________, 2005	Exhibit 10.4	incorporated by reference from Exhibit 10.4 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006

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Exhibit	Description of Exhibit	Location	
10.5	Form of Warrant to Purchase Common Stock dated _________, 2005	Exhibit 10.5	incorporated by reference from Exhibit 10.5 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.6	Form of Subordinated Note dated October 31, 2004	Exhibit 10.6	incorporated by reference from Exhibit 10.6 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.7	Form of Warrant to Purchase Shares of AdCare Health Systems, Inc. dated October 31, 2004	Exhibit 10.7	incorporated by reference from Exhibit 10.7 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.8	Promissory Note between Assured Health Care, Inc., AdCare Health Systems, Inc. and WesBanco Bank, Inc., in the original amount of $1,650,000	Exhibit 10.8	incorporated by reference from Exhibit 10.8 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.9	Promissory Note between AdCare Health Systems, Inc. and WesBanco Bank, Inc., in the original amount of $300,000	Exhibit 10.9	incorporated by reference from Exhibit 10.9 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.10	Promissory Note between AdCare Health Systems, Inc. and Cornerstone Bank in the original amount of $96,000	Exhibit 10.10	incorporated by reference from Exhibit 10.10 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.11	Promissory Note between AdCare Health Systems, Inc. and Cornerstone Bank in the original amount of $2,041,000	Exhibit 10.11	incorporated by reference from Exhibit 10.11 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.12	Promissory Note between AdCare Health Systems, Inc. and Cornerstone Bank in the original amount of $190,000	Exhibit 10.12	incorporated by reference from Exhibit 10.12 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.13	Promissory Note between Hearth & Care of Greenfield, LLC and Cornerstone Bank in the original amount of $1,412,000	Exhibit 10.13	incorporated by reference from Exhibit 10.13 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.14	Reimbursement Agreement between Community s Hearth & Home, Ltd. and Cornerstone Bank dated December 1, 2002	Exhibit 10.14	incorporated by reference from Exhibit 10.14 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.15		Exhibit 10.15	

	Regulatory Agreement and Mortgage Note between Hearth and Home of Vandalia, Inc. and Banc One Capital Funding Corporation, in the original amount of $ 3,721,500		incorporated by reference from Exhibit 10.15 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.16	Regulatory Agreement and Mortgage Note between The Pavilion Care Center, LLC and Red Mortgage Capital, Inc, in the original amount of $2,295,000	Exhibit 10.16	incorporated by reference from Exhibit 10.16 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006

Exhibit	Description of Exhibit	Location	
10.17	Promissory Note between Covington Realty, LLC and AdCare Health Systems, Inc., in the original amount of $100,000	Exhibit 10.17	incorporated by reference from Exhibit 10.17 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.18	Promissory Note between AdCare Health Care Systems, Inc, and Assured Health Care, Inc. and Mary Fair, in the original amount of $450,000	Exhibit 10.18	incorporated by reference from Exhibit 10.18 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
10.19	Promissory Note between AdCare Health Care Systems, Inc, and Homer McKnight, in the original amount of $835,000	Exhibit 10.19	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended April 30, 2007.
10.20	Investment Banking Agreement entered into with Capital City Partners dated December 29, 2006	Exhibit 10.20	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended April 30, 2007.
10.21	Consulting Agreement entered into with The McKnight Group dated March 5, 2007	Exhibit 10.21	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended April 30, 2007.
10.22	Reimbursement Agreement between Community s Hearth & Home, Ltd. and The Huntington National Bank dated September 13, 2007	Exhibit 10-22	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended March 31, 2008.
10.23	Form of Warrant granted to management to Purchase Shares of AdCare Health Systems, Inc. dated November 20, 2007	Exhibit 10-23	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended March 31, 2008.
10.24	Regulatory Agreement and Mortgage Note between The Pavilion Care Center, LLC and Red Mortgage Capital, Inc, in the original amount of $2,108,800 dated November 27, 2007	Exhibit 10.24	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended March 31, 2008.
10.25	Letter Agreement with Prospect Financial Advisors and GCC Capital dated January 30, 2008	Exhibit 10.25	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended March 31, 2008.
10.26	Regulatory Agreement and Mortgage Note between Hearth & Home of Urbana and Red Mortgage Capital, Inc, in the original amount of $2,142,700 dated June 26, 2008	Exhibit 10.26	incorporated by reference from Exhibit 10.26 of the Company s annual report on form 10-K filed March 31, 2009.
10.27	Regulatory Agreement and Mortgage Note between Community s Hearth & Home and Red Mortgage Capital, Inc, in the original amount of $1,863,800 dated	Exhibit 10.27	incorporated by reference from Exhibit 10.27 of the Company s annual report on form 10-K filed March 31, 2009.

	June 26, 2008		
10.28	Promissory Note between Assured Health Care and Huntington National Bank in the original amount of $760,000 dated July 24, 2008	Exhibit 10.28	incorporated by reference from Exhibit 10.28 of the Company s annual report on form 10-K filed March 31, 2009.

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Exhibit	Description of Exhibit	Location	
10.29	Promissory Note between AdCare Health Systems, Inc. and Huntington National Bank in the original amount of $300,000 dated October 17, 2008	Exhibit 10.29	incorporated by reference from Exhibit 10.29 of the Company s annual report on form 10-K filed March 31, 2009.
10.30	Promissory Note between AdCare Health Systems, Inc. and Huntington National Bank in the original amount of $100,000 dated November 14, 2008	Exhibit 10.30	incorporated by reference from Exhibit 10.30 of the Company s annual report on form 10-K filed March 31, 2009.
10.31	Regulatory Agreement and Mortgage Note between Hearth & Care of Greenfield and Red Mortgage Capital, Inc, in the original amount of $2,524,800 dated July 29, 2008_	Exhibit 10.31	incorporated by reference from Exhibit 10.31 of the Company s annual report on form 10-K filed March 31, 2009.
10.32	Promissory Note between AdCare Health Systems and the AdCare Deferred Compensation plan for a $150,000 line of credit dated January 2008.	Exhibit 10.32	incorporated by reference from Exhibit 10.32 of the Company s annual report on form 10-K filed March 31, 2009.
10.33	Regulatory Agreement and Mortgage Note between Hearth & Home of Van Wert and Red Mortgage Capital, Inc, in the original amount of $2,181,200 dated November 1, 2009_	Exhibit 10.33	attached hereto
14	Code of Ethics	Exhibit 14	incorporated by reference from Exhibit 10.19 of the Company s annual report on form 10-KSB as amended April 30, 2007
21.1	Subsidiaries of the Registrant	Exhibit 21.1	incorporated by reference from Exhibit 21.1 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
23.1	Consent of Battelle & Battelle LLP	Exhibit 23.1	attached hereto
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act	Exhibit 31.1	attached hereto
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act	Exhibit 31.2	attached hereto
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act	Exhibit 32.1	attached hereto
32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act	Exhibit 32.2	attached hereto
99.1	Audit Committee Charter	Exhibit 99.1	incorporated by reference from Exhibit 99.1 of the Company s Registration Statement Form

			SB (Registration No. 333-131542) filed February 3, 2006
99.2	Compensation Committee Charter	Exhibit 99.2	incorporated by reference from Exhibit 99.2 of the Company s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
99.3	Press Release dated March 31, 2010	Exhibit 99.3	Press release announcing fiscal 2009 results

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Signatures

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AdCare Health Systems, Inc. (Registrant)

by

/s/ Gary L. Wade

Gary L. Wade, President and Chief Executive Officer

March 31, 2010

March 31, 2010

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ David A. Tenwick David A. Tenwick	Director, Chairman	March 31, 2010
/s/ Gary L. Wade Gary L. Wade	Director, President and Chief Executive Officer	March 31, 2010
/s/ Chistopher F. Brogodon Christopher F. Brogdon	Director, Vice Chairman and Chief Acquisitions Officer	March 31, 2010
/s/ Scott Cunningham Scott Cunningham	Chief Financial Officer	March 31, 2010
/s/ Jeffrey L. Levine Jeffrey L. Levine	Director	March 31, 2010
/s/ Philip S. Radcliffe Philip S. Radcliffe	Director	March 31, 2010

/s/ Laurence E. Sturtz Laurence E. Sturtz	Director	March 31, 2010
/s/ Peter J. Hackett Peter J. Hackett	Director	March 31, 2010
/s/ Boyd P. Gentry Boyd P. Gentry	Director	March 31, 2010
/s/ Joshua J. McClellan Josh McClellan	Director	March 31, 2010

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in this Form 10-K, of AdCare Health Systems, Inc. for the years ended December 31, 2009 and 2008 of our report dated March 31, 2010 into the Company's previously filed Registration Statement (No. 333-131542).

/s/Battelle & Battelle, LLP

Dayton, Ohio

March 31, 2010

Exhibit 31.1

CERTIFICATIONS

I, Gary L. Wade certify, that:

1.

I have reviewed this annual report on Form 10-K of AdCare Health Systems, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4.

The small business issuer s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15 d-15(f)) for the small business issuer and have:

a.

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b.

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c.

Evaluated the effectiveness of the small business issuer s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d.

Disclosed in this report any change in the small business issuer s internal control over financial reporting that occurred during the small business issuer s most recent fiscal quarter (the small business issuer s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer s internal control over financial reporting.

5.

The small business issuer s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer s auditors and the audit committee of the small business issuer s board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer s ability to record, process, summarize and report financial information; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer s internal control over financial reporting.

Date: March 31, 2010

By /s/Gary L. Wade
President and Chief Executive Officer

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Exhibit 31.2

CERTIFICATIONS

I, Scott Cunningham, certify, that:

1.

I have reviewed this annual report on Form 10-K of AdCare Health Systems, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4.

The small business issuer s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15 d-15(f)) for the small business issuer and have:

a.

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b.

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c.

Evaluated the effectiveness of the small business issuer s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d.

Disclosed in this report any change in the small business issuer s internal control over financial reporting that occurred during the small business issuer s most recent fiscal quarter (the small business issuer s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer s internal control over financial reporting.

5.

The small business issuer s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer s auditors and the audit committee of the small business issuer s board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer s ability to record, process, summarize and report financial information; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer s internal control over financial reporting.

Date: March 31, 2010	By /s/Scott Cunningham
	Chief Financial Officer

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Exhibit 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADDED BY

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of AdCare Health Systems, Inc. (the Company) on Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission (the Report), I, Gary L. Wade, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as added by § 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: March 31, 2010

By: /s/ Gary L. Wade
Gary L. Wade, Chief Executive Officer

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Exhibit 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADDED BY

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of AdCare Health Systems, Inc. (the Company) on Form 10-K for the period ended December 31, 2009 as filed with the Securities and Exchange Commission (the Report), I, Scott Cunningham, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as added by § 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: March 31, 2010

By: /s/ Scott Cunningham
Scott Cunningham, Chief Financial Officer

Exhibit 99.3

AdCare Health Systems Reports Record Fiscal 2009 Results

Record Annual Revenues of $26.7 Million Drives Record Net Income of $0.10 Per Share

SPRINGFIELD, Ohio, March 31, 2010 AdCare Health Systems, Inc. (NYSE AMEX: ADK), an Ohio-based long-term care, home care and management company, reported record results for the fiscal year ended December 31, 2009.

Revenue in 2009 increased 8% to a record $26.7 million from $24.8 million in 2008. The improvement was primarily due to a 3.3% average occupancy increase in skilled nursing centers for the year.

For fiscal 2009, net income was a record $440,000 or $0.10 per diluted share, versus a net loss of $1.1 million or $(0.28) per basic and diluted share in 2008. Net income in 2008 included a $414,000 gain recognized upon the acquisition of the New Lincoln Lodge.

Cash and cash equivalents at December 31, 2009 totaled $4.5 million, as compared to $1.3 million at the end of fiscal 2008. The increase was due primarily to $1.9 million generated by operations in 2009 and a $2.4 million net equity financing completed in the fourth quarter of 2009.

2009 was a milestone for AdCare, as our fifth consecutive year of revenue growth resulted in our first profitable year as a public company, said David A. Tenwick, AdCare s chairman. The record results were the outcome of the solid foundation we laid in 2008, which allowed us to increase our occupancy while controlling our expenses. We accomplished this while maintaining the best quality of care and sustaining our position as the provider of choice in the areas we serve.

In 2009, we also repositioned AdCare to grow more aggressively through acquisitions. In the fourth quarter we strengthened our balance sheet through the issuance of new equity and we expanded our board of directors, including appointing Christopher Brogdon as vice chairman.

As our largest individual shareholder, Chris has demonstrated a strong, long-term commitment to AdCare. His extensive track record of building publicly-traded companies through strategic acquisitions has continued with us as our new chief acquisitions officer. Chris led the recent negotiations to acquire two nursing facilities, which is expected to close in the second quarter under favorable financing terms and expand our bottom line while adding more than

60% to our annualized top line.

Brogdon commented: As the year advances, we continue to see tremendous opportunities in the highly fragmented health care segments of senior assisted living, elderly nursing care and home health care services. With several more potential acquisitions in our pipeline, we expect the foundation we laid in 2009 will make 2010 another milestone year for AdCare.

About AdCare Health Systems

AdCare Health Systems, Inc. (NYSE AMEX: ADK) develops, owns and manages assisted living facilities, nursing homes and retirement communities and provides home health care services. Prior to becoming a publicly traded company in November of 2006, AdCare operated as a private company for 18 years. AdCare's 850 employees provide high-quality care, management services and other services for patients and residents residing in 19 facilities, six of which are assisted living facilities, 11 skilled nursing centers and two independent senior living communities. The company has ownership interests in eight of those facilities. In the

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ever-expanding marketplace of long-term care, AdCare's mission is to provide quality healthcare services to the elderly. For more information about AdCare, visit www.adcarehealth.com.

Safe Harbor Statement

Statements contained in this press release that are not historical facts may be forward-looking statements within the meaning of federal law, which can be identified by the use of forward-looking terminology such as "believes," "expects", plans or similar expressions. Statements in this announcement that are forward-looking include, but are not limited to statements made by Mr. Tenwick or Mr. Brogdon that recent negotiations to acquire two nursing facilities are expected to close in the second quarter under favorable financing terms and expand the company s bottom line while adding more than 60% to its annualized top line, and that the foundation the company laid in 2009 will make 2010 another milestone year for AdCare. Such forward-looking statements reflect management's beliefs and assumptions and are based on information currently available to management. The forward-looking statements involve known and unknown risks, results, performance or achievements of the company to differ materially from those expressed or implied in such statements. Such factors are also identified in the public filings made by the company with the Securities and Exchange Commission and include the company's ability to secure lines of credit and/or an acquisition credit facility, find suitable acquisition properties at favorable terms, changes in the health care industry because of political and economic influences, changes in regulations governing the industry, changes in reimbursement levels including those under the Medicare and Medicaid programs and changes in the competitive marketplace. There can be no assurance that such factors or other factors will not affect the accuracy of such forward-looking statements.

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Year Ended December 31, 2009	2008
Revenues:		
Patient care revenues	$24,834,831	$23,008,754
Management, consulting and development fee revenue	1,856,269	1,784,540
Total revenue	26,691,100	24,793,294
Expenses:		
Payroll and related payroll costs	15,371,150	15,649,862
Other operating expenses	8,626,987	8,248,157
Depreciation and amortization	918,851	882,900
Total expenses	24,916,988	24,780,919
Income from Operations	1,774,112	12,375
Other Income (Expense):		
Interest income	5,472	23,287
Interest expense, others	(1,207,749)	(1,265,622)
Interest expense, related parties	(2,177)	(36,446)
Other (expense) income	(46,745)	4,200
Total other (expenses)	(1,251,199)	(1,274,581)
Gain on Acquisition	-	413,954
Income (Loss) Before Income Taxes	522,913	(848,252)
Income Tax (Expense)	(42,567)	(170,007)
Net Income (Loss)	480,346	(1,018,259)
Net (Income) Attributable to Noncontrolling Interests	(40,063)	(57,919)
Net Income (Loss) Attributable to AdCare Health Systems	$ 440,283	$(1,076,178)
Net Income (Loss) Income Per Share, Basic:	0.11	$ (0.28)

Net Income (Loss) Income Per Share, Diluted:	0.10	$ (0.28)
Weighted Average Common Shares Outstanding,		
Basic	3,917,286	3,786,129
Diluted	4,425,631	3,786,129

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(unaudited)

	December 31,	
ASSETS	2009	2008
Current Assets:		
Cash	$ 4,481,100	$ 1,266,315
Accounts receivable:		
Long-term care resident receivables, net	1,838,560	2,008,847
Management, consulting and development receivables, net	124,761	258,811
Advances and receivables from affiliates	16,407	17,635
Prepaid expenses and other	541,958	478,534
Total current assets	7,002,786	4,030,142
Restricted cash	1,430,674	1,155,596
Property and equipment, net	16,445,028	16,772,660
License, net	1,189,307	1,189,307
Goodwill	2,679,482	2,679,482
Other assets	1,357,160	1,012,340
Total assets	$ 30,104,437	$ 26,839,527
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of notes payable and other debt	$ 698,504	$ 713,323
Current portion of notes payable to stockholder	9,432	9,432
Accounts payable	1,039,422	1,009,002
Accrued expenses	2,597,151	2,838,407
Total current liabilities	4,344,509	4,570,164
Notes payable and other debt, net of current portion	16,701,028	16,974,788
Notes payable to stockholder, net of current portion	24,444	34,626
Other liabilities	746,074	299,314

Income tax payable	212,574	170,007
Total liabilities	22,028,629	22,048,899
Stockholders' equity:		
Preferred stock, no par value; 500,000 shares authorized;		
no shares issued or outstanding	-	-
Common stock and additional paid-in capital, no par value;		
14,500,000 shares authorized; 5,360,007 shares issued and outstanding	17,571,801	14,766,967
Accumulated deficit	(9,805,249)	(10,245,532)
Total stockholders' equity	7,766,552	4,521,435
Noncontrolling interest in subsidiaries	309,256	269,193
Total equity	8,075,808	4,790,628
Total liabilities and stockholders' equity	$ 30,104,437	$ 26,839,527

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Company Contact

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Investor Relations

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