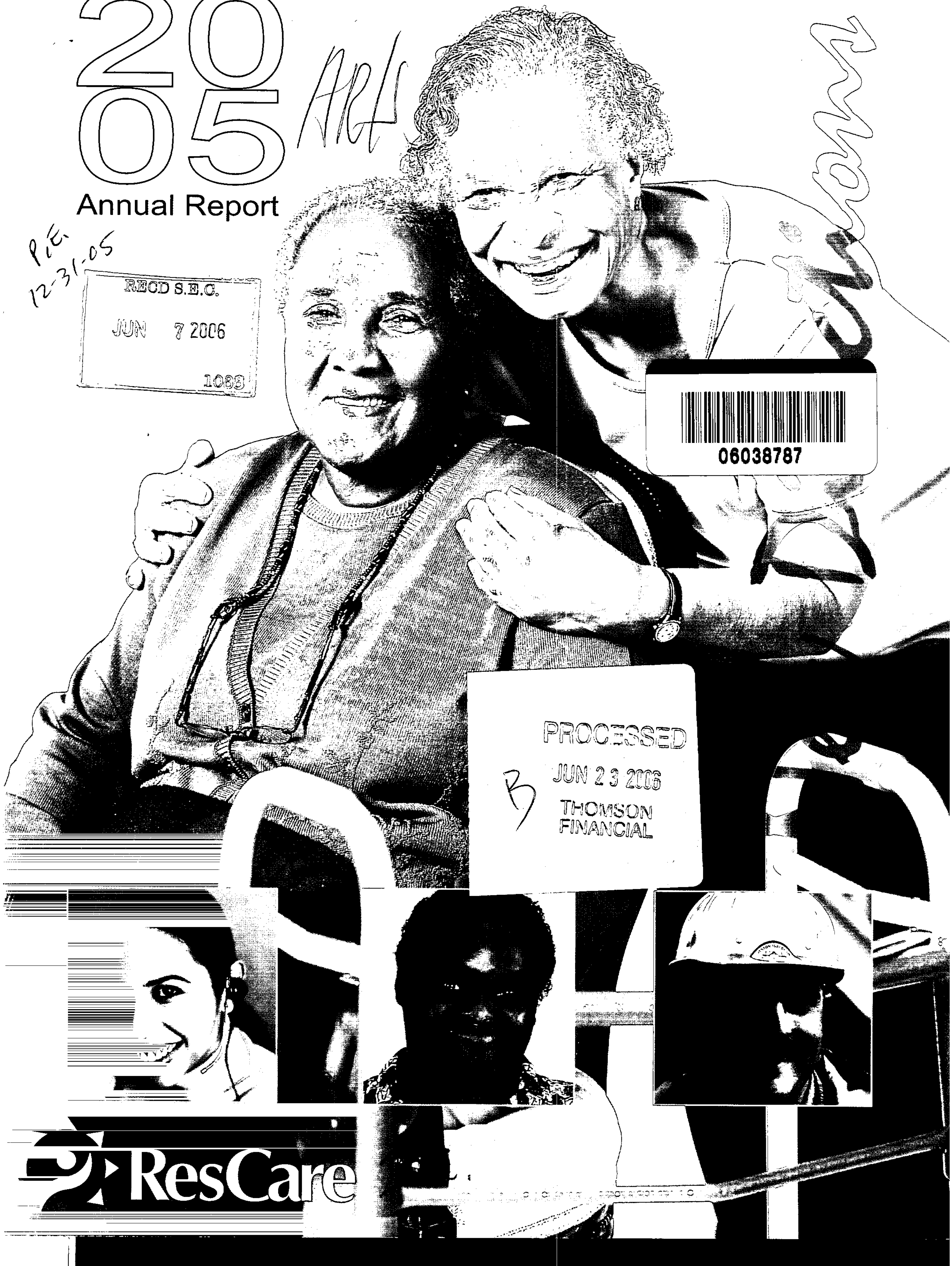
2005 Annual Report



ResCare

Photo by Richard Green, *The Salinas Californian*

About Our Company

ResCare is a human service company supporting people with developmental and other disabilities, youth with special needs, adults experiencing barriers to employment and older people in their homes. We're proud to provide an array of individually tailored services, including home supports and foster care, therapy, skills and vocational training, and in-home care.

ResCare was founded in 1974 and is based in Louisville, Kentucky. Our name comes from two words: Respect and Care. Those words guide our strong mission statement and the ResCare Quality Way, which serve as our foundation. Our ultimate goal is for the people we support to achieve the best quality of life.

Our greatest asset is the experience and expertise gained from three decades of service to some of the nation's most vulnerable populations. This provides stability, which is vitally important to the individuals we support, their families and our employees. Our extensive quality assurance and best practices programs are designed to provide measurable and quantifiable results.

Letter to Shareholders

What a great job I have! Shareholders like you invest in our company, giving me the ability to hire talented professionals whose primary goal is to provide services to people with diverse needs. We are grateful for this chance to make a difference.

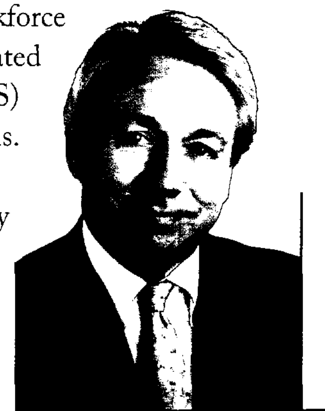
We have a simple, but invaluable mission. We provide services to help people build their lives and reach their highest potential. ResCare employees get up every morning knowing they are contributing to a better life for the people they touch that day. We know what we have to do, and we do it with experience, pride and humility. We recognize that working in a company with such a strong mission is a rare opportunity.

Growth and Diversification

Growth and Diversification

2005 was a record year for ResCare. We energized our growth strategy with accretive acquisitions that diversify our revenues and expand our services to more people. We substantially increased our focus on in-home care for elderly people and employment and training services. As we increase the scale of the company, improve our financial performance and add value to ResCare, the people we serve benefit and so do our shareholders. I want to review the actions we've taken to diversify our funding and to fully become a human service company that addresses the needs of a broad spectrum of people.

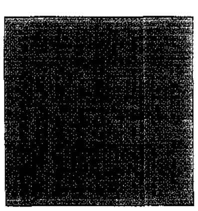
In 2005, we announced that our subsidiary, Arbor E&T, LLC, would purchase the operating assets and business of the Workforce Services Group of Affiliated Computer Services (ACS) - State & Local Solutions. The acquisition, which was completed in January 2006, is expected to generate approximately $165 million in annual revenues. The purchase was funded through existing cash and availability under ResCare's senior credit facility.

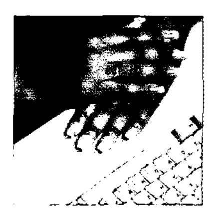


Ronald G. Geary
Chairman, President and
Chief Executive Officer

This operating segment has contracts in 15 states and Washington, DC, and provides services to adults who have lost their jobs or face some barrier to employment. It offers job development, training and placement through federally funded programs administered by state and local governments. The workforce training services are provided primarily through "one-stop" programs, which are convenient service sites that enable job seekers and employers to receive government assistance, employment or training-related services coordinated through a single location. This accretive acquisition made ResCare the largest private provider of one-stop services in the country. It also expands ResCare's services into two new states—Idaho and Wisconsin.

In late 2005, we completed the acquisition of home care services businesses in California and in Texas, with combined annual private-pay revenues of over $5 million.





In total, during 2005, we increased our annual revenue-generating capacity by over $50 million in our Community Services Group, primarily in the home care services area. In addition, we were awarded another $7 million in annual revenues from Job Corps contracts in our Employment and Training Services Group.

As we increase the scale of the company, improve our financial performance and add value to your investment, the people we serve benefit and so do our shareholders.

We know which acquisitions are an ideal fit. We can afford to be selective in what has been a buyer's market. As a result, the acquired businesses have had a significant positive impact on earnings per share. In the long term, we expect the returns to be even better.

We are excited about these achievements. They demonstrate that we can identify excellent prospects, integrate them successfully and operate our existing core businesses without interruption or distraction. Growth is certainly not without its challenges, but we have developed systems that can effectively manage through those challenges. Again, I thank ResCare's dedicated employees whose efforts drive the company's expansion and progress.

Financial Strength

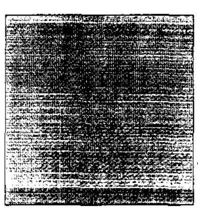
I am pleased to report that the fourth quarter of 2005 was the 56th consecutive quarter, covering more than 14 years, in which revenues increased over the prior year quarter. Revenues for the fourth quarter of 2005 increased 9% over the prior year period to $281.0 million. Revenues for the year increased 8% over the prior year to $1.09 billion. Net income for the year was $21.2 million, or $0.66 per diluted common share, versus $21.5 million, or $0.23 per diluted common share, in the prior year.

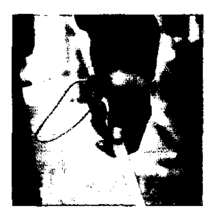
During 2005, we completed a restructuring of debt through a private placement of $150 million of Senior Notes due October 15, 2013. In addition we amended and restated our senior secured credit facility, consisting of a $175 million revolver, which could be increased to $225 million at our option. The completion of these financing transactions substantially strengthens the balance sheet of our company. Also, the willingness of investors and lenders to invest in ResCare endorses our business plan and confirms the strength of the company.

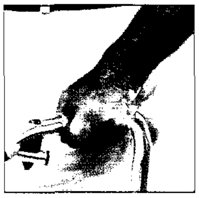
During the refinancing, Moody's upgraded ResCare's corporate rating from B1 to Ba3. Standard and Poor's affirmed the corporate credit rating of B+, while increasing the outlook from stable to positive.

Personnel

In the third quarter of 2005, our operations team faced incredible logistical challenges in the wake of Hurricanes Katrina and Rita. Many of our employees suffered personal losses. However, their commitment to the individuals we serve was nothing short of heroic.





ResCare evacuated nearly 500 people during Hurricanes Katrina and Rita. We moved 100 people with the most critical needs to homes in Texas and Indiana and provided those remaining with full services in our other Louisiana operations.

The logistics, planning and execution of the evacuations were superbly handled. I offer my heartfelt thanks to the employees who stood by us and the people we serve ensuring their safety and health. I have never been more proud of our company.

At an executive level, I would like to highlight the promotion of David W. Miles as our new Chief Financial Officer. David, who is a certified public accountant, has been a member of the ResCare family since 1998 and served as Vice President and Controller until he took over as interim Chief Financial Officer in February 2005. Prior to joining ResCare, he was with Ernst & Young LLP for 10 years. It speaks well for David and for ResCare that, after a national search, the most qualified candidate for our CFO position was a strong member of our own team.

We hold all of our employees in high esteem and recognize that their efforts are the cornerstone of our success. In that regard, in 2005, we endorsed the Direct Support Professional Fairness and Security Act of 2005, HR 1264, introduced into Congress by Representatives Lee Terry and Lois Capps, whom we commend for their support of people with disabilities and the workers who care for them. The legislation is designed to promote adequate wages necessary to attract, train and retain the direct support workers who are essential for people with disabilities to live and work in their communities.

We hold all of our employees in high esteem and recognize that their efforts are the cornerstone of our success.

The bill is one outcome of the American Network of Community Options and Resources (ANCOR) National Advocacy Campaign's efforts to improve wages of more than two million direct support professionals in America. ResCare has been a leading participant in initiating and maintaining the campaign that began in 2001.

Past and Future

The past year has been a success. It is comforting and fulfilling to be able to make that statement to our shareholders. Such an achievement is particularly rewarding to all of us at ResCare because our success means a better life for others as well. The linkage between our obligation to shareholders and to the people we serve is direct and measurable. The value we add to employees, shareholders and to society is real and compelling. Helping someone to build a life and giving them an opportunity to contribute is a noble and rewarding goal for a public company. We consider it an honor, and we take it very seriously.

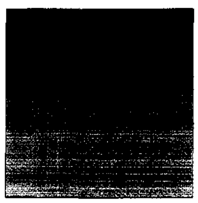
2006 holds great promise for ResCare. We have more capital to put to work, there are great opportunities in the marketplace and there are people who need our services.

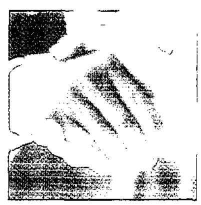
Of course, we will remain disciplined and measured in our approach, but, under the circumstances, it is difficult not to be excited about our situation and the advantage we have in our industry. We have a full pipeline, it is still a buyer's market, we have a solid record of integrating acquisitions, and we expect this favorable investment environment to continue.

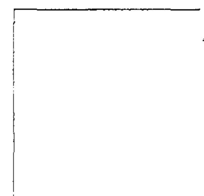
I am grateful to our employees and our shareholders. We appreciate your trust and the responsibility you have granted us to be stewards of your investment in ResCare.

Sincerely,

Ronald G. Geary
Chairman, President and Chief Executive Office







Investor Information

AUDITORS
KPMG LLP Louisville, KY

ANNUAL MEETING
The annual meeting of shareholders will be held at 10:00 a.m., June 22, 2006, at Louisville Marriott East, 1903 Embassy Square Boulevard, Louisville, KY 40299

REGISTRAR AND TRANSFER AGENT
National City Bank, Stock Transfer Department, P.O. Box 92301, Cleveland, OH 44193-0900
(800) 622-6757

Inquiries regarding stock transfers, lost certificates or address changes should be sent to the above address.

COMMON STOCK
ResCare stock is traded on NASDAQ (RSCR)

FORM 10-K AND OTHER INFORMATION
The Annual Report to the Securities and Exchange Commission on Form 10-K and other financial information such as interim and annual reports to shareholders are available without charge upon request:

Investor Relations Department
ResCare
10140 Linn Station Road
Louisville, KY 40223
Phone: (502) 394-2100
Fax: (502) 394-2251
communication@rescare.com

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

[X] **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2005**

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for transition period from to __________________

Commission File Number: 0-20372

RES-CARE, INC.

(Exact name of registrant as specified in its charter)

KENTUCKY (State or other jurisdiction of incorporation or organization)	**61-0875371** (IRS Employer Identification No.)
10140 Linn Station Road **Louisville, Kentucky** (Address of principal executive offices)	**40223** (Zip Code)

Registrant's telephone number, including area code: **(502) 394-2100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Act. Yes __ No ✓.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ___ No ✓.

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ✓ No___.

Indicate by check mark if disclosure of delinquent filers pursuant 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 of this Form 10-K. __

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12-b of the Act (Check one): Large accelerated filer: __ Accelerated filer: ✓ Non-accelerated filer: __

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

The aggregate market value of the shares of registrant held by non-affiliates of the registrant, based on the closing price of such on the NASDAQ National Market System on June 30, 2005, was approximately $343,345,000. For purposes of the foregoing calculation only, all directors and executive officers of the registrant and their affiliates have been deemed affiliates of the registrant. As of February 15, 2006, there were 27,072,738 shares of the registrant's common stock, no par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for its 2006 annual meeting of shareholders are incorporated by reference into Part III.

RES-CARE, INC. AND SUBSIDIARIES
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2005
TABLE OF CONTENTS

Preliminary Note Regarding Forward-Looking Statements

All references in this Annual Report on Form 10-K to "ResCare," "our company," "we," "us," or "our" mean Res-Care, Inc. and, unless the context otherwise requires, its consolidated subsidiaries. Statements in this report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act. In addition, we expect to make such forward-looking statements in future filings with the Securities and Exchange Commission, in press releases, and in oral and written statements made by us or with our approval. These forward-looking statements include, but are not limited to: (1) projections of revenues, income or loss, earnings or loss per share, capital structure and other financial items; (2) statements of plans and objectives of ResCare or our management or Board of Directors; (3) statements of future actions or economic performance, including development activities; and (4) statements of assumptions underlying such statements; and (5) statements about the limitations on the effectiveness of controls. Words such as "believes," "anticipates," "expects," "intends," "plans," "targeted," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially from those in such statements. Some of the events or circumstances that could cause actual results to differ from those discussed in the forward-looking statements are discussed in Item 1A – "Risk Factors." Such forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date on which such statement is made.

PART I

Item 1. Business

General

Res-Care, Inc. is a human service company that provides residential, therapeutic, job training aı educational supports to people with developmental or other disabilities, to youth with special needs, to adults wl are experiencing barriers to employment and to older people who need home care assistance. All references in th Annual Report on Form 10-K to "ResCare," "our company," "we," "us," or "our" mean Res-Care, Inc. an unless the context otherwise requires, its consolidated subsidiaries.

Our programs include an array of services provided in both residential and non-residential settings f adults and youths with mental retardation or other developmental disabilities (MR/DD), and youths who ha special educational or support needs, are from disadvantaged backgrounds, or have severe emotional disorder including some who have entered the juvenile justice system. We also offer, through drop-in or live-in service personal care, meal preparation, housekeeping and transportation to the elderly in their own homes. Additionall we provide services to welfare recipients, young people and people who have been laid off or have speci barriers to employment, to transition into the workforce and become productive employees. Because most of o MR/DD consumers require services over their entire lives and many states have extensive waiting lists f services, our MR/DD operations have experienced high occupancy rates. Occupancy rates in our employme training services operations experience shorter lengths of stay.

At December 31, 2005, we provided services on a daily basis to approximately 41,000 persons wit special needs in 34 states, Washington, D.C., Canada and Puerto Rico. We provide services on a daily basis t approximately 26,500 individuals with disabilities in community group homes, personal residences and oth community-based programs and in larger facilities, to approximately 7,000 disadvantaged youths in federall funded Job Corps centers, and to approximately 7,500 welfare recipients and individuals who have been laid o or have barriers to employment.

On January 3, 2006, our Employment Training Services segment completed the purchase of the operatin assets and business of the Workforce Services Group of Affiliated Computer Services, Inc. (ACS Workforc Services). ACS Workforce Services has contracts in 15 states and Washington, D.C. and provides services t adults who have lost their jobs or face some barrier to employments. After this transaction, we provide services t persons with special needs in 36 states, Washington, D.C., Canada and Puerto Rico.

Description of Services by Segment

As of December 31, 2005, we had three reportable operating segments: (i) Disabilities Services, (ii) Jo Corps Training Services and (iii) Employment Training Services.

Effective January 1, 2006, in order to better reflect the services provided, the Disabilities Service segment is now named Community Services and will be referenced as such throughout this Annual Report o Form 10-K. Note 9 of the Notes to Consolidated Financial Statements includes additional information regardin our segments, including the disclosure of required financial information. The information in Note 9 i incorporated herein by reference and should be read in conjunction with this section.

Community Services

We are the nation's largest private provider of services for individuals with mental retardation or othe developmental disabilities, and we also provide periodic in-home care services to the elderly. At December 31 2005, we served individuals in 28 states. Our programs, administered in both residential and non-residentia settings, are based predominantly on individual support plans designed to encourage greater independence and th development or maintenance of daily living skills. These goals are achieved through tailored application of our different services including social, functional and vocational skills training, supported employment and emotional and psychological counseling. Individuals are supported by an interdisciplinary team consisting of our employees and professional contractors, such as qualified mental retardation professionals, or QMRPs, support/service coordinators, physicians, psychologists, therapists, social workers and other direct support professionals.

For our individuals with MR/DD, we offer an alternative to large, state-run institutional settings by providing high quality, and individually focused programs on a more cost efficient basis than traditional state-run programs. For our elderly clients, we provide support services and training to enable the individuals to continue to live safely in their home and remain active in their community.

Our community services are provided in a variety of different environments including:

- *Periodic In-Home Services.* These programs offer periodic and customized support to assist and provide respite care to primary caregivers. Our services enable select individuals with MR/DD to return home and receive care away from large, state-run institutions. This is often an alternative that states offer to assist the caregivers of individuals with MR/DD who are on a waiting list for long-term care placement. Our services also enable elderly individuals who need assistance to be served in the comfort of their own homes. For both individuals with MR/DD and the elderly, service is provided on an hourly basis and is coordinated in response to the individual's identified needs and may include personal care, habilitation, respite care, attendant care and housekeeping.

- *Group Homes.* Our group homes are family-style houses in the community where four to eight individuals live together usually with full time staffing for supervision and support. Individuals are encouraged to take responsibility for their home, health and hygiene and are encouraged to actively take part in work and community functions.

- *Supported Living.* Our supported living programs provide services tailored to the specific needs of one, two or three individuals living in a home or an apartment in the community. Individuals may need only a few hours of staff supervision or support each week or they may require services 24 hours a day.

- *Residential Facilities.* Seventeen of our approximately 3,300 service sites are larger residential facilities, which provide around-the-clock support to ten or more individuals. In these facilities, we strive to create a home-like atmosphere that emphasizes individuality and choice.

- *Vocational Skills Training and Day Programs.* These programs offer individuals with developmental disabilities the opportunity to become active in their communities and/or attain meaningful employment. Vocational skills training programs contract with local industries to provide short or long-term work. Day programs provide interactive and educational activities and projects for individuals to assist them in reaching their full potential.

We believe that the breadth and quality of our services and support and training programs makes us attractive to state and local governmental agencies and not-for-profit providers who may wish to contract with us. Our programs are designed to offer specialized support to these individuals not generally available in larger state institutions and traditional long-term care facilities.

- *Social Skills Training.* Social skills training focuses on problem solving, anger management and adaptive skills to enable individuals with disabilities to interact with others in the residential setting and in their community. We emphasize contact with the community at-large as appropriate for each individual. The desired outcome is to enable each individual to participate in home, family and community life as fully as possible.

Many individuals with developmental and other disabilities require behavioral intervention services. We provide these services through psychiatrists, psychologists and behavioral specialists, most of whom serve as consultants on a contract basis. All operations utilize a non-aversive approach to behavior support which is designed to avoid consequences involving punishment or extreme restrictions on individual rights. Whenever possible, the interdisciplinary team and direct support staff employ behavior support techniques rather than psychotropic medications to modify behavior, the goal being to minimize the use of medications whenever possible. When indicated, medications are administered in strict compliance with all applicable regulations.

- *Functional Skills Training.* Functional skills training encourages mastery of personal skills and the achievement of greater independence. As needed, individual habilitation or support plans may focus on basic skills training or maintenance in such areas as personal hygiene and dressing, as well as more complex activities such as shopping and use of public transportation. Individuals are encouraged to participate in daily activities such as housekeeping and meal preparation as appropriate.

- *Vocational Skills Training and Day Programs.* We provide extensive vocational training or specialized day programs for many of the individuals we support. Some individuals are able to be placed in community-based jobs, either independently or with job coaches, or may participate as a member of a work team contracted for a specific service such as cleaning, sorting or maintenance. Clients not working in the community may be served through vocational workshops or day programs appropriate for their needs. We operate such programs and also contract for these services with outside providers. Our philosophy is to enable all individuals served to perform productive work in the community or otherwise develop vocational skills based on their individual abilities. Individuals participating in specialized day programs may have physical or health restrictions which prevent them from being employed or participating in vocational programs. Specialized day programs may include further training in daily living skills, community integration or specialized recreation activities.

- *Counseling and Therapy Programs.* Our counseling and therapy programs address the physical, emotional and behavioral challenges of individuals with MR/DD and the elderly. Goals of the programs include the development of enhanced physical agility and ambulation, acquisition and/or maintenance of adaptive skills for both personal care and work, as well as the development of coping skills and the use of alternative, responsible, and socially acceptable interpersonal behaviors. Individualized counseling programs may include group and individual therapies. Occupational and physical therapies and therapeutic recreation are provided based on the assessed needs of each individual.

At each of our operations, we provide comprehensive individualized support and training programs tha encourage greater independence and the development of personal and vocational skills commensurate with th particular person's capabilities. As they progress, new programs are created to encourage greater independence self-respect and the development of additional personal, social and/or vocational skills.

Revenues for our Community Services operations are derived primarily from services provided under th Medicaid program administered by the states and from management contracts with private operators, generall not-for-profit providers, who contract with state government agencies and are also reimbursed under the Medicai program. Our services include social, functional and vocational skills training, supported employment an emotional and psychological counseling for individuals with mental retardation or other developmental disabilities. We also provide respite, therapeutic and other services on an as-needed basis or hourly basis through our periodic in-home services programs that are reimbursed on a unit-of-service basis. Reimbursement methods vary by state and service type, and may be based on a variety of methods including flat-rate, cost-based reimbursement, per person per diem, or unit-of-service basis. Generally, rates are adjusted annually based upon historical costs experienced by us and by other service providers, or economic conditions and their impact on state budgets. At facilities and programs where we are the provider of record, we are directly reimbursed under state Medicaid programs for services we provide and such revenues are affected by occupancy levels. At most facilities and programs that we operate pursuant to management contracts, the management fee is negotiated with the provider of record. See Notes to Consolidated Financial Statements included in this Annual Report for a further discussion of our revenue recognition policies with respect to Medicaid contracts.

Job Corps Training Services

Since 1976, we have been operating programs for disadvantaged youths through the federal Job Corps program administered by the Department of Labor (DOL), which provides for the educational and vocational skills training, health care, employment counseling and other support necessary to enable disadvantaged youths to become responsible working adults. The Job Corps program is designed to address the severe unemployment problem faced by disadvantaged youths throughout the United States and Puerto Rico. The typical Job Corps student is a 16-24 year old high school dropout who reads at the seventh grade level, comes from a disadvantaged background, has not held a regular job, and was living in an environment characterized by a troubled home life or other disruptive conditions.

We operate 17 Job Corps centers in nine states and Puerto Rico with contract capacity for approximately 7,000 students. We also provide, under separate contracts with the Department of Interior or the primary operator, certain administrative, counseling, educational, vocational and other support services for four Job Corps centers not operated by us. Our centers currently operate at approximately 92% capacity due to high demand, however, only approximately 1% of the eligible population in the United States is served by some type of Job Corps program due to funding constraints. Each center offers training in several vocational areas depending upon the particular needs and job market opportunities in the region. Students are required to participate in basic education classes to improve their academic skills and complement their vocational training. High school equivalency classes are available to obtain GED certificates. We provide these services in campus-style settings utilizing housing and classroom facilities owned and managed by the DOL. Upon completion of the program, each student is referred to the nearest job placement agency for assistance in finding a job or enrolling in a school or training program. Approximately 89% of the students completing our programs have obtained jobs or continue their education elsewhere.

Under Job Corps contracts, we are reimbursed for direct facility and program costs related to Job Corps center operations, allowable indirect costs for general and administrative costs, plus a predetermined management fee. The management fee can take the form of a fixed contractual amount or be computed based on certain performance criteria. All such amounts are reflected as revenue, and all such direct costs are reflected as facility and program costs. Final determination of amounts due under Job Corps contracts is subject to audit and review by the DOL, and renewals and extension of Job Corps contracts are based in part on performance reviews.

Employment Training Services

We operate job training and placement programs that assist welfare recipients and disadvantaged job seekers in finding employment and improving their career prospects. We currently operate 57 career centers in eleven states serving over 7,500 individuals at any one time, or approximately 350,000 annually. These centers are part of a nationwide system of government-funded offices that provide assistance, job preparation and placement to any youth or adult. The services include providing information on the local labor market, vocational assessments, career counseling, workshops to prepare people for success in the job market, referrals to occupational skill training for high-demand occupations, job search assistance, job placement and help with job retention and career advancement. Many of our centers are designed as "one-stop" career centers, which serv both job seekers and employers. Several types of assistance are offered by different organizations in a sing facility. In addition to job seekers, "one-stop" centers serve the business community by providing job matchin; screening, referral, and other specialized services for employers. Our Employment Training Services programs a administered under performance-based and fixed fee contracts with local and state governments funded by feder agencies, including the DOL and Department of Health and Human Services.

Other

A small portion of our business is dedicated to operating charter schools and international job training an placement agencies. Together these represent less than 1% of our total revenues.

Operations

Community Services

Community Services operations are organized under geographic regions. In general, each cluster of grou homes, supported living program or larger facility is overseen by an executive director. In addition, a prograr manager supervises a comprehensive team of professionals and community-based consultants who participate i the design and implementation of individualized programs for each individual served. QMRPs work with direc service staff and professionals involved in the programs to ensure that quality standards are met and that progres towards each individual's goals and objectives are monitored and outcomes are achieved. Individual support plan are reviewed and modified by the team as needed. The operations utilize community advisory boards an consumer satisfaction surveys to solicit input from professionals, family members and advocates, as well as fron the neighboring community, on how to continue to improve service delivery and increase involvement with th neighborhood or community.

Our direct service staff has the most frequent contact with the individuals we serve and generally i recruited from the community in which the facility or program is located. These staff members are screened t meet certain qualification requirements and receive orientation, training and continuing education.

The provision of community services is subject to complex and substantial state and federal regulation and we strive to ensure that our internal controls and reporting systems comply with Medicaid and other progran requirements, policies and guidelines. We design and implement programs, often in coordination with appropriat state agencies, in order to assist the state in meeting its objectives and to facilitate the efficient delivery of qualit services. Under the direction of our Compliance department, management and staff keep current with new laws regulations and policy directives affecting the quality and reimbursement of the services provided.

We have developed a model of ongoing program evaluation and quality management which we believe provides critical feedback to measure the quality of our various operations. Each operation conducts its owr quality assurance program using the ResCare Best in Class (BIC) performance benchmarking system. BIC performance results are reviewed by management on an on-going basis. Management and operational goals anc objectives are established for each facility and program as part of an annual budget and strategic planning process A weekly statistical reporting system and quarterly statement of progress provide management with relevant and timely information on the operations of each facility. Survey results from governmental agencies for each operation are recorded in a database and summary reports are reviewed by senior management. We believe the BIC system is a vital management tool to evaluate the quality of our programs and has been useful as a marketing tool to promote our programs, since it provides more meaningful information than is usually provided by routine monitoring by governmental agencies. All Community Services senior staff participate in a performance-based management system which evaluates individual performance based on critical job function outcomes. Additionally, we demonstrate our commitment to the professional development of our employees by offering classes and training programs, as well as tuition reimbursement benefits.

Job Corps Training Services

We operate our Job Corps centers under contracts with the DOL, which provides the facility. We are directly responsible for the management, staffing and administration of our Job Corps centers. Our typical Job Corps operation consists of a three-tier management staff structure. The center director has the overall responsibility for day-to-day management at each facility and is assisted by several senior staff managers who typically are responsible for academics, vocational training, social skills, safety and security, health services and behavior management. Managers are assisted by front line supervisors who have specific responsibilities for such areas as counseling, food services, maintenance, finance, residential life, recreation, property, purchasing, human resources and transportation.

An outcome performance measurement report for each center, issued by the DOL monthly, measures two primary categories of performance: (i) education results, as measured by GED/HSD achievement and/or vocational completion and attainment of employability skills; and (ii) placements of graduates. These are then combined into an overall performance rating. The DOL ranks centers on a 100-point scale. We review performance standards reports and act upon them as appropriate to address areas where improvement is needed. As of the end of the most recent performance year ended July 2005, we were the highest rated contractor of Job Corps centers under these measures.

Employment Training Services

We operate our programs under contracts with local and state funding sources, such as "Workforce Investment Boards," who receive federal funds passed down to states and localities – cities, counties, or consortia thereof. The physical facilities that house these programs are leased by us, either from private landlords or from local funding sources under resource sharing agreements. The management structure is two-tiered, with on-site staff in the field receiving technical assistance and support in operations and financial management from a regional office. Field level program directors are responsible for day-to-day operation of their program, supervising staff that provides varying combinations of assessment, counseling, case management, instruction, job development and placement, and job retention/career advancement services. Each field director reports to a regional project director in the support office, who is responsible for overall management of each contract.

Basic performance measures are prescribed by the federal government, and supplemented at the discretion of state and local funding sources, through local option. Effective July 1, 2005, the U.S. Office of Management and Budget has implemented a standard set of "Common Measures" that are applied to all human and social services programs operated by six federal agencies – including the Departments of Labor and Health & Human Services, from which the bulk of our funding originates. The common measures include, for adults: entered employment, earnings change after six months, employment retention after six and nine months, and cost effectiveness – measured by cost per participant. The common measures for youth are: literacy and numeracy gains; attainment of degree or certificate; placement in employment, education, training, or the military; and cost per participant. Methods of performance evaluation and analysis by funding sources vary by state and locality. We review performance of all programs internally, on a weekly, monthly, quarterly, and annual basis.

Contracts

State Contracts. We participate under contracts that are regulated by federal and state agencies as a provider of services under Medicaid. Although the contracts generally have a stated term of one year and generally may be terminated without cause on 60 days notice, the contracts are typically renewed annually if we have complied with licensing, certification, program standards and other regulatory requirements. Serious deficiencies can result in delicensure or decertification actions by these agencies. As provider of record, we contractually obligate ourselves to adhere to the applicable federal and state regulations regarding the provision of services, the maintenance of records and submission of claims for reimbursement under Medicaid and pertinent state Medicaid Assistance programs. Pursuant to provider agreements, we agree to accept the payment received from the government entity as payment in full for the services administered to the individuals and to provide the government entity with information regarding the owners and managers of ResCare, as well as to comply wi requests and audits of information pertaining to the services rendered. Provider agreements can be terminated ; any time for non-compliance with the federal, state or local regulations. Reimbursement methods vary by sta and service type and can be based on flat-rate, cost-based reimbursement, per person per diem, or unit-of-servic basis. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes t Consolidated Financial Statements.

Management Contracts. Private operators, generally not-for-profit providers who contract with stat agencies, typically contract us to manage the day-to-day operations of facilities or programs under manageme contracts. Most of these contracts are long-term (generally two to five years in duration, with several contract having 30-year terms) and are subject to renewal or re-negotiation provided that we meet program standards an regulatory requirements. Most management contracts cover groups of two to 16 facilities except in West Virgini in which contracts cover individual homes. Depending upon the state's reimbursement policies and practice management contract fees are computed on the basis of a fixed fee per individual, which may include some forr of incentive payment, a percentage of operating expenses (cost-plus contracts), a percentage of revenue or a overall fixed fee paid regardless of occupancy. Our management contracts provide for working capital advance to the provider of record, subject to the contractual arrangement. Historically, our Medicaid provider contracts an management contracts have been renewed or satisfactorily renegotiated.

Job Corps Contracts. Contracts for Job Corps centers are awarded pursuant to a rigorous bid process After successfully bidding, we operate the Job Corps centers under comprehensive contracts negotiated with th DOL. Under Job Corps contracts, we are reimbursed for all facility and program costs related to Job Corps cente operations, allowable indirect costs for general and administrative costs, plus a predetermined management fee normally a fixed percentage of facility and program costs. For certain of our current contracts and any contrac renewals, the management fee is a combination of fixed and performance-based.

The contracts cover a five-year period, consisting of an initial two-year term with three one-year renewa terms exercisable at the option of the DOL. The contracts specify that the decision to exercise an option is base on an assessment of: (i) the performance of the center as compared to its budget; (ii) compliance with federal state and local regulations; (iii) qualitative assessments of center life, education, outreach efforts and placemen record; and (iv) the overall rating received by the center. Shortly before the expiration of the five-year contrac period (or earlier if the DOL elects not to exercise a renewal term), the contract is re-bid, regardless of the operator's performance. The current operator may participate in the re-bidding process. In situations where the DOL elects not to exercise a renewal term, however, it is unlikely that the current operator will be successful ir the re-bidding process. It is our experience that there is usually an inverse correlation between the performance ratings of the current operator and the number of competitors who will participate in the re-bidding process, with relatively fewer competitors expected where such performance ratings are high.

As of February 15, 2006, we operate seventeen Job Corps centers under fourteen separate contracts with the DOL, one of which expires in 2006, one in 2007, two in 2008, five in 2009, three in 2010, and two in 2011. We intend to selectively pursue additional centers through the Request for Proposals (RFP) process.

We also provide, under separate contracts with the Department of Interior or the primary operator, certain administrative, counseling, educational, vocational and other support services for several Job Corps centers not operated by us.

Job Training and Placement Contracts and International Contracts. Contracts for the job training and placement centers and the international operations are awarded pursuant to a bid process. We are reimbursed for all facility and program costs related to the center or facility operations, allowable indirect costs plus a management fee. The contracts vary in duration, currently from six months to 36 months.

Marketing and Development

Our marketing activities focus on initiating and maintaining contacts and working relationships with state and local governments and governmental agencies responsible for the provision of the types of services offered by us, and identifying other providers who may consider a management contract arrangement or other transaction with us.

In our pursuit of government contracts, we contact governments and governmental agencies in geographical areas in which we operate and in others in which we have identified expansion potential. Contacts are made and maintained by both regional operations personnel and corporate development personnel, augmented as appropriate by other senior management. We target new areas based largely on our assessment of the need for our services, the system of reimbursement, the receptivity to out-of-state and proprietary operators, expected changes in the service delivery system (i.e., privatization or downsizing), the labor climate and existing competition.

We also seek to identify service needs or possible changes in the service delivery or reimbursement system of governmental entities that may be driven by changes in administrative philosophy, budgetary considerations, pressure or legal actions brought by advocacy groups. As needs or possible changes are identified, we attempt to work with and provide input to the responsible government personnel and to work with provider associations and consumer advocacy groups to this end. If an RFP results from this process, we then determine whether and on what terms we will respond and participate in the competitive process.

With regard to identifying other providers who may be management contract or other transaction candidates, we attempt to establish relationships with providers through presentations at national and local conferences, membership in national and local provider associations, direct contact by mail, telephone or personal visits.

In some cases, we may be contacted directly and requested to submit proposals or become a provider in order to provide services to address specific problems. These problems may include an emergency takeover of a troubled operation or the need to develop a large number of community placements within a certain time period. Before taking over these operations, which may be financially and/or operationally troubled, the operations generally must meet specific criteria. These criteria include the ability to "tuck-in" the operations into our existing group home clusters, thereby substantially eliminating general and administrative expenses of the absorbed operations.

Referral Sources

We receive substantially all of our MR/DD clients from third party referrals. Generally, family members of individuals with MR/DD are made aware of available residential or alternative living arrangements through a state or local case management system. Case management systems are operated by governmental or private agencies. Other service referrals come from doctors, hospitals, private and workers' compensation insurers and attorneys. In either case, where it is determined that some form of service is appropriate, a referral of one or more providers of such services is then made to family members or other interested parties.

We generally receive referrals or placements of individuals to our youth and training programs, other than Job Corps, through state or local agencies or entities responsible for such services. Individuals are recruited to our Job Corps programs largely through private contractors. We also have contracts directly with the DOL to recruit students to our own centers. Our reputation and prior experience with agency staff, case workers and others in positions to make referrals to us are important for building and maintaining census in our operations.

Customers

We are substantially dependent on revenues received under contracts with federal, state and loca government agencies. For the year ended December 31, 2005, we derived 9% of our revenues under contracts fc MR/DD services in Texas and 14% of our revenues under contracts under the federal Job Corps program Generally, these contracts are subject to termination at the discretion of governmental agencies and in certai other circumstances such as failure to comply with applicable regulations or quality of service issues.

Seasonality

We operate certain alternative and private schools which are subject to seasonality as a result of schoc being out of session in parts of the second and third quarters. However, this seasonality does not have a significan impact on our consolidated results of operations.

Foreign Operations

We operate certain programs in Canada, through contracts with Canadian governmental agencies t provide services. The operating results of these programs are not significant to our consolidated results o operations.

We created an international operations unit in late 2004. For the year ended December 31, 2005, ou international job training and placement operations, located in Iraq and Jordan, generated revenues o approximately $1.1 million, representing approximately 0.1% of total revenues. Our international operations uni had minimal financial impact in 2004. Our subcontract operating certain employment training centers in Ira terminated effective September 30, 2005. For the nine months ended September 30, 2005, the Iraq contrac generated revenues of approximately $1.0 million. The termination of this contract did not have a material impac on our consolidated financial condition, results of operations or cash flows.

Competition

Our Community Services, Job Corps Training Services and Employment Training Services segments are subject to a number of competitive factors, including range and quality of services provided, cost-effectiveness. reporting and regulatory expertise, reputation in the community, and the location and appearance of facilities anc programs. These markets are highly fragmented, with no single company or entity holding a dominant market share. We compete with other for-profit companies, not-for-profit entities and governmental agencies.

With regard to Community Services, individual states remain a provider of MR/DD services, primarily through the operation of large institutions. Not-for-profit organizations are also active in all states and range from small agencies serving a limited area with specific programs to multi-state organizations. Many of these organizations are affiliated with advocacy and sponsoring groups such as community mental health and mental retardation centers and religious organizations.

Currently, only a limited number of companies actively seek Job Corps contracts because the bidding process is highly specialized and technical and requires a significant investment of personnel and other resources over a period of several months. Approximately one-half of the privately operated centers are operated by the three largest operators. Competition for Job Corps contracts has increased as the DOL has made efforts to encourage new participants in the program, particularly small businesses, including minority-owned businesses.

The job training and placement business is also one that other entities may enter without substantial capital investment. The industry is currently served by a small number of large for-profit service providers and several thousand, largely non-profit providers.

Certain proprietary competitors operate in multiple jurisdictions and may be well capitalized. We also compete in some markets with smaller local companies that may have a better understanding of the local conditions and may be better able to gain political and public acceptance. Such competition may adversely affect our ability to obtain new contracts and complete transactions on favorable terms. We face significant competition from all of these providers in the states in which we now operate and expect to face similar competition in any state that we may enter in the future.

Professional staff retention and development is a critical factor in the successful operation of our business. The competition for talented professional personnel, such as therapists and QMRPs, is intense. We typically utilize a standard professional service agreement for provision of services by certain professional personnel, which is generally terminable on 30 or 60-day notice. The demands of providing the requisite quality of service to individuals with special needs contribute to a high turnover rate of direct service staff, which may lead to increased overtime and the use of outside consultants and other personnel. Consequently, a high priority is placed on recruiting, training and retaining competent and caring personnel.

Government Regulation and Reimbursement

Our operations are subject to compliance with various federal, state and local statutes and regulations. Compliance with state licensing requirements is a prerequisite for participation in government-sponsored assistance programs, such as Medicaid. The following sets forth in greater detail certain regulatory considerations applicable to us:

Funding Levels. Federal and state funding for our Community Services business is subject to statutory and regulatory changes, administrative rulings, interpretations of policy, intermediary determinations and governmental funding restrictions, all of which may materially increase or decrease program reimbursement. Congress has historically attempted to curb the growth of federal funding of such programs, including limitations on payments to programs under the Medicaid program. Although states in general have historically increased rates to compensate for inflationary factors, some have curtailed funding due to state budget deficiencies or other reasons. In such instances, providers acting through their state trade associations may attempt to negotiate or employ legal action in order to reach a compromise settlement. Future revenues may be affected by changes in rate structures, state budgets, methodologies or interpretations that may be proposed or under consideration in states where we operate.

Reimbursement Requirements. To qualify for reimbursement under Medicaid programs, facilities and programs are subject to various requirements of participation and other requirements imposed by federal and state authorities. In order to maintain a Medicaid or state contract, certain statutory and regulatory requirements must be met. These participation requirements relate to client rights, quality of services, physical facilities and administration. Long-term providers, like our company, are subject to periodic unannounced inspection by state authorities, often under contract with the appropriate federal agency, to ensure compliance with the requirements of participation in the Medicaid or state program.

Licensure. In addition to Medicaid participation requirements, our facilities and programs are usually subject to annual licensing and other regulatory requirements of state and local authorities. These requirements relate to the condition of the facilities, the quality and adequacy of personnel and the quality of services. State licensing and other regulatory requirements vary by jurisdiction and are subject to change and interpretation.

Regulatory Enforcement. From time to time, we receive notices from regulatory inspectors that, in their opinion, there are deficiencies for failure to comply with various regulatory requirements. We review such notices and take corrective action as appropriate. In most cases, we and the reviewing agency agree upon the steps to be taken to address the deficiency, and from time to time, we or one or more of our subsidiaries may enter into agreements with regulatory agencies requiring us to take certain corrective action in order to maintain licensure. Serious deficiencies, or failure to comply with any regulatory agreement, may result in the assessment of fines or penalties and/or decertification or delicensure actions by the Center for Medicare and Medicaid Services or stε regulatory agencies.

Restrictions on Acquisitions and Additions. All states in which we currently operate have adopted laws regulations which generally require that a state agency approve us as a provider, and many require a determinati that a need exists prior to the addition of covered individuals or services.

Cross Disqualifications and Delicensure. In certain circumstances, conviction of abusive or fraudule behavior with respect to one facility or program may subject other facilities and programs under common contr or ownership to disqualification from participation in the Medicaid program. Executive Order 12549 prohibits ar corporation or facility from participating in federal contracts if it or its principals (including but not limited officers, directors, owners and key employees) have been debarred, suspended, or declared ineligible, or ha been voluntarily excluded from participating in federal contracts. In addition, some state regulators provide th all facilities licensed with a state under common ownership or controls are subject to delicensure if any one more of such facilities are delicensed.

Regulation of Certain Transactions. The Social Security Act, as amended by the Health Insuranc Portability and Accountability Act of 1996 (HIPAA), provides for the mandatory exclusion of providers an related individuals from participation in the Medicaid program if the individual or entity has been convicted of criminal offense related to the delivery of an item or service under the Medicaid program or relating to neglect c abuse of residents. Further, individuals or entities may be, but are not required to be, excluded from the Medicai program in circumstances including, but not limited to, the following: convictions relating to fraud; obstruction c an investigation of a controlled substance; license revocation or suspension; exclusion or suspension from a stat or federal health care program; filing claims for excessive charges or unnecessary services or failure to furnis medically necessary services; or ownership or control by an individual who has been excluded from the Medicai program, against whom a civil monetary penalty related to the Medicaid program has been assessed, or who ha been convicted of a crime described in this paragraph. In addition, we are subject to the federal "anti-kickbac law" which makes it a felony to solicit, receive, offer to pay, or pay any kickback, bribe, or rebate in return fo referring a resident for any item or service, or in return for purchasing, leasing or ordering any good, service o item, for which payment may be made under the Medicaid program. A violation of the anti-kickback statute is felony and may result in the imposition of criminal penalties, including imprisonment for up to five years and/or fine of up to $25,000, as well as the imposition of civil penalties and/or exclusion from the Medicaid program Some states have also enacted laws similar to the federal anti-kickback laws that restrict business relationship among health care service providers.

Federal and state criminal and civil statutes prohibit false claims. Criminal provisions at 42 U.S.C Section 1320a-7b prohibit knowingly filing false claims or making false statements to receive payment o certification under Medicare and Medicaid, or failing to refund overpayments or improper payments. Violation are considered felonies punishable by up to five years imprisonment and/or $25,000 fines. Criminal penalties ma also be imposed pursuant to The Federal False Claims Act, which can be found at 18 U.S.C. Section 287. Ir addition, under HIPAA, Congress enacted a criminal health care fraud statute for fraud involving a health care benefit program, which it defined to include both public and private payors. Civil provisions at 31 U.S.C. Sectior 3729 prohibit the known filing of a false claim or the known use of false statements to obtain payment. Penaltie for violations are fines ranging from $5,500 to $11,000, plus treble damages, for each claim filed. Also, the statute allows any individual to bring a suit, known as a qui tam action, alleging false or fraudulent Medicare or Medicaid claims or other violations of the statute and to potentially share in any amounts paid by the entity to the government in fines or settlement. We have sought to comply with these statutes; however, we cannot assure you that these laws will ultimately be interpreted in a manner consistent with our practices or business transactions.

HIPAA also mandates, among other things, that the Department of Health and Human Services adopt standards for the exchange of electronic health information in an effort to encourage overall administrative simplification and enhance the effectiveness and efficiency of the healthcare industry. The Department of Health and Human Services must adopt standards for the following:

- Electronic transactions and code sets;
- Unique identifiers for providers, employers, health plans and individuals;
- Security and electronic signatures;
- Privacy; and
- Enforcement.

Although HIPAA was intended ultimately to reduce administrative expenses and burdens faced within the health care industry, we believe the law will initially bring about significant and, in some cases, costly changes. The Department of Health and Human Services has released several rules to date mandating the use of new standards with respect to certain health care transactions and health information. For instance, the Department of Health and Human Services has issued a rule establishing uniform standards for common health care transactions, including;

- Health care claims information;
- Plan eligibility, referral certification and authorization;
- Claims status;
- Plan enrollment and disenrollment;
- Payment and remittance advice;
- Plan premium payments; and
- Coordination of benefits.

The Department of Health and Human Services also has released standards relating to the privacy of individually identifiable health information. These standards not only require our compliance with rules governing the use and disclosure of protected health information, but they also require us to impose those rules, by contract, on any business associate to whom we disclose information. Sanctions for failing to comply with the HIPAA health information practices provisions include criminal penalties and civil sanctions.

Moreover, on February 20, 2003, the Department of Health and Human Services issued final rules governing the security of health information. These rules specify a series of administrative, technical and physical security procedures for entities such as us to use to ensure the confidentiality of electronic protected health information. The security standards became effective April 21, 2003, with a compliance date of April 21, 2005, for most covered entities.

In January 2004, the Center for Medicare/Medicaid Services published a rule announcing the adoption of the National Provider Identifier as the standard unique health identifier for health care providers to use in filing and processing health care claims and other transactions. The rule was effective May 23, 2005, with a compliance date of May 23, 2007.

Management believes that we are complying with those HIPAA rules that have gone into effect. Whil management anticipates that we will be able to fully comply with those HIPAA requirements that have not ye become effective, we cannot at this time estimate the cost of compliance with such rules. Although the new healt information standards are likely to have a significant effect on the manner in which we handle health data an communicate with payors, based on our current knowledge, we believe that the cost of our compliance will nc have a material adverse effect on our business, financial condition or results of operations.

Environmental Laws. Certain federal and state laws govern the handling and disposal of medica infectious, and hazardous waste. Failure to comply with those laws or the regulations promulgated under ther could subject an entity covered by these laws to fines, criminal penalties, and other enforcement actions.

OSHA. Federal regulations promulgated by the Occupational Safety and Health Administration impos additional requirements on us including those protecting employees from exposure to elements such as blood borne pathogens. We cannot predict the frequency of compliance, monitoring, or enforcement actions to which w may be subject as regulations are implemented and there can be no assurance that such regulations will nc adversely affect our operations.

Insurance

We maintain professional and general liability, auto, workers' compensation and other business insuranc coverages. The professional and general liability coverage provides for a $1 million deductible per occurrence fo policy year commencing July 1, 2005, and claims limits of $5 million per occurrence up to a $6 million annua aggregate limit. The automobile coverage provides for a $1 million deductible per occurrence and claims limits o $5 million per occurrence up to a $5 million aggregate limit. In addition, excess liability limits of $15 millio have been purchased effective July 1, 2005, to bring the total liability coverage limits to $20 million. The exces liability policy covers the general and professional liability program, as well as the automobile liability program Our workers' compensation coverage provides for a $1 million deductible per occurrence, and claims up t statutory limits. The property coverage provides for an aggregate limit of $100 million, with varying deductible and sublimits depending on the type of loss. We believe insurance coverages and self-insurance reserves ar adequate for our current operations. However, we cannot assure that any potential losses on asserted claims wil not exceed such insurance coverages and self-insurance reserves.

Employees

As of December 31, 2005, we employed approximately 35,000 employees. As of that date, we wer subject to collective bargaining agreements with approximately 2,000 of our employees. We have not experience any work stoppages and believe we have good relations with our employees. The acquisition of ACS Workforc Services Group added approximately 3,000 employees, none of which are subject to collective bargainin agreements.

Available Information

ResCare files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports with the Securities and Exchange Commission (SEC). These reports are available at the SEC's website at http://www.sec.gov. Our reports will also be available on our website a http://www.rescare.com as soon as reasonably practicable after such material is electronically filed with o furnished to the SEC. You may also obtain electronic or paper copies of our SEC reports free of charge b contacting our communications department, 10140 Linn Station Road, Louisville, Kentucky 40223, (telephone 502-394-2100 or communications@rescare.com.

Item 1A. Risk Factors

Changes in federal, state and local reimbursement policies could adversely affect our revenues and profitability.

We derive virtually all of our revenues from federal, state and local government agencies, including state Medicaid programs. Our revenues therefore depend to a large degree on the size of the governmental appropriations for the services we provide. Budgetary pressures, as well as economic, industry, political and other factors, could influence governments not to increase and in some cases, to decrease appropriations for these services, which could reduce our revenues materially. In fact, in connection with Medicaid, a Medicaid commission has been established to advise the Secretary of the Department of Health and Human Services on, among other things, ways to achieve $10 billion in Medicaid savings over five years. Many state governments also continue to experience shortfalls in their Medicaid budgets despite cost containment efforts. Future federal or state initiatives could institute managed care programs for individuals we serve or otherwise make material changes to the Medicaid program as it now exists. Future revenues may be affected by changes in rate-setting structures, methodologies or interpretations that may be proposed or are under consideration in states where we operate. Furthermore, federal, state and local government agencies generally condition their contracts with us upon a sufficient budgetary appropriation. If a government agency does not receive an appropriation sufficient to cover its contractual obligations with us, it may terminate a contract or defer or reduce our reimbursement. Additionally, there is risk that previously appropriated funds could be reduced through subsequent legislation. For example, President Bush's proposed budget for fiscal 2007 proposes substantial cuts in federal spending for workforce employment and training. We cannot predict whether any of the proposed cuts will be made or how they will impact us. The loss or reduction of reimbursement under our contracts could have a material adverse effect on our business, financial condition and operating results.

Our revenues and operating profitability depend on our reimbursement rates.

Our revenues and operating profitability depend on our ability to maintain our existing reimbursement levels, to obtain periodic increases in reimbursement rates to meet higher costs and demand for more services, and to receive timely payment. If we do not receive or cannot negotiate increases in reimbursement rates at approximately the same time as our costs of providing services increase, our revenues and profitability could be adversely affected.

Labor shortages could reduce our margins and profitability and adversely affect the quality of our care.

Our cost structure and ultimate operating profitability are directly related to our labor costs. Labor costs may be adversely affected by a variety of factors, including limited availability of qualified personnel in each geographic area, local competitive forces, the ineffective utilization of our labor force, changes in minimum wages or other direct personnel costs, strikes or work stoppages by employees represented by labor unions, and changes in client services models, such as the trends toward supported living and managed care. The difficulty experienced in hiring direct service staff and nursing staff in certain markets from time to time has resulted in higher labor costs in some of our operating units. These higher labor costs are associated with increased overtime, recruitment and retention, training programs, and use of temporary staffing personnel and outside clinical consultants.

We face substantial competition in attracting and retaining experienced personnel, and we may be unable to grow our business if we cannot attract and return qualified employees.

Our success depends to a significant degree on our ability to attract and retain highly qualified and experienced social service professionals who possess the skills and experience necessary to deliver high quality services to our clients. These employees are in great demand and are likely to remain a limited resource for the foreseeable future. Contractual requirements and client needs determine the number, education and experience levels of social service professionals we hire. Our ability to attract and retain employees with the requisi experience and skills depends on several factors including, but not limited to, our ability to offer competiti wages, benefits and professional growth opportunities. The inability to attract and retain experienced personn could have a material adverse effect on our business.

We may not realize the anticipated benefit of any future acquisitions and we may experience difficulties i integrating these acquisitions.

As part of our growth strategy, we intend to make selective acquisitions, including the January 3, 200 acquisition of ACS Workforce Services. Growing our business through acquisitions involves risks because wi any acquisition there is the possibility that:

- we may be unable to maintain and renew the contracts of the acquired business;
- unforeseen difficulties may arise when integrating the acquired operations, including information systems and accounting controls;
- operating efficiencies, synergies, economies of scale and cost reductions may not be achieved as expected;
- the business we acquire may not continue to generate income at the same historical levels on which we based our acquisition decision;
- management may be distracted from overseeing existing operations by the need to integrate the acquired business;
- we may acquire or assume unexpected liabilities or there may be other unanticipated costs;
- we may fail to retain and assimilate key employees of the acquired business;
- we may finance the acquisition by additional debt and may become highly leveraged; and
- the culture of the acquired business may not match well with our culture.

As a result of these risks, there can be no assurance that any future acquisition will be successful or that will not have a material adverse effect on our business, financial condition and results of operations.

Our insurance coverage and self-insurance reserves may not cover future claims.

Changes in the market for insurance may affect our ability to obtain insurance coverage at reasonab rates. Changes in our annual insurance costs and self-insured retention limits depend in large part on the insuran market. The professional and general liability coverage provides for a $1 million deductible per occurrence f policy year commencing July 1, 2005, and claims limits of $5 million per occurrence up to a $6 million annu aggregate limit. The automobile coverage provides for a $1 million deductible per occurrence and claims limits $5 million per occurrence up to a $5 million aggregate limit. In addition, we purchased excess liability covera with limits of $15 million effective July 1, 2005, to bring the total liability coverage limits to $20 million. Tl excess liability policy covers the general and professional liability program, as well as the automobile liabili program. Our workers' compensation coverage provides for a $1 million deductible per occurrence, and claims u to statutory limits. The property coverage provides for an aggregate limit of $100 million, with varyir deductibles and sub-limits depending on the type of loss. We utilize historical data to estimate our reserves for o insurance programs. If losses on asserted claims exceed the current insurance coverage and accrued reserves, o business, results of operations, financial condition and ability to meet obligations under our indebtedness could t adversely affected.

Our industry is subject to substantial government regulation and if we fail to comply with those regulations, we could suffer penalties or be required to make significant changes to our operations.

The health care industry, including our company, is required to comply with extensive and complex laws and regulations at the federal, state and local government levels relating to, among other things:

- licensure and certification;
- adequacy and quality of health care services;
- qualifications of health care and support personnel;
- confidentiality, maintenance and security issues associated with medical records and claims processing;
- relationships with referral sources;
- operating policies and procedures;
- addition of facilities and services; and
- billing for services.

Many of these laws and regulations are expansive, and we do not always have the benefit of significant regulatory or judicial interpretation of them. In the future, different interpretations or enforcement of these laws and regulations could subject our current or past practices to allegations of impropriety or illegality or could require us to make changes in our facilities, equipment, personnel, services, capital expenditure programs and operating expenses.

If we fail to comply with applicable laws and regulations, we could be subject to various sanctions, including criminal penalties, civil penalties (including the loss of our licenses to operate one or more of our facilities) and exclusion of one or more of our facilities from participation in the Medicare, Medicaid and other federal and state health care programs. For example, one of our operating subsidiaries is subject to criminal charges brought by the Attorney General in one of the states in which we operate arising from the death of a client. This subsidiary served approximately 125 clients. We voluntarily surrendered the license of the subsidiary involved and settled the related civil litigation, which was covered by insurance. We believe we have viable defenses to the criminal allegations against this subsidiary and an adverse outcome would not affect the participation of our other facilities in federal and state health programs. If similar allegations were to arise in the future in respect of a more significant subsidiary or in respect of ResCare, an adverse outcome could have a material adverse effect on our business.

Both federal and state government agencies have heightened and coordinated civil and criminal enforcement efforts as part of numerous ongoing investigations of health care companies. These investigations relate to a wide variety of topics, including:

- billing practices;
- quality of care;
- financial relationships with referral sources; and
- medical necessity of services provided.

Like other participants in the health care industry, we receive requests for information from governmen agencies in connection with the regulatory or investigational authority. Moreover, health care providers are alsc subject to "qui tam" whistleblower lawsuits and false claims provisions at both the state and federal level.

We are required to comply with laws governing the transmission of privacy of health information.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires us to comply witl standards for the exchange of health information within our company and with third parties, such as payors business associates and patients. These include standards for common health care transactions, such as:

- claims information, plan eligibility, payment information and the use of electronic signatures;
- unique identifiers for providers, employers, health plans and individuals; and
- security, privacy and enforcement.

The Department of Health and Human Services has released final rules to implement a number of these requirements, and several HIPAA initiatives have become effective, including privacy protections, transactior standards and security standards. If we fail to comply with these standards, we could be subject to crimina penalties and civil sanctions.

Increases in regulatory oversight can result in higher operating costs.

Although we are operating in compliance with established laws and regulations, state regulatory agencies often have broad powers to mandate the types and levels of services we provide to individuals without providing appropriate funding. We have experienced this unfunded, increased regulatory oversight in the District of Columbia. This increased regulatory oversight has resulted in higher operating costs, including labor, consulting and maintenance expenditures, and historical losses. This, in turn, led to our decision to cease providing disabilities services in the District in the first half of 2006.

Our operations may subject us to substantial litigation.

Our management of residential, training, educational and support programs for our clients exposes us tc potential claims or litigation by our clients or other individuals for wrongful death, personal injury or othei damages resulting from contact with our facilities, programs, personnel or other clients. Regulatory agencies may initiate administrative proceedings alleging violations of statutes and regulations arising from our programs and facilities and seeking to impose monetary penalties on us. We could be required to pay substantial amounts of money to respond to regulatory investigations or, if we do not prevail, in damages or penalties arising from these legal proceedings and some awards of damages or penalties may not be covered by any insurance. If our third-party insurance coverage and self-insurance reserves are not adequate to cover these claims, it could have a material adverse effect on our business, results of operations, financial condition and ability to satisfy our obligations under our indebtedness.

Media coverage critical of us or our industry may harm our results.

Media coverage of the industry, including operators of facilities and programs for individuals with mental retardation and other developmental disabilities, has, from time to time, included reports critical of the current trend toward privatization and of the operation of certain of these facilities and programs. Adverse media coverage about providers of these services in general, and us in particular, could lead to increased regulatory scrutiny in some areas, and could adversely affect our revenues and profitability by, among other things, adversely affecting our ability to obtain or retain contracts, discouraging government agencies from privatizing facilities and programs, increasing regulation and resulting compliance costs, or discouraging clients from using our services.

Our facility and program expenses fluctuate.

Our facility and program expenses may also fluctuate from period to period, due in large part to changes in labor costs and insurance costs. Labor costs are affected by a number of factors, including the availability of qualified personnel, effective management of our programs, changes in service models, state budgetary pressures, severity of weather and other natural disasters. Our annual insurance costs and self-insured retention limits can rise due to developments in the insurance market or our claims history. Significant fluctuations in our facility and program expenses may adversely affect our business, results of operations and financial condition.

Our quarterly operating results may fluctuate significantly.

Our revenues and net income may fluctuate from quarter to quarter, in part because annual Medicaid rate adjustments may be announced by the various states at different times of the year and are usually retroactive to the beginning of the particular state's fiscal reporting period. Generally, future adjustments in reimbursement rates in most states will consist primarily of cost-of-living adjustments, adjustments based upon reported historical costs of operations, or other negotiated changes in rates. However, many states in which we operate are experiencing budgetary pressures and certain of these states, from time to time, have initiated service reductions, or rate freezes and/or rate reductions. Some reimbursement rate increases must be paid to our direct care staff in the form of wage pass-throughs. Additionally, some states have, from time to time, revised their rate-setting methodologies, which has resulted in rate decreases as well as rate increases.

Our inability to renew our existing contracts with governmental agencies and to obtain additional contracts would adversely affect our revenues.

Our Job Corps contracts are re-bid, regardless of operating performance, at least every five years. We may not be successful in bidding for contracts to operate, or to continue operating, Job Corps centers. Changes in the market for services and contracts, including increasing competition, transition costs or costs to implement awarded contracts, could adversely affect the timing and/or viability of future development activities. Additionally, many of our contracts are subject to state or federal government procurement rules and procedures. Changes in procurement policies that may be adopted by one or more of these agencies could also adversely affect our ability to obtain and retain these contracts.

If downsizing, privatization and consolidation in our industry do not continue, our business may not continue to grow.

The maintenance and expansion of our operations depend on the continuation of trends toward downsizing, privatization and consolidation, and our ability to tailor our services to meet the specific needs of the populations we serve. Our success in a changing operational environment is subject to a variety of political, economic, social and legal pressures, virtually all of which are beyond our control. Such pressures include a desire of governmental agencies to reduce costs and increase levels of services; federal, state and local budgetary constraints; political pressure from unions opposed to privatization or for-profit service providers; and actions brought by advocacy groups and the courts to change existing service delivery systems. Material changes resulting from these trends and pressures could adversely affect the demand for and reimbursement of our services and our operating flexibility, and ultimately our revenues and profitability.

If we fail to establish and maintain relationships with officials of government agencies, we may not be able to successfully procure or retain government-sponsored contracts which could negatively impact our revenues.

To facilitate our ability to procure or retain government-sponsored contracts, we rely in part on establishing and maintaining relationships with officials of various government agencies. These relationships enable us to maintain and renew existing contracts and obtain new contracts and referrals. These relationships also enable us to provide informal input and advice to the government agencies prior to the development of a "request for proposal" or program for privatization of social services and enhance our chances of procuring contracts with these payors. The effectiveness of our relationships may be reduced or eliminated with changes in the personnel holding various government offices or staff positions. We also may lose key personnel who have these relationships. Any failure to establish, maintain or manage relationships with government and agency personnel may hinder our ability to procure or retain government-sponsored contracts.

Events that harm our reputation with governmental agencies and advocacy groups could reduce our revenues and operating results.

Our success in obtaining new contracts and renewals of our existing contracts depends upon maintaining our reputation as a quality service provider among governmental authorities, advocacy groups for individuals with developmental disabilities and their families, and the public. We also rely on government entities to refer clients to our facilities and programs. Negative publicity, changes in public perception, the actions of clients under our care or investigations with respect to our industry, operations or policies could increase government scrutiny, increase compliance costs, hinder our ability to obtain or retain contracts, reduce referrals, discourage privatization of facilities and programs, and discourage clients from using our services. Any of these events could have a material adverse effect on our business, results of operations, financial condition or ability to satisfy our obligations under our indebtedness.

A loss of our status as a licensed service provider in any jurisdiction could result in the termination of existing services and our inability to market our services in that jurisdiction.

We operate in numerous jurisdictions and are required to maintain licenses and certifications in order to conduct our operations in each of them. Each state and county has its own regulations, which can be complicated, and each of our service lines can be regulated differently within a particular jurisdiction. As a result, maintaining the necessary licenses and certifications to conduct our operations can be cumbersome. Our licenses and certifications could be suspended, revoked or terminated for a number of reasons, including: the failure by some of our facilities or employees to properly care for clients; the failure to submit proper documentation to the government agency, including documentation supporting reimbursements for costs; the failure by our programs to abide by the applicable regulations relating to the provisions of human services; or the failure of our facilities to abide by the applicable building, health and safety codes and ordinances. We have had some of our licenses or certifications temporarily suspended in the past. If we lost our status as a licensed provider of human services in any jurisdiction or any other required certification, we would be unable to market our services in that jurisdiction, and the contracts under which we provide services in that jurisdiction could be subject to termination. Moreover, such an event could constitute a violation of provisions of contracts in other jurisdictions, resulting in other contract terminations. Any of these events could have a material adverse effect on our operations.

Expenses incurred under government contracts are subject to scrutiny.

We derive virtually all of our revenues from state and local government agencies, and a substantial portion of these revenues are state-funded with federal Medicaid matching dollars. As a result of our participation in these government funded programs, we are often subject to governmental reviews, audits and investigations to verify our compliance with applicable laws and regulations. As a result of these reviews, audits and investigations, these government payors may be entitled to, in their discretion:

- terminate or modify our existing contracts;
- suspend or prevent us from receiving new contracts or extending existing contracts because of violations or suspected violations of procurement laws or regulations;
- impose fines, penalties or other sanctions on us;
- reduce the amount we are paid under our existing contracts; and/or

- require us to refund amounts we have previously been paid.

In some states, we operate on a cost reimbursement model in which revenues are recognized at the time costs are incurred. In these states, payors audit our historical costs on a regular basis, and if it is determined that we do not have enough costs to justify our rates, our rates may be reduced, or we may be required to retroactively return fees paid to us. We cannot assure you that our rates will be maintained, or that we will be able to keep all payments made to us until an audit of the relevant period is complete.

Our revenue growth has been related to increases in the number of individuals served in each of our operating segments.

Our historical growth in revenues has been directly related to increases in the number of individuals served in each of our operating segments. This growth has depended largely upon development-driven activities, including the acquisitions of other businesses or facilities, the acquisition of management contract rights to operate facilities, the award of contracts to open new facilities or start new operations or to assume management of facilities previously operated by governmental agencies or other organizations, and the extension or renewal of contracts previously awarded to us. Our future revenues will depend primarily upon our ability to maintain, expand and renew existing service contracts and leases, and to a lesser extent upon our ability to obtain additional contracts to provide services to the special needs populations we serve, through awards in response to requests for proposals for new programs, in connection with facilities being privatized by governmental agencies, or by selected acquisitions.

We depend upon the continued services of certain members of our senior management team, without whom our business operations would be significantly disrupted.

Our success depends, in part, on the continued contributions of our executive officers and other key employees. Our management team has significant industry experience and would be difficult to replace. If we lose or suffer an extended interruption in the service of one or more of our senior officers, our financial condition and operating results could be adversely affected. Moreover, the market for qualified individuals is highly competitive and we may not be able to attract and retain qualified personnel to replace or succeed members of our senior management or other key employees, should the need arise.

Much of our revenue is derived from state and local government and government procedures can be complex.

Government reimbursement, group home credentialing and client Medicaid eligibility and service authorization procedures are often complicated and burdensome, and delays can result from, among other reasons, difficulties in timely securing documentation and coordinating necessary eligibility paperwork between agencies. These reimbursement and procedural issues occasionally cause us to have to resubmit claims several times before payment is remitted and are primarily responsible for our aged receivables. Changes in the manner in which state agencies interpret program policies and procedures, and review and audit billings and costs could also affect our business, results of operations, financial condition and our ability to meet obligations under our indebtedness.

If we cannot maintain our controls and procedures for managing our billing and collecting, our business, results of operations, financial condition and ability to satisfy our obligations under our indebtedness could be adversely affected.

The collection of accounts receivable is a significant management challenge and requires continual focus. The limitations of some state information systems and procedures, such as the ability to obtain timely documentation or disperse funds electronically, may limit the benefits we derive from our automated billing and collection system. We must maintain our controls and procedures for managing our billing and collection activities if we are to collect our accounts receivable on a timely basis. An inability to do so could adversely affect our business, results of operations, financial condition and ability to satisfy our obligations under ou indebtedness.

We may not be able to generate sufficient cash flows to meet our debt service obligations.

Our ability to generate sufficient cash flows from operations to make scheduled payments on our deb obligations and maintain compliance with various financial covenants contained in our debt arrangements wil depend on our future financial performance, which will be affected by a range of economic, competitive an business factors, many of which are outside of our control. If we do not generate sufficient cash flows fron operations to satisfy our debt obligations and maintain covenant compliance, we may have to undertak alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delayin capital investments or seeking to raise additional capital.

We can provide no assurance that any refinancing would be possible, that any assets could be sold, or, i sold, of the timing of the sales and the amount of proceeds realized from those sales, or that additional financin could be obtained on acceptable terms, if at all. Our inability to generate sufficient cash flows to satisfy our deb obligations, maintain covenant compliance or refinance our obligations on commercially reasonable terms woul have a material adverse effect on our business, financial condition and results of operations, as well as on ou ability to satisfy our obligations under our indebtedness.

We have a significant amount of debt, which could adversely affect our business financial condition an results of operations and could prevent us from fulfilling our obligations under the notes.

Our level of indebtedness could have important consequences, including:

- making it more difficult for us to satisfy our obligations under our indebtedness, which could result in an event of default under the debt;
- requiring us to dedicate a substantial portion of our cash flow from operations to make required payments on indebtedness, thereby reducing the availability of cash flow for working capital, capital expenditures and other general corporate purposes;
- limiting our ability to obtain additional financing in the future;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- impairing our ability to withstand a downturn in our business or in the economy generally; and
- placing us at a competitive disadvantage against other less leveraged competitors.

The occurrence of any one of these events could have a material adverse effect on our business, financial condition and results of operations, as well as our ability to satisfy our obligations under our indebtedness.

We operate in a highly competitive industry, which can adversely affect our results.

We compete with other for-profit companies, not-for-profit entities, and governmental agencies for contracts. Competitive factors may favor other providers, thereby reducing our success in obtaining contracts, which in turn would hinder our growth. Non-profit providers may be affiliated with advocacy groups, health organizations, or religious organizations that have substantial influence with legislators and government agencies. States may give preferences to non-profit organizations in awarding contracts. Non-profit providers also may have access to government subsidies, foundation grants, tax deductible contributions and other financial resources not available to us. Governmental agencies and non-profit providers may be subject to limits on liability that do not apply to us. In some markets, smaller local companies may have a better understanding of local conditions and may have more political and public influence than we do. The competitive advantages enjoyed by other providers may decrease our ability to procure contracts and limit our revenues. Increased competition may also result in pricing pressures, loss of or failure to gain market share or loss of clients or payors, any of which could harm our business.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2005, we owned approximately 85 properties and operated facilities and programs at approximately 1,960 leased properties. Other facilities and programs are operated under management contracts. We believe that our properties are adequate and suitable for our business as presently conducted.

Item 3. Legal Proceedings

From time to time, we, or a provider with whom we have a management agreement, become a party to legal and/or administrative proceedings that, in the event of unfavorable outcomes, may adversely affect revenues and period to period comparisons.

In July 2000, American International Specialty Lines Insurance Company, or AISL, filed a Complaint for Declaratory Judgment against us and certain of our subsidiaries in the U.S. District Court for the Southern District of Texas, Houston Division. In the Complaint, AISL sought a declaration of what insurance coverage was available to ResCare in the case styled *In re: Estate of Trenia Wright, Deceased, et al. v. Res-Care, Inc., et al.*, which was filed in Probate Court No. 1 of Harris County, Texas (the Lawsuit). After the filing, we entered into an agreement with AISL whereby any settlement reached in the Lawsuit would not be dispositive of whether the claims in the Lawsuit were covered under the insurance policies issued by AISL. AISL thereafter settled the Lawsuit for $9.0 million. It is our position that: (i) the Lawsuit initiated coverage under policies of insurance in more than one policy year, thus affording adequate coverage to settle the Lawsuit within coverage and policy limits, (ii) AISL waived any applicable exclusions for punitive damages by its failure to send a timely reservation of rights letter and (iii) the decision by the Texas Supreme Court in *King v. Dallas Fire Insurance Company*, 85 S.W.3d 185 (Tex. 2002) controls. Prior to the Texas Supreme Court's decision in the *King* case, summary judgment was granted in favor of AISL but the scope of the order was unclear. Based on the *King* decision, the summary judgment was set aside. Thereafter, subsequent motions for summary judgment filed by both AISL and ResCare were denied. The case was tried, without a jury, in late December 2003. On March 31, 2004, the Court entered a judgment in favor of AISL in the amount of $5.0 million. It is our belief that the Court improperly limited the evidence ResCare could place in the record at trial and the type of claims it could present. Accordingly, an appeal of the Court's decision has been filed with the Fifth Circuit Court of Appeals and a supersedeas bond has been filed with the Court of $6.0 million. Oral arguments were held on August 31, 2005. We have not made any provision in our consolidated financial statements for the potential liability that may result from final adjudication of this matter, as we do not believe it is probable that an unfavorable outcome will result from this matter. Based on the advice of counsel, we do not believe it is probable that the ultimate resolution of this matter will result in a material liability to us nor have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

On September 2, 2001, in a case styled *Nellie Lake, Individually as an Heir-at-Law of Christina Zellner, deceased; and as Personal Representative of the Estate of Christina Zellner v. Res-Care, Inc., et al.*, in the U.S. District Court of the District of Kansas at Wichita, a jury awarded noneconomic damages to Ms. Lake in the amount of $100,000, the statutory maximum, as well as $5,000 for economic loss. In addition, the jury awarded the Estate of Christina Zellner $5,000 of noneconomic damages and issued an advisory opinion recommending an award of punitive damages. On February 4, 2002, the jury awards were entered by the Court, along with an awai of punitive damages in the amount of $1 million. We appealed based on numerous appealable errors at trial ar settled the case without any contribution from AISL, for approximately $750,000. Prior to settlement, in Jul 2002, we filed a Declaratory Judgment action against AISL in the United States District Court for the Wester District of Kentucky alleging that the policy should be interpreted under Kentucky law, thus affording u coverage for $650,000 that AISL contends is not covered by insurance. We have since sought leave of court t amend our complaint for breach of contract, bad faith insurance practices, as well as unfair claims practices unde applicable Kentucky statutes. In the interim, AISL filed a motion to transfer this action to the U.S. District Cou of the District of Kansas which was granted. AISL filed a motion for summary judgment, which was denied, ou motion to amend our pleadings was granted and we filed a motion for partial summary judgment which i pending. Based on the advice of counsel, we believe any damages resulting from this matter are covered b insurance. We previously established a reserve in our consolidated financial statements for the potential liabilit that may reasonably result from final adjudication of this matter. Further, we believe that recovery of th settlement is probable and, therefore we do not believe that the ultimate resolution of this matter will have material adverse effect on our consolidated financial condition, results of operations or liquidity.

In August 1998, with the approval of the State of Indiana, we relocated approximately 100 individual from three of our larger facilities to community-based settings. In June 1999, in a lawsuit styled *Omega Healthcare Investors, Inc. v. Res-Care Health Services, Inc.*, the lessor of these facilities filed suit against us in U.S. District Court, Southern District of Indiana, alleging in connection therewith breach of contract, conversion and fraudulent concealment. In January 2001, January 2002 and July 2002, Omega filed amended complaints alleging wrongful conduct in the appraisal process for the 1999 purchase of three other facilities located in Indiana, for conversion of the Medicaid certifications of the 1998 Indiana facilities and a facility in Kentucky tha downsized in 1999, and for breach of contract in allowing the Kentucky facility to be closed. The parties had filed various motions for partial summary judgment. The Court denied Omega's motion seeking summary judgment on breach of contract on the termination of the three Indiana facility leases in 1998, the Kentucky lease termination and the 1999 purchase of three facilities in Indiana. In addition, the Court has granted ResCare's motion on the "unjust enrichment" and "conversion" of the Medicaid certifications, as well as the breach of contract claim in terminating the lease of the Kentucky facility and the alleged wrongful conduct in the appraisal process. The case previously set for trial in October 2005 was rescheduled for December 2005. During 2005, we established a reserve in our consolidated financial statements for the potential liability that may reasonably result from final adjudication of this matter and in November 2005 the case, except for the breach of contract claim in allowing the Kentucky facility to be closed, was settled within the reserved amounts. In January 2006, Omega filed a Notice of Appeal on the Kentucky breach of contract claim with the U.S. Court of Appeals for the Seventh Circuit, claiming nearly $3.7 million in compensatory damages. We believe that this appeal is without merit and will defend it vigorously. We have not made any provision in our consolidated financial statements for any potential liability that may result from this appeal. We do not believe that the ultimate resolution of this matter will have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

In addition, we are a party to various other legal and/or administrative proceedings arising out of the operation of our facilities and programs and arising in the ordinary course of business. We believe that, generally, these claims are without merit. Further, many of such claims may be covered by insurance. We do not believe the results of these proceedings or claims, individually or in the aggregate, will have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of ResCare's security holders during the fourth quarter of 2005.

PART II

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

Our common stock began trading on the NASDAQ National Market on December 15, 1992, under the symbol "RSCR". As of February 28, 2006, we had approximately 5,100 shareholders based on the number of holders of record and an estimate of the number of individual participants represented by security position listings.

The following table sets forth the reported high and low sale prices for our common stock as reported by NASDAQ.

	2005		2004	
Quarter Ended	**High**	**Low**	**High**	**Low**
March 31	16.72	11.38	12.95	7.97
June 30	14.80	10.83	15.50	10.35
September 30	15.85	13.26	12.71	10.05
December 31	19.30	14.70	16.37	11.36

We currently do not pay dividends and do not anticipate doing so in the foreseeable future.

During the quarter ended December 31, 2005, ResCare issued options to purchase 225,000 shares of common stock and awarded 31,664 shares of restricted stock to employees under the 2005 Omnibus Incentive Compensation Plan. The table below sets forth information about the grant date and fair market value on the date of the grant. The issuance of these options and shares is exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

Plan	Grant Date	Shares Granted	Fair Market Value on Grant Date
2005 Omnibus Incentive Compensation Plan	December 30, 2005	225,000	$ 3,908,250
2005 Omnibus Incentive Compensation Plan	December 31, 2005	31,664	$ 550,004

Item 6. Selected Financial Data

The selected consolidated financial data below should be read in conjunction with "Management' Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financi Statements and related notes.

	Year Ended December 31				
	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Income Statement Data:					
Revenues	$1,088,770	$1,009,016	$ 961,333	$ 919,724	$ 885,71
Operating income [1]	49,306	52,530	45,243	28,480	12,77
Net income (loss)	21,222	21,507	13,387	2,676	(4,37
Net income (loss) attributable to common shareholders	17,954	6,117 [2]	13,387	2,676	(4,37
Basic earnings (loss) per common share	0.68	0.24	0.55	0.11	(0.18
Diluted earnings (loss) per common share	0.66	0.23	0.54	0.11	(0.18
Other Financial Data:					
Depreciation and amortization	$ 13,865	$ 12,207	$ 12,254	$ 11,862	$ 21,07
Facility rent [3]	40,617	37,468	35,362	32,212	29,79
Selected Historical Ratios:					
Percentage of total debt to total capitalization	34.2%	40.3%	49.6%	59.7%	60.8
Ratio of earnings to fixed charges [4]	2.1x	1.8x	1.5x	1.1x	0.8
Balance Sheet Data:					
Working capital	$ 95,915	$ 120,619	$ 71,298	$ 144,546	$ 142,87
Total assets	611,102	586,666	503,026	546,612	534,93
Long-term obligations	152,584	168,066	184,576	261,123	268,01
Total debt, including capital leases	157,138	182,536	189,685	262,424	269,711
Shareholders' equity	301,998	270,543	192,908	176,992	173,93

(1) Operating income for the year ended December 31, 2005 includes a charge of $11.9 million ($7.9 million net of tax or $0.25 pe share) related to the debt refinancing. Operating income for the year ended December 31, 2004, includes expenses of $0.8 millio ($0.5 million net of tax or $0.02 per share) related to payments required under the provisions of the director stock option plans a a result of the Onex transaction. Operating income for the year ended December 31, 2003 includes a charge of $2.2 million ($1. million net of tax, or $0.06 per share) related to a debt refinancing ($2.5 million, pre-tax charge) and extinguishment of debt ($0. million, pre-tax gain). Operating income for the year ended December 31, 2002 includes a charge of $14.8 million ($9.5 millio net of tax, or $0.39 per share) related to a write-off of accounts receivable in the fourth quarter. In addition, we recorded a charg of $1.5 million ($1.0 million net of tax, or $0.04 per share) for costs associated with an investigation and closure of a portion of a non-core operation. Further, operating income for 2002 includes gains on the extinguishment of debt of $1.3 million ($0.8 million net of tax, or $0.03 per share). Operating income for the year ended December 31, 2001 includes a restructuring charge o approximately $1.6 million ($0.9 million net of tax, or $0.04 per share) for costs associated with the exit from Tennessee. In addition, we recorded a charge of $22.0 million ($13.2 million net of tax, or $0.54 per share) related to additional reserves fo accounts receivable and insurance claims.

(2) Under the accounting treatment for the Onex transaction in June 2004, the non-cash beneficial conversion feature assumed in the preferred stock issuance was calculated at $14.8 million and is a deduction from net income in computing basic and diluted earnings per share attributable to common shareholders. The beneficial conversion feature did not affect net income, cash flows, total shareholders' equity, or compliance with our debt covenants.

(3) Facility rent is defined as land and building lease expense less amortization of any deferred gain on applicable lease transactions.

(4) For the purpose of determining the ratio of earnings to fixed charges, earnings are defined as income before income taxes, plus fixed charges. Fixed charges consist of interest expense on all indebtedness and amortization of capitalized debt issuance costs and an estimate of interest within rental expense.

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

Overview

The following Management's Discussion and Analysis ("MD&A") section is intended to help the reader understand ResCare's financial performance and condition. MD&A is provided as a supplement to, and should be read in conjunction with, our Consolidated Financial Statements and the accompanying notes. All references in this MD&A to "ResCare", "our company", "we", "us", or "our" mean Res-Care, Inc. and, unless the context otherwise requires, its consolidated subsidiaries. The individual sections of MD&A are:

- *Our Business* - a general description of our business and revenue sources.
- *Application of Critical Accounting Policies* - a discussion of accounting policies that require critical judgments and estimates.
- *Year in Review* - highlights of the past year.
- *Results of Operations* - an analysis of our consolidated results of operations for the periods presented including analysis of our operating segments.
- *Financial Condition, Liquidity and Capital Resources* - an analysis of cash flows, sources and uses of cash and financial position.
- *Contractual Obligations and Commitments* - a tabular presentation of our contractual obligations and commitments for future periods.

Our Business

We receive revenues primarily from the delivery of residential, training, educational and support services to various populations with special needs. As of December 31, 2005, we had three reportable operating segments: (i) Disabilities Services, (ii) Job Corps Training Services and (iii) Employment Training Services. Effective January 1, 2006, in order to better reflect the services provided, the Disabilities Services segment is now named Community Services and is referenced as such throughout this Annual Report on Form 10-K. Further information regarding our segments is included in the Notes to Consolidated Financial Statements. Management's discussion and analysis of each segment is included below.

Revenues for our Community Services operations are derived primarily from state Medicaid programs, other government agencies, commercial insurance companies and from management contracts with private operators, generally not-for-profit providers, who contract with state government agencies and are also reimbursed under the Medicaid program. Our services include social, functional and vocational skills training, supported employment and emotional and psychological counseling for individuals with mental retardation or other disabilities. We also provide respite, therapeutic and other services on an as-needed basis or hourly basis through our periodic in-home services programs that are reimbursed on a unit-of-service basis. Reimbursement varies by state and service type, and may be based on a variety of methods including flat-rate, cost-based reimbursement, per person per diem, or unit-of-service basis. Generally, rates are adjusted annually based upon historical costs experienced by us and by other service providers, or economic conditions and their impact on state budgets. At facilities and programs where we are the provider of record, we are directly reimbursed under state Medicaid programs for services we provide and such revenues are affected by occupancy levels. At most facilities and programs that we operate pursuant to management contracts, the management fee is negotiated with the provider of record.

We operate vocational training centers under the federal Job Corps program administered by the DOI through our Job Corps Training Services operations. Under Job Corps contracts, we are reimbursed for direc facility and program costs related to Job Corps center operations, allowable indirect costs for general an administrative costs, plus a predetermined management fee. The management fee can take the form of a fixe contractual amount or be computed based on certain performance criteria. All of such amounts are reflected a revenue, and all such direct costs are reflected as facility and program costs. Final determination of amounts du under Job Corps contracts is subject to audit and review by the DOL, and renewals and extension of Job Corp contracts are based in part on performance reviews.

We operate job training and placement programs that assist disadvantaged job seekers in findin employment and improving their career prospects through our Employment Training Services operations. Thes programs are administered through performance-based or fixed-fee contracts with local and state governments.

Application of Critical Accounting Policies

Our discussion and analysis of the financial condition and results of operations are based upon ou Consolidated Financial Statements, which have been prepared in accordance with accounting principles generall accepted in the United States of America (GAAP). The preparation of these financial statements requires the us of estimates and judgments that affect the reported amounts and related disclosures of commitments an contingencies. We rely on historical experience and on various other assumptions that we believe to be reasonabl under the circumstances to make judgments about the carrying values of assets and liabilities that are not readil apparent from other sources. Actual results may differ materially from these estimates.

We believe the following critical accounting policies involve the more significant judgments and estimates used in the preparation of our Consolidated Financial Statements. Management has discussed the development, selection, and application of our critical accounting policies with our Audit Committee.

Valuation of Accounts Receivable

Accounts receivable consist primarily of amounts due from Medicaid programs, other government agencies and commercial insurance companies. An estimated allowance for doubtful accounts receivable is recorded to the extent it is probable that a portion or all of a particular account will not be collected. In evaluating the collectibility of accounts receivable, we consider a number of factors, including historical loss rates, age of the accounts, changes in collection patterns, the status of ongoing disputes with third-party payors, general economic conditions and the status of state budgets. Complex rules and regulations regarding billing and timely filing requirements in various states are also a factor in our assessment of the collectibility of accounts receivable. Actual collections of accounts receivable in subsequent periods may require changes in the estimated allowance for doubtful accounts. Changes in these estimates are charged or credited to the results of operations in the period of the change of estimate. There were no material changes in our method of providing for reserves for doubtful accounts during 2005.

Reserves for Insurance Risks

We self-insure a substantial portion of our professional, general and automobile liability, workers' compensation and health benefit risks. Provisions for losses for these risks are based upon actuarially determined estimates and include an amount determined from reported claims and an amount based on past experiences for losses incurred but not reported. These liabilities are necessarily based on estimates and, while we believe that the provision for loss is adequate, the ultimate liability may be more or less than the amounts recorded. The liabilities are reviewed quarterly and any adjustments are reflected in earnings in the period known. During 2005, we changed the rate used to discount our estimates of workers' compensation claims reserves from 6.0% to 5.0%, reflecting our claims payment experience and the current interest rate environment. The decrease in the discount rate of 100 basis points increased the reserve, and resulting expense, by approximately $0.5 million. Further information regarding our insurance programs is contained elsewhere in this document under "Risk Factors."

Legal Contingencies

We are party to numerous claims and lawsuits with respect to various matters. The material legal proceedings in which ResCare is currently involved are described in Item 3 of this report and Note 13 to the Consolidated Financial Statements. We provide for costs related to contingencies when a loss is probable and the amount is reasonably determinable. We confer with outside counsel in estimating our potential liability for certain legal contingencies. While we believe our provision for legal contingencies is adequate, the outcome of legal proceedings is difficult to predict and we may settle legal claims or be subject to judgments for amounts that exceed our estimates. There were no material changes to our method of providing reserves for legal contingencies during 2005.

Valuation of Long-Lived Assets

We regularly review the carrying value of long-lived assets with respect to any events or circumstances that indicate a possible inability to recover their carrying amount. Indicators of impairment include, but are not limited to, loss of contracts, significant census declines, reductions in reimbursement levels and significant litigation. Our evaluation is based on cash flow, profitability and projections that incorporate current or projected operating results, as well as significant events or changes in the reimbursement and regulatory environment. If circumstances suggest the recorded amounts cannot be recovered, the carrying values of such assets are reduced to fair value based upon various techniques to estimate fair value. We recorded no material asset valuation losses during 2005.

Goodwill

With respect to businesses we have acquired, we evaluate the costs of purchased businesses in excess of net assets acquired (goodwill) for impairment at least annually as of year end, unless significant changes in circumstances indicate a potential impairment may have occurred sooner. We are required to test goodwill on a reporting unit basis. We use a fair value approach to test goodwill for impairment and recognize an impairment charge for the amount, if any, by which the carrying amount of goodwill exceeds its implied fair value. Fair values are established using a weighted average of comparative market multiples in the current market conditions and discounted cash flows.

Discounted cash flow computations depend on a number of factors including estimates of future market growth and trends, forecasted revenue and costs, expected periods the assets will be utilized, appropriate discount rates and other variables. We base our fair value estimates on assumptions we believe to be reasonable, but which are unpredictable and inherently uncertain. Actual future results may differ from those estimates. The discount rates used as of our year-end annual impairment evaluation for the Community Services, Job Corps Training Services and Employment Training Services reporting units were 10.9%, 13.9% and 14.4%, respectively. A variance in the discount rate could have a significant impact on the variance analysis. In addition, we make certain judgments about the selection of comparable companies used in determining market multiples in valuing our reporting units, as well as certain assumptions to allocate shared assets and liabilities to calculate values for each of our reporting units. No valuation losses were recorded during 2005.

Revenue Recognition

Community Services. Revenues are derived primarily from state Medicaid programs, other government agencies, commercial insurance companies and from management contracts with private operators, generally not-for-profit providers, who contract with state agencies and are also reimbursed under the Medicaid programs. Revenues are recorded at rates established at or before the time services are rendered. Revenue is recognized in the period services are rendered.

Job Corps Training Services. Revenues include amounts reimbursable under cost reimbursement contracts with the DOL for operating Job Corps centers. The contracts provide reimbursement for all facility and program costs related to operations, allowable indirect costs for general and administrative costs, plus predetermined management fee, normally a combination of fixed and performance-based. Final determination c amounts due under the contracts is subject to audit and review by the applicable government agencies. Revenue : recognized in the period associated costs are incurred and services are rendered.

Employment Training Services. Revenues are derived primarily through performance-based or fixed-fe contracts with local and state governments. Revenue is recognized in the period in which services are rendered.

Laws and regulations governing the government programs and contracts are complex and subject t interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amount in the near term. For each operating segment, expenses are subject to examination by agencie administering the contracts and services. We believe that adequate provisions have been made for potentia adjustments arising from such examinations. There were no material changes in the application of our revenu recognition policies during 2005.

Year in Review

Revenues for the year ended December 31, 2005 were $1.1 billion, net income was $21.2 million, an cash provided from operations was $44.6 million. These items are discussed in more detail in the followin sections of the MD&A.

The following highlights some of the events of the past year:

- On October 3, 2005, we issued $150 million of 7.75% Senior Notes due October 15, 2013 in a private placement under Rule 144A of the Securities Act of 1933. The Senior Notes, which had an issue price of 99.261% of the principal amount, are unsecured obligations ranking equal to existing and future debt and are subordinate to existing and future secured debt. We used a portion of the proceeds from the offering of the Senior Notes to repurchase the 10.625% Senior Notes due November 15, 2008.

- Also on October 3, 2005, we amended and restated our existing senior secured credit facility. As amended and restated, the facility consists of $175 million revolving credit facility, which could be increased to $225 million at our option and expires on October 3, 2010. The credit facility will be used primarily for letters of credit required under our insurance programs, working capital purposes, and to fund acquisitions. In connection with these refinancing transactions, in September 2005 we repaid our outstanding term loan, which totaled $28 million.

- In the fourth quarter, we recorded charges in connection with our October 3, 2005 debt refinancing transaction of approximately $11.9 million pretax ($7.9 million net of tax, or $0.25 per share). In conjunction with the debt refinancing transactions, we will experience a decrease in our interest expense of approximately $4.2 million in 2006 versus 2005 related to the $150 million Senior Notes.

- The Community Services segment added 19 new operations which complement our core business in this segment. These operations are expected to generate annual revenues of approximately $51 million and provide services to approximately 2,200 consumers.

- The Job Corps Training Services segment was awarded a $14.5 million, two-year contract with three one-year renewal options to run the Northlands Job Corps Center in Vergennes, Vermont. In addition, Job Corps Training Services was awarded a $29.5 million, two-year contract with three one-year renewal options to continue operating the Guthrie Job Corps

Center in Guthrie, Oklahoma, and a $18.0 million, two-year contract with three one-year renewal options to continue operating the Old Dominion Job Corps center in Monroe, Virginia.

- During 2005, our Employment Training Services segment commenced significant operations under its New York City WeCARE contract, contributing revenues of approximately $13 million for the year.

- Our subcontract to provide vocational assessment, training and job placement to Iraqi citizens terminated on September 30, 2005 as a result of changes in U.S. government funding priorities. We still maintain a small presence in Jordan. For the nine months ended September 30, 2005, the Iraq contract generated revenues of approximately $1.0 million.

- On December 16, 2005, we notified the District of Columbia that we expect our Community Services segment to cease providing disabilities services in the District effective during the second quarter of 2006 due to higher operating costs and substantial losses resulting from changes in regulatory oversight requirements. We will likely incur some exit costs for lease terminations and other expenses during 2006. For the year ended December 31, 2005, revenues from the District of Columbia for disabilities services were approximately $16 million.

In addition, the following events occurred after year end:

- Effective January 3, 2006, our Employment Training Services segment completed the purchase of the operating assets and business of the Workforce Services Group of Affiliated Computer Services, Inc. (ACS Workforce Services). ACS Workforce Services has contracts in 15 states and Washington, D.C. and provides services to adults who have lost their jobs or face some barrier to employment. The operations are expected to generate annual revenues of approximately $165 million.

- The Job Corps Training Services segment was awarded a $28.4 million, two-year contract with three one-year renewal options to continue operating the Edison Job Corps Academy in New Jersey and a $31.3 million, two-year contract with three one-year renewal options to continue operating three Puerto Rico Job Corps centers.

Results of Operations

	Year Ended December 31		
	2005	2004	2003
	(Dollars in thousands)		
Revenues:			
Community Services	$ 864,455	$ 819,597	$ 787,90
Job Corps Training Services	152,749	145,375	138,78
Employment Training Services	64,475	38,341	30,12
Other	7,091	5,703	4,52
Consolidated	$ 1,088,770	$1,009,016	$ 961,33
Operating Income:			
Community Services	$ 86,065	$ 76,702	$ 69,73
Job Corps Training Services	16,422	15,853	15,21
Employment Training Services	5,703	3,804	3,53
Corporate and Other	(58,884)	(43,829)	(43,24
Consolidated	$ 49,306	$ 52,530	$ 45,24
Operating Margin:			
Community Services	10.0%	9.4%	8.9
Job Corps Training Services	10.8%	10.9%	11.0
Employment Training Services	8.8%	9.9%	11.7
Consolidated	4.5%	5.2%	4.7

Consolidated

Consolidated revenues increased 8% in 2005 from 2004 and 5% from 2003 to 2004, as more ful described in the segment discussions below.

Operating income decreased 6% in 2005 from 2004 and operating margin decreased from 5.2% to 4.5 This decrease is attributed to the $11.9 million charge recorded in connection with our 2005 debt refinancir offset primarily by the operating margin improvement in the Community Services segment.

Operating income increased 16% in 2004 over 2003 and operating margin increased from 4.7% to 5.2 This increase is attributed to the revenue growth and operating margin improvement in the Community Servic discussed below.

As a percentage of total revenues, corporate general and administrative expenses remained consistent 3.9% in 2005, 3.8% in 2004 and 3.8% in 2003.

As a percent of total revenues, depreciation and amortization remained consistent at 1.3% in 2005, 1. in 2004 and 1.3% in 2003.

Net interest expense decreased $2.4 million in 2005 compared to 2004 due primarily to higher inte rates on investments, the debt refinancing in October 2005 and the redemption of the 5.9% converti subordinated notes in March 2005. Interest expense decreased $4.6 million in 2004 compared to 2003, follow the redemption of our 6% convertible subordinated notes as of December 31, 2003.

Our effective income tax rates were 33.5%, 34.4% and 36.0% in 2005, 2004 and 2003, respectively. effective rate for 2005 is lower than the statutory rate principally due to non-taxable investment income and benefit of increased job credits, as compared to 2004. The effective rate for 2004 was lower than 2003 due to n taxable investment income and increased jobs credits as compared to 2003.

Community Services

Community Services revenues increased 5% in 2005 over 2004 compared to a 4% increase in 2004 over 2003. This increase was due primarily to acquisitions and growth in the higher margin periodic in-home services, partially offset by census reductions in the District of Columbia. Periodic in-home service revenues increased \$26.4 million in 2005 over 2004. Revenues increased in 2004 from incremental revenues for new homes added, growth in our periodic in-home services and various small acquisitions in 2004. Operating margin increased in 2005 over 2004 to 10.0% from 9.4%, as a result of continued growth in the periodic in-home services, multiple acquisitions in 2005 and continued cost controls. Further, insurance costs, including workers' compensation, decreased as a percentage of revenue approximately 50 basis points as compared to 2004. These improvements were offset by census reductions and increased costs associated with the operating issues we are experiencing in the District of Columbia. Operating margin for this division increased to 9.4% in 2004 from 8.9% in 2003, as a result of continued growth in periodic in-home services, new homes added, continued improvement in the management of labor costs and continued cost controls.

ResCare has been operating in the District of Columbia for many years; however, the regulatory environment and operational issues have resulted in higher operating costs and substantial losses. During the fourth quarter of 2005, we announced that we are ceasing our community services to individuals with developmental disabilities in the District of Columbia by the second quarter of 2006. We continue to work with the District and other providers on the ultimate outcome of the homes we are operating. We do not have sufficient information at this time to estimate the amount of loss, if any, from exiting the business. We do not believe the exit from the District of Columbia will have a material adverse effect on our consolidated financial position, results of operations or liquidity.

Job Corps Training Services

Job Corps Training Services revenues increased 5% in 2005 over 2004 due primarily to the addition of the Northlands Job Corps Center in July 2005 and contractual increases. Revenues increased approximately 5% in 2004 over 2003 due primarily to the addition of the Homestead Job Corps center in April 2004 and contractual increases. Operating margins in 2005 decreased slightly from 2004 due primarily to changes in the DOL's incentive-based payments. The performance criteria in 2005 is more restrictive in an effort to control costs. Operating margin for 2004 decreased slightly from 2003 for similar reasons.

Employment Training Services

Employment Training Services revenues increased 68% in 2005 over 2004 due primarily to the acquisition of the operations of TTI America (TTI) in the fourth quarter of 2004 and a new contract in New York City in 2005. TTI and the New York City contract added combined revenues of \$31.1 million in 2005. Revenues increased approximately 27% in 2004 over 2003 due to additional contracts. Operating income for this segment increased 50% for 2005 over 2004; however operating margins decreased 110 basis points primarily due to the start-up of the New York City contract. Operating margin decreased 180 basis points in 2004 over 2003 due to lower negotiated margins on the additional contracts added in 2004.

Financial Condition, Liquidity and Capital Resources

Total assets increased 4% in 2005 over 2004. As described below, the increase in accounts receivable is due to increased revenues associated with the acquisitions and contracts awarded during 2005. During 2005, we completed 19 acquisitions with aggregate estimated annual revenues of \$51 million. Primarily as a result of these acquisitions, goodwill increased \$39.2 million from December 31, 2004.

As of December 31, 2005, cash, cash equivalents and short-term investments were \$37.5 million as compared to \$81.6 million at December 31, 2004. Cash provided by operating activities for 2005 was \$44.6 million compared to \$41.8 million for 2004 and \$51.5 million in 2003. The increase in 2005 from 2004 was primarily the result of higher net income excluding the refinancing loss, offset by net working capital needs. Th decrease in 2004 from 2003 was primarily the result of tax refunds received in 2003 which were not present i 2004.

Days revenue in net accounts receivable were 51 days at December 31, 2005 compared with 48 days a December 31, 2004 and December 31, 2003. The increase in the number of days is attributable to a few state extending payment terms and to the growth in the Employment Training Services segment. Net account receivable at December 31, 2005 increased to $160.8 million, compared to $138.2 million at December 31, 200 and $129.2 million at December 31, 2003. The increase in net accounts receivable from 2004 to 2005 is primaril due to revenue growth associated with the acquisitions and contract awards. The increase in 2004 net account receivable over 2003 is due to growth at Arbor, new homes growth, and the acquisition of TTI in December 2004 Additionally, we experienced delayed collections in the fourth quarter of 2004 from the DOL due to changes i the DOL's payment processing. Approximately 5% of the total net accounts receivable balance was greater tha 360 days at both December 31, 2005 and December 31, 2004.

Capital expenditures were consistent with the Company's historical experience, comprised principally o maintenance capital expenditures, with a less significant amount expended for strategic systems. We investe over $42 million ($37 million in cash and $5 million in seller notes) in 2005 acquiring various businesses in ou Community Services group. Similarly, approximately $13 million and $10 million were expended in 2004 an 2003, on businesses operating in both Employment Training Services and Community Services.

Our financing activities during 2005 include the repayment of the $150 million 10.625% senior notes, th $28 million term loan and the 5.9% convertible subordinated notes, offset by proceeds from the new $150 millio 7.75% senior notes. We also incurred various costs in connection with the October 2005 refinancing. Optio exercise activity resulted in $6.5 million in proceeds in 2005. Cash provided by financing activities in 2004 wa attributable primarily to the June 2004 issuance of preferred stock to Onex Partners. For 2003, we redeemed th 6% subordinated notes.

Our capital requirements relate primarily to our plans to expand through selective acquisitions and th development of new facilities and programs, and our need for sufficient working capital for general corporat purposes. Since most of our facilities and programs are operating at or near capacity, and budgetary pressures an other forces are expected to limit increases in reimbursement rates we receive, our ability to continue to grow a the current rate depends directly on our acquisition and development activity. We have historically satisfied ou working capital requirements, capital expenditures and scheduled debt payments from our operating cash flow and utilization of our credit facility.

On October 3, 2005, we issued $150 million of 7.75% Senior Notes due October 15, 2013 in a private placement under Rule 144A of the Securities Act of 1933. The new Senior Notes, which had an issue price of 99.261% of the principal amount, are unsecured obligations ranking equal to existing and future debt and are subordinate to existing and future secured debt. The Senior Notes are jointly, severally, fully and unconditionally guaranteed by our 100% owned U.S. subsidiaries. We used a portion of the proceeds from the offering of the Senior Notes to repurchase our 10.625% Senior Notes due November 15, 2008. The new Senior Notes were registered under the Securities Act of 1933 in February 2006.

Also on October 3, 2005, we amended and restated our existing senior secured credit facility. As amended and restated, the facility consists of $175 million revolving credit facility, which can be increased to $225 million at our option and expires on October 3, 2010. The credit facility will be used primarily for working capital purposes and for letters of credit required under our insurance programs and to finance acquisition and development activities. The credit facility is secured by a lien on all of our assets and, through secured guarantees, on all of our domestic subsidiaries' assets.

As of December 31, 2005, we had irrevocable standby letters of credit in the principal amount of $60.1 million issued primarily in connection with our insurance programs. As of December 31, 2005, we had $114.9

million available under the revolver. The amended and restated credit facility contains various financial covenants relating to net worth, capital expenditures and rentals and requires us to maintain specified ratios with respect to interest coverage and leverage. We are in compliance with our debt covenants as of December 31, 2005. Our ability to achieve the thresholds provided for in the financial covenants largely depends upon the maintenance of continued profitability and/or reductions of amounts borrowed under the facility, and continued cash collections.

Included in our cash and cash equivalents balance at December 31, 2004 was $9.1 million of cash held on deposit with an insurance carrier as collateral for our insurance program. In October 2005, in accordance with our collateral arrangement with the insurance carrier, we exchanged the $9.1 million of cash held on deposit for a letter of credit.

Operating funding sources for 2005 were approximately 76% through Medicaid reimbursement, 14% from the DOL and 10% from other payors. We believe our sources of funds through operations and available through the credit facility described above will be sufficient to meet our working capital, planned capital expenditure and scheduled debt repayment requirements for the next twelve months.

Contractual Obligations and Commitments

Information concerning our contractual obligations and commercial commitments follows (in thousands):

Contractual Obligations	Payments Due by Period Twelve Months Ending December 31				
	Total	2006	2007-2008	2009-2010	2011 and Thereafter
Long-term Debt	$ 156,661	$ 3,458	$ 2,973	$ 153	$ 150,077
Capital Lease Obligations	1,586	1,096	331	155	4
Operating Leases	149,468	34,391	50,235	33,785	31,057
Purchase Contracts	—	—	—	—	—
Total Contractual Obligations	$ 307,715	$ 38,945	$ 53,539	$ 34,093	$ 181,138

Other Commercial Commitments	Total Amounts Committed	Amount of Commitments Expiring per Period Twelve Months Ending December 31			
		2006	2007-2008	2009-2010	2011 and Thereafter
Standby Letters-of-Credit	$ 60,067	$ 60,067	—	—	—

In accordance with the definition under Securities and Exchange Commission rules, the following qualify as off-balance sheet arrangements:

- any obligation under certain guarantees or contracts;
- a retained or contingent interest in assets transferred to an unconsolidated entity or similar entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;
- any obligation under certain derivative instruments; and
- any obligation under a material variable interest held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the registrant, or engages in leasing, hedging or research and development services with the registrant.

We had no significant off-balance sheet transactions or interests in 2005.

New Accounting Pronouncements Not Yet Adopted

See Note 1 to the Notes to Consolidated Financial Statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The Company has short-term investments of $27.7 million as of December 31, 2005 that bear interest a variable rates. A 100 basis point movement in the interest rate would result in an approximate $0.3 millioı annualized effect on interest income and cash flows.

While we are exposed to changes in interest rates as a result of any outstanding variable rate debt, we d not currently utilize any derivative financial instruments related to our interest rate exposure. At December 31 2005, we had no variable rate debt outstanding as compared to $15 million outstanding at December 31, 2004 Our senior secured credit facility, which has an interest rate based on margins over LIBOR or prime, tiered base upon leverage calculations, had no borrowings as of December 31, 2005.

Item 8. Financial Statements and Supplementary Data

Refer to pages F-1 through F-34.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

ResCare's management, under the supervision and with the participation of the Chairman and Chie Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), evaluated the effectiveness of the desig and operation of our disclosure controls and procedures as of December 31, 2005. Based on that evaluation, th CEO and CFO concluded that ResCare's disclosure controls and procedures are effective in timely making know to them material information required to be disclosed in the reports filed or submitted under the Securitie Exchange Act. There were no changes in ResCare's internal controls over financial reporting during the fourt quarter of 2005 that have materially affected, or are reasonably likely to materially affect, the internal control ove financial reporting.

Limitations on the Effectiveness of Controls

A control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that the control system's objectives will be met. Further, the design of a control system must reflect th fact that there are resource constraints, and the benefits of controls must be considered relative to their cost: Because of the inherent limitations in all control systems, no evaluation of controls can provide absolut assurance that all control issues and instances of fraud, if any, with our company have been detected. Thes inherent limitations include the realities that judgments in decision-making can be faulty, that breakdowns ca occur because of simple errors or mistakes, and that controls can be circumvented by the acts of individuals c groups. Because of the inherent limitations in a cost-effective control system, misstatements due to error or frau may occur and not be detected.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control – Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2005. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Item 9B. Other Information

None.

PART III

Items 10, 11, 12, 13 and 14. Directors and Executive Officers of the Registrant; Executive Compensatio Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matte Certain Relationships and Related Transactions; and Principal Accountant Fees and Services.

The information required by these Items is omitted because we are filing a definitive proxy stateme pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report whi includes the required information. The required information contained in our proxy statement is incorporat herein by reference.

We have adopted a code of ethics applicable to directors, officers and employees, which is posted on o website at http://www.rescare.com. If we amend or waive any of the provisions of the Code of Ethics applicab to our directors, executive officers or senior financial officers, we intend to disclose the amendment or waiver (our website. We will provide to any person without charge, upon request, a copy of the Code of Ethics. You c: request a copy by contacting our communications department, 10140 Linn Station Road, Louisville, Kentuck 40223, (telephone) 502-394-2100 or communications@rescare.com.

PART IV

Item 15. Exhibits and Consolidated Financial Statement Schedules.

(a)(1) Index to Consolidated Financial Statements and Financial Statement Schedules:

(1) All other financial statement schedules have been omitted, as the required information is inapplicable or the information is presented in the financial statements or related notes.

(a)(2) Index to Exhibits:

3.1 .... Amended and Restated Articles of Incorporation of the Registrant dated December 18, 1992 incorporating the Amendment to Amended and Restated Articles of Incorporation dated May 29, 1997. Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998 is hereby incorporated by reference.

3.2 .... Articles of Amendment to the Registrant's Articles of Incorporation dated June 23, 2004. Exhibits 3(i) and 4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 is hereby incorporated by reference.

3.3 .... Amended and Restated Bylaws of the Registrant. Exhibit 4.5 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-50726) is hereby incorporated by reference.

4.1 .... Amended and Restated Articles of Incorporation of the Registrant dated December 18, 1992 incorporating the Amendment to Amended and Restated Articles of Incorporation dated May 29, 1997. Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998 is hereby incorporated by reference.

4.2 .... Articles of Amendment to the Registrant's Articles of Incorporation dated June 23, 2004. Exhibits 3(i) and 4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 is hereby incorporated by reference.

4.3 .... Amended and Restated Bylaws of the Registrant. Exhibit 4.5 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-50726) is incorporated by reference.

(a)(2) Index to Exhibits (*Continued*):

4.4............................ Article VI of the Articles of Incorporation of the Registrant, which describes tr preferences, limitations and relative rights of the various classes and series of tl Registrant's shares, is included in Exhibits 3.1 and 3.2.

4.5............................ Preferred Stock Purchase Agreement, dated as of March 10, 2004, by an between the Registrant and Onex Partners LP, Onex American Holdings II LLC, Onex U.S. Principals LP, Res-Care Executive Investco LLC. Exhibit 4.4 t the Registrant's Annual Report on Form 10-K for the year ended December 3 2003 is hereby incorporated by reference.

4.6............................ Registration Rights Agreement by and among the Registrant and Onex Partne LP, Onex American Holdings III, LLC, Onex U.S. Principals LP and Res-Ca Executive Investco LLC dated as of March 10, 2004. Exhibit 10.1 to tl Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 200 is hereby incorporated by reference.

4.7............................ Indenture dated October 3, 2005, by and among the Registrant, the Subsidia Guarantors party thereto, and Wells Fargo Bank, National Association, as truste relating to the Registrant's 7¾% Senior Notes due 2013. Exhibit 10.2 to tl Registrant's Quarterly Report on Form 10-Q for the quarter ended September 3(2005 is hereby incorporated by reference.

4.8............................ Registration Rights Agreement dated October 3, 2005, by and among tl Registrant, the Subsidiary Guarantors party thereto and the initial purchase named therein, relating to the Registrant's 7¾% Senior Notes due 2013. Exhib 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ende September 30, 2005 is hereby incorporated by reference.

10.1.......................... Amendment to Employment Agreement between the Registrant and Ronald (Geary dated as of October 26, 1995, and amended December 31, 2002. Exhib 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ende June 30, 2003 is hereby incorporated by reference.

10.2.......................... Management Services Agreement between Onex Partners Manager LP and tl Registrant dated June 23, 2004. Exhibit 10.3 to the Registrant's Quarterly Repo on Form 10-Q for the quarter ended June 30, 2004 is hereby incorporated b reference.

10.3.......................... Shareholders Voting Agreement between Ronald G. Geary and Onex Partners L dated June 23, 2004 and related proxy. Exhibit 10.4 to the Registrant's Quarterl Report on Form 10-Q for the quarter ended June 23, 2004 is hereby incorporate by reference.

10.4.......................... Amended and Restated Credit Agreement, dated as of October 3, 2005, amon the Registrant, the Lenders from time to time parties thereto, JPMorgan Chas Bank, N.A., as Administrative Agent, National City Bank of Kentucky, a Syndication Agent, and General Electric Capital Corporation and U.S. Ban National Association, as Documentation Agents, and J.P. Morgan Securities Inc as Lead Arranger and Sole Book Runner. Exhibit 10.1 to the Registrant Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 hereby incorporated by reference.

(a)(2) Index to Exhibits (*Continued*):

10.5 .... Indenture dated October 3, 2005, by and among the Registrant, the Subsidiary Guarantors party thereto, and Wells Fargo Bank, National Association, as trustee, relating to the Registrant's 7¾% Senior Notes due 2013. Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 is hereby incorporated by reference.

10.6 .... Registration Rights Agreement dated October 3, 2005, by and among the Registrant, the Subsidiary Guarantors party thereto and the initial purchasers named therein, relating to the Registrant's 7¾% Senior Notes due 2013. Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 is hereby incorporated by reference.

10.7 .... Res-Care, Inc. 2005 Omnibus Incentive Compensation Plan. Exhibit 10.1 to Form S-8 Registration Statement (Reg. No. 333-126282) filed June 30, 2005 is hereby incorporated by reference.

10.8 .... Form of Restricted Stock Award Agreement. Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 is hereby incorporated by reference.

10.9 .... Employment Agreement between the Registrant and Vincent F. Doran. Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed on August 5, 2005 is hereby incorporated by reference.

10.10 .... Employment Agreement between the Registrant and Paul G. Dunn. Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed on August 5, 2005 is hereby incorporated by reference.

10.11 .... Employment Agreement between the Registrant and Katherine W. Gilchrist. Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed on August 5, 2005 is hereby incorporated by reference.

10.12 .... Employment Agreement between the Registrant and Ralph G. Gronefeld, Jr. Exhibit 99.4 to the Registrant's Current Report on Form 8-K filed on August 5, 2005 is hereby incorporated by reference.

10.13 .... Employment Agreement between the Registrant and David W. Miles. (filed herewith)

10.14 .... Form of Stock Option Agreement. Exhibit 10.16 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference.

10.15 .... Form of Non-Employee Director Stock Option Agreement. Exhibit 10.17 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004 is hereby incorporated by reference.

10.16 .... Form of Restricted Stock Agreement. Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 is hereby incorporated by reference.

(a)(2) Index to Exhibits (*Continued*):

10.17	ResCare Nonemployee Director Deferred Stock Compensation Program. Exhib 99.1 to the Registrant's Current Report on Form 8-K filed on January 25, 2006 i hereby incorporated by reference.
10.18	ResCare Nonemployee Director Deferred Stock Compensation Program Electio Form. Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed o January 25, 2006 is hereby incorporated by reference.
21.1	Subsidiaries of the Registrant. (filed herewith)
23.1	Consent of KPMG LLP. (filed herewith)
31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and Rul 15d-14(a) of the Securities Exchange Act, as amended. (filed herewith)
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and Rul 15d-14(a) of the Securities Exchange Act, as amended. (filed herewith)
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant t 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002. (filed herewith)

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RES-CARE, INC

Date: March 8, 2006

By: /s/ Ronald G. Geary
Ronald G. Geary
Chairman of the Board, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, 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/ Ronald G. Geary Ronald G. Geary	Chairman of the Board, President, Chief Executive Officer and Director (Principal Executive Officer)	March 8, 2006
/s/ David W. Miles David W. Miles	Chief Financial Officer (Principal Accounting Officer)	March 8, 2006
/s/ David Braddock David Braddock	Director	March 8, 2006
/s/ Robert E. Hallagan Robert E. Hallagan	Director	March 8, 2006
/s/ Olivia F. Kirtley Olivia F. Kirtley	Director	March 8, 2006
/s/ Robert M. Le Blanc Robert M. Le Blanc	Director	March 8, 2006
/s/ Steven S. Reed Steven S. Reed	Director	March 8, 2006
/s/ E. Halsey Sandford E. Halsey Sandford	Director	March 8, 2006
/s/ Nigel S. Wright Nigel S. Wright	Director	March 8, 2006

EXHIBIT 21.1

SUBSIDIARIES OF THE REGISTRANT

Subsidiary	State of Incorporation
Community Alternatives Indiana, Inc.	Delaware
Community Alternatives Nebraska, Inc.	Delaware
Community Advantage, Inc.	Delaware
Texas Home Management, Inc.	Delaware
Capital TX Investments, Inc.	Delaware
THM Homes, Inc.	Delaware
Community Alternatives Texas Partner, Inc.	Delaware
Res-Care New Mexico, Inc.	Delaware
Res-Care Ohio, Inc.	Delaware
CATX Properties, Inc.	Delaware
Res-Care California, Inc. d/b/a RCCA Services	Delaware
RSCR California, Inc.	Delaware
Res-Care Kansas, Inc.	Delaware
Res-Care Illinois, Inc.	Delaware
ResCare International, Inc.	Delaware
Res-Care Oklahoma, Inc.	Delaware
Youthtrack, Inc.	Delaware
Res-Care Training Technologies, Inc.	Delaware
RSCR West Virginia, Inc.	Delaware
Community Alternatives Virginia, Inc.	Delaware
Community Alternatives Kentucky, Inc.	Delaware
Alternative Youth Services, Inc.	Delaware
Res-Care Premier, Inc.	Delaware
CNC/Access, Inc.	Rhode Island
Community Alternatives Illinois, Inc.	Delaware
Community Alternatives Missouri, Inc.	Missouri
The Academy for Individual Excellence, Inc.	Delaware
ResCare Finance, Inc.	Delaware
Creative Networks, L.L.C.	Arizona
Res-Care New Jersey, Inc.	Delaware
Normal Life, Inc.	Kentucky
Res-Care Alabama, Inc.	Delaware
Res-Care Washington, Inc.	Delaware
Southern Home Care Services, Inc.	Georgia
Tangram Rehabilitation Network, Inc.	Texas
PeopleServe, Inc.	Delaware
Arbor E&T, LLC	Kentucky

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Res-Care, Inc.:

We consent to incorporation by reference in the registration statements (No. 33-61878), (No. 333-50726), (No. 333-126279), (No. 333-126282) and (No. 333-117008) on Form S-8 and (No. 333-131590) on Form S-4 of Res-Care, Inc. of our reports dated March 8, 2006, with respect to the consolidated balance sheets of Res-Care, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005 and related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 and the effectiveness of internal control over financial reporting as of December 31, 2005, which reports appear in the December 31, 2005 annual report on Form 10-K of Res-Care, Inc.

/s/ KPMG LLP

Louisville, Kentucky
March 8, 2006

EXHIBIT 31.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Ronald G. Geary, certify that:

1. I have reviewed this annual report on Form 10-K of Res-Care, 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 registrant as of, and for, the periods presented in this report;

4. The registrant'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 15d-15(f), for the registrant 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 registrant, 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 registrant'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 registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   (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 registrant'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 registrant's internal control over financial reporting.

Date: March 8, 2006

By: /s/ Ronald G. Geary
Ronald G. Geary
Chairman, President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, David W. Miles, certify that:

1. I have reviewed this annual report on Form 10-K of Res-Care, 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 registrant as of, and for, the periods presented in this report;

4. The registrant'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 15d-15(f), for the registrant 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 registrant, 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 registrant'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 registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   (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 registrant'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 registrant's internal control over financial reporting.

Date: March 8, 2006

By: /s/ David W. Miles
David W. Miles
Chief Financial Officer

EXHIBIT 32

CERTIFICATION

In connection with the Annual Report of Res-Care, Inc. (the "Company") on Form 10-K for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

(1) The Annual Report on Form 10-K of the Company for the annual period ended December 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 8, 2006

By: /s/ Ronald G. Geary
Ronald G. Geary
Chairman, President and Chief Executive Officer

Date: March 8, 2006

By: /s/ David W. Miles
David W. Miles
Chief Financial Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS AND SCHEDULE

All other financial statement schedules have been omitted, as the required information is inapplicable or the information is presented in the financial statements or related notes.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Res-Care, Inc.:

We have audited the consolidated financial statements of Res-Care, Inc. and subsidiaries as listed in the accompanying index on page F-1. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index on page F-1. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule 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. 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Res-Care, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Res-Care, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 8, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Louisville, Kentucky
March 8, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Res-Care, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that Res-Care, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Res-Care, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process 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. A company's 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 assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's 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.

In our opinion, management's assessment that Res-Care, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, Res-Care, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Res-Care, Inc. and subsidiaries as listed in the accompanying index on Page F-1, and our report dated March 8, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Louisville, Kentucky
March 8, 2006

RES-CARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2005 and 2004
(In thousands, except share data)

	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,894	$ 28,404
Short-term investments	27,650	53,235
Accounts receivable, net of allowance for doubtful accounts of $9,279 in 2005 and $8,806 in 2004	160,821	138,202
Refundable income taxes	343	—
Deferred income taxes	22,426	20,056
Prepaid expenses and other current assets	10,666	12,338
Total current assets	231,800	252,235
Property and equipment, net	74,175	72,975
Goodwill	281,016	241,789
Other assets	24,111	19,667
	$ 611,102	$ 586,666
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 40,592	$ 37,773
Accrued expenses	90,739	77,715
Current portion of long-term debt	3,458	13,481
Current portion of obligations under capital leases	1,096	989
Accrued income taxes	—	1,658
Total current liabilities	135,885	131,616
Long-term liabilities	422	199
Long-term debt	152,094	166,480
Obligations under capital leases	490	1,586
Deferred gains	3,865	4,530
Deferred income taxes	16,348	11,712
Total liabilities	309,104	316,123
Commitments and contingencies		
Shareholders' equity:		
Preferred shares, authorized 1,000,000 shares, no par value, except 48,095 shares designated as Series A with stated value of $1,050 per share, 48,095 shares issued and outstanding in 2005 and 2004	46,609	46,609
Common stock, no par value, authorized 40,000,000 shares, issued 28,723,857 in 2005 and 2004, outstanding 26,946,078 shares in 2005 and 25,909,910 shares in 2004	49,603	48,871
Additional paid-in capital	64,742	54,316
Retained earnings	140,987	119,765
Accumulated other comprehensive income	1,194	982
Unearned stock compensation	(1,137)	—
Total shareholders' equity	301,998	270,543
	$ 611,102	$ 586,666

See accompanying notes to consolidated financial statements.

RES-CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2005, 2004 and 2003
(In thousands, except per share data)

	2005	2004	2003
Revenues	$ 1,088,770	$1,009,016	$ 961,333
Facility and program expenses	971,500	905,213	865,461
Facility and program contribution	117,270	103,803	95,872
Operating expenses (income):			
Corporate general and administrative	42,060	38,609	36,188
Depreciation and amortization	13,865	12,207	12,254
Loss on refinancing	11,914	—	—
Other operating expenses, net	125	457	2,187
Total operating expenses	67,964	51,273	50,629
Operating income	49,306	52,530	45,243
Other expenses:			
Interest expense	19,475	20,878	25,773
Interest income	(2,081)	(1,128)	(1,447)
Total other expenses, net	17,394	19,750	24,326
Income before income taxes	31,912	32,780	20,917
Income tax expense	10,690	11,273	7,530
Net income	21,222	21,507	13,387
Non-cash beneficial conversion feature	—	(14,784)	—
Net income attributable to preferred shareholders	3,268	606	—
Net income attributable to common shareholders	$ 17,954	$ 6,117	$ 13,387
Basic earnings per common share	$ 0.68	$ 0.24	$ 0.55
Diluted earnings per common share	$ 0.66	$ 0.23	$ 0.54
Weighted average number of common shares:			
Basic	26,424	25,341	24,500
Diluted	27,087	26,694	24,801

See accompanying notes to consolidated financial statements.

RES-CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOMI
Years Ended December 31, 2005, 2004 and 2003
(In thousands)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Stock Compensation	al
	Shares	Amount	Shares	Amount					
Balance at January 1, 2003	—	$ —	24,418	$47,904	$ 29,620	$ 99,655	$ (187)	$ —	$ 1' 992
Net income	—	—	—	—	—	13,387	—	—	387
Foreign currency translation adjustment arising during period	—	—	—	—	—	—	804	—	804
Comprehensive income									191
Exercise of stock options, including related tax benefit	—	—	357	231	1,494	—	—	—	725
Balance at December 31, 2003	—	—	24,775	48,135	31,114	113,042	617	—	1 908
Net income	—	—	—	—	—	21,507	—	—	507
Foreign currency translation adjustment arising during period	—	—	—	—	—	—	365	—	365
Comprehensive income									872
Issuance of preferred stock	48	46,609	—	—	14,784	(14,784)	—	—	609
Exercise of stock options, including related tax benefit	—	—	1,135	736	8,418	—	—	—	154
Balance at December 31, 2004	48	46,609	25,910	48,871	54,316	119,765	982	—	2' 543
Net income	—	—	—	—	—	21,222	—	—	222
Foreign currency translation adjustment arising during period	—	—	—	—	—	—	212	—	212
Comprehensive income									434
Restricted stock grants	—	—	—	—	1,278	—	—	(1,278)	—
Restricted stock amortization	—	—	—	—	—	—	—	141	141
Exercise of stock options, including related tax benefit	—	—	1,036	732	9,148	—	—	—	880
Balance at December 31, 2005	48	$46,609	26,946	$49,603	$ 64,742	$140,987	$ 1,194	$ (1,137)	$ 3 998

See accompanying notes to consolidated financial statements.

RES-CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2005, 2004 and 2003

(In thousands)

	2005	2004	2003
Operating activities:			
Net income	$ 21,222	$ 21,507	$ 13,387
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	13,865	12,207	12,254
Amortization of discount and deferred debt issuance costs on notes	1,228	1,173	1,908
Restricted stock compensation	141	—	—
Deferred income taxes, net	2,266	(53)	2,638
Provision for losses on accounts receivable	4,789	5,283	7,328
Tax benefit from exercise of stock options	3,376	2,593	417
Loss on sale of assets	377	207	195
Loss on extinguishment of debt	11,914	—	1,330
Changes in operating assets and liabilities:			
Accounts receivable	(27,408)	(14,286)	(11,918)
Prepaid expenses and other current assets	1,701	(2,160)	3,641
Other assets	(1,791)	1,887	(367)
Accounts payable	2,819	(244)	4,028
Accrued expenses	12,286	10,684	5,499
Deferred gains	(665)	(941)	(1,028)
Accrued income taxes	(2,001)	3,526	11,451
Long-term liabilities	435	390	707
Cash provided by operating activities	44,554	41,773	51,470
Investing activities:			
Purchases of property and equipment	(14,175)	(16,017)	(14,141)
Acquisitions of businesses, net of cash acquired	(36,959)	(11,249)	(9,758)
Proceeds from sale of assets	64	32	405
Purchases of short term investments	(409,900)	(217,750)	(400)
Redemptions of short term investments	435,485	164,515	15,515
Cash used in investing activities	(25,485)	(80,469)	(8,379)
Financing activities:			
Long-term debt repayments	(192,101)	(7,989)	(95,877)
Borrowings of long-term debt	162,223	—	20,351
Payments on obligations under capital leases	(989)	(1,521)	(2,407)
Proceeds received from exercise of stock options	6,504	6,561	1,308
Net proceeds from the issuance of preferred stock	—	46,609	—
Debt issuance costs	(4,131)	—	—
Tender premium costs	(9,085)	—	—
Cash (used in) provided by financing activities	(37,579)	43,660	(76,625)
(Decrease) increase in cash and cash equivalents	(18,510)	4,964	(33,534)
Cash and cash equivalents at beginning of year	28,404	23,440	56,974
Cash and cash equivalents at end of year	$ 9,894	$ 28,404	$ 23,440
Supplemental disclosures of cash flow information:			
Cash paid (received) for:			
Interest	$ 17,119	$ 20,809	$ 26,863
Income taxes (net of refunds of $0.6 million, $0.4 million and $11.6 million, respectively)	6,801	5,497	(6,563)
Supplemental schedule of non-cash investing and financing activities:			
Notes issued in connection with acquisitions	5,434	2,025	—
Capital lease obligations converted to operating leases	—	177	1,767
Capital lease obligations incurred in connection with asset acquisition	—	—	2,897
Account receivable converted to note receivable	—	—	875

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

1. Summary of Significant Accounting Policies

Basis of Presentation and Description of Business

The consolidated financial statements include the accounts of Res-Care, Inc. and its subsidiaries. A references in these financial statements to "ResCare," "our company," "we," "us," or "our" mean Res-Care, In and, unless the context otherwise requires, its consolidated subsidiaries. Significant intercompany accounts ar transactions have been eliminated in consolidation.

We receive revenues primarily from the delivery of residential, therapeutic, job training and education supports services to various populations with special needs.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in th United States of America requires us to make estimates and assumptions that affect the reported amounts of asse and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reporte amounts of revenues and expenses during the reporting period. Actual results may differ materially from thos estimates.

Segments

Commencing January 1, 2005, as a result of integrating the former Youth Services operating segment int our existing segments, Youth Services is no longer an operating segment. As a result of the dissolution of thi segment, as well as the expansion of our job training and placement programs for disadvantaged job seekers, w now have the following three reportable segments: (i) Disabilities Services, (ii) Job Corps Training Services an (iii) Employment Training Services. Effective January 1, 2006, in order to better reflect the services provided, th Disabilities Services segment is now named Community Services.

Revenue Recognition

Community Services: Revenues are derived primarily from 28 different state Medicaid programs and fron management contracts with private operators, generally not-for-profit providers, who contract with stat government agencies and are also reimbursed under the Medicaid programs. Revenues from the state Medicai programs are recorded at rates established at or before the time services are rendered. Depending upon the state' reimbursement policies and practices, management contract fees are computed on the basis of a fixed fee pe individual, which may include some form of incentive payment, a percentage of operating expenses (cost-plu contracts), a percentage of revenue or an overall fixed fee paid regardless of occupancy. Revenue is recognized in the period services are rendered.

Job Corps Training Services: Revenues include amounts reimbursable under cost reimbursement contracts with the U.S. Department of Labor (DOL) for operating Job Corps centers for education and training programs. The contracts provide reimbursement for all facility and program costs related to operations, allowable indirect costs for general and administrative costs, plus a predetermined management fee, primarily performance-based. Final determination of amounts due under the contracts is subject to audit and review by the applicable government agencies. Revenue is recognized in the period associated costs are incurred.

Employment Training Services: Revenues are derived through performance-based and fixed-fee contracts from state and local governments. Revenue is recognized in the period services are rendered.

Laws and regulations governing the government programs and contracts are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. For each operating segment, expenses are subject to examination by agencies administering the contracts and services. We believe that adequate provisions have been made for potential adjustments arising from such examinations.

We are substantially dependent on revenues received under contracts with federal, state and local government agencies. Operating funding sources for 2005 were approximately 76% through Medicaid reimbursement, 14% from the DOL and 10% from other payors. For the years ended December 31, 2005, 2004 and 2003, we derived 9%, 10% and 11%, respectively, of our revenues under contracts for individuals with mental retardation or other developmental disabilities services in Texas and 14% of our revenues each year under contracts under the federal Job Corps program. Generally, these contracts are subject to termination at the election of governmental agencies and in certain other circumstances such as failure to comply with applicable regulations or quality of service issues.

Facility and Program Expenses

We classify expenses directly related to providing services as facility and program expenses, except for depreciation and amortization related to our facilities and programs, which are shown separately in the consolidated statement of income. Direct costs and expenses principally include salaries and benefits for direct care professionals and operating management, contracted labor costs, insurance costs, transportation costs for clients requiring services, certain client expenses such as food, supplies and medicine, residential occupancy expenses, which primarily comprise rent and utilities, and other miscellaneous direct service-related expenses.

Cash Equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. As of December 31, 2004, included in our cash and cash equivalents balance was $9.1 million of cash held on deposit with an insurance carrier as collateral for our insurance program. In October 2005, in accordance with our collateral arrangement with the insurance carrier, we exchanged the cash held on deposit for a letter of credit.

Short-term Investments

Short-term investments include auction rate securities, which are variable rate securities tied to short-term interest rates with maturities on the face of the securities in excess of 90 days. Auction rate securities have rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28, 35, or 49 days. The securities trade at par and are callable at par on any payment date at the option of the issuer. Investment earnings paid during a given period are based upon the reset rate determined during the prior auction.

Although these securities are issued and rated as long-term securities, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. We have historically classified these instruments as cash equivalents if the period between interest rate resets was 90 days or less, which was based on our ability to either liquidate our holdings or roll our investment over to the next reset period.

During 2005, we determined that our investments in auction rate securities should be classified as short-term investments. In addition, "Purchases (redemptions) of short-term investments", included in the accompanying Consolidated Statements of Cash Flows, have been revised to reflect the purchase and sale of auction rate securities during the periods presented.

Valuation of Accounts Receivable

Accounts receivable consist primarily of amounts due from Medicaid programs, other governme agencies and commercial insurance companies. An estimated allowance for doubtful accounts receivable recorded to the extent it is probable that a portion or all of a particular account will not be collected. In evaluatin the collectibility of accounts receivable, we consider a number of factors, including historical loss rates, age of th accounts, changes in collection patterns, the status of ongoing disputes with third-party payors, general econom conditions and the status of state budgets. Complex rules and regulations regarding billing and timely filin requirements in various states are also a factor in our assessment of the collectibility of accounts receivabl Actual collections of accounts receivable in subsequent periods may require changes in the estimated allowanc for doubtful accounts. Changes in these estimates are charged or credited to the results of operations in the perio of the change of estimate.

Valuation of Long-Lived Assets

We regularly review the carrying value of long-lived assets with respect to any events or circumstance that indicate a possible inability to recover their carrying amount. Indicators of impairment include, but are nc limited to, loss of contracts, significant census declines, reductions in reimbursement levels and significar litigation. Our evaluation is based on cash flow, profitability and projections that incorporate current or projecte operating results, as well as significant events or changes in the reimbursement or regulatory environment. I circumstances suggest the recorded amounts cannot be recovered, the carrying values of such assets are reduce to fair value based upon various techniques to estimate fair value.

Goodwill

We test goodwill for impairment annually as of year end, unless changes in circumstances indicate ar impairment may have occurred sooner. We test goodwill on a reporting unit basis, in which a reporting unit i defined as the operating segment. We use a fair value approach to test goodwill for impairment and recognize ar impairment charge for the amount, if any, by which the carrying amount of goodwill exceeds its implicit fai value. Fair values are established using a weighted-average of discounted cash flows and comparative marke multiples in the current market conditions. No impairment loss was recognized as a result of the impairment test in 2005, 2004 and 2003.

Debt Issuance Costs

Debt issuance costs are capitalized and amortized as interest expense over the terms of the related debt.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable tc differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

Deferred Gains on Sale and Leaseback of Assets

Gains from the sale and leaseback of assets are deferred and amortized over the term of the operating lease as a reduction of rental expense.

Legal Contingencies

We are a party to numerous claims and lawsuits with respect to various matters. We provide for costs related to contingencies when a loss is probable and the amount is reasonably determinable. We confer with outside counsel in estimating our liability for certain legal contingencies. While we believe our provision for legal contingencies is adequate, the outcome of legal proceedings is difficult to predict and we may settle legal claims or be subject to judgments for amounts that exceed our estimates.

Insurance

We self-insure a substantial portion of our professional and general liability, workers' compensation, auto, property and health benefit risks. Provisions for losses for these risks are based upon actuarially determined estimates. The allowances for these risks include an amount determined from reported claims and an amount based on past experiences for losses incurred but not reported. Estimates of workers' compensation claims reserves are discounted using a discount rate of approximately 5% at December 31, 2005 and 6% at December 31, 2004. The decrease in the discount rate of 100 basis points increased the reserve, and resulting expense, by approximately $0.5 million in 2005. The discount rate was decreased in 2005 to reflect our claims payment experience and the current interest rate environment. These liabilities are necessarily based on estimates and, while we believe that the provision for loss is adequate, the ultimate liability may be more or less than the amounts recorded. The liabilities are evaluated quarterly and any adjustments are reflected in earnings in the period known.

Operating Leases

We lease certain residential and operating facilities and office space under operating leases. Facility lease agreements may include rent holidays and rent escalation clauses. We recognize rent holiday periods and scheduled rent increases on a straight-line basis over the lease term beginning with the date we take possession of the leased space.

Depreciation and Amortization

Depreciation and amortization are provided by the straight-line method over the estimated useful lives of the assets. Estimated useful lives for buildings are 20-35 years. Assets under capital lease and leasehold improvements are amortized over the term of the respective lease or the useful life of the asset, if shorter. The useful lives of furniture and equipment vary from three to seven years. Depreciation expense includes amortization of assets under capital lease.

We act as custodian of assets where we have contracts to operate facilities or programs owned or leased by the U.S. Department of Labor, various states and private providers.

Foreign Currency Translation

A foreign subsidiary designates its local currency as its functional currency, and we record the translation of its assets and liabilities into U.S. dollars at the balance sheet dates as translation adjustments and include them as a component of accumulated other comprehensive income.

Stock-Based Compensation

As permitted by Statement of Financial Accounting Standards (SFAS) No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of Financial Accounting Standards Board (FASB) Statement No. 123* (SFAS 148), we continue to account for our stock-based employee compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. Compensation expense related to stock options is not reflected in net income, as all options granted under those plans had an exercise price equal to the market value c the underlying common stock on the date of the grant. Compensation expense is recorded for restricted stoc grants over their vesting periods based on fair value, which is equal to the market price of our common stock o the date of the grant. The following table illustrates the effect on net income attributable to common shareholdeı and earnings per common share if we had applied the fair value recognition provisions of SFAS No. 12: *Accounting for Stock-Based Compensation* (SFAS 123), to stock-based employee compensation.

	Year Ended December 31		
	2005	2004	2003
Net income, attributable to common shareholders, as reported	$ 17,954	$ 6,117	$ 13,38
Add: Stock-based compensation, net, as reported	72	—	–
Deduct: Total stock-based employee compensation expense determined under fair value method of all awards, net of related tax effects	(1,925)	(2,176)	(3,41
Net income attributable to common shareholders, pro forma	$ 16,101	$ 3,941	$ 9,96
Basic earnings per common share			
As reported	$ 0.68	$ 0.24	$ 0.5
Pro forma	0.61	0.16	0.4
Diluted earnings per common share			
As reported	$ 0.66	$ 0.23	$ 0.5
Pro forma	0.59	0.15	0.4

For purposes of computing the pro forma effect of stock-based employee compensation expense, option with pro-rata vesting are recognized using the straight-line method over the life of the vesting period. Th following table sets forth the fair value of each option grant during 2005, 2004 and 2003 using the Black-Schole option-pricing model and the applicable weighted-average assumptions:

	Year Ended December 31		
	2005	2004	2003
Fair value per option	$ 8.26	$ 3.98	$ 2.47
Risk-free interest rate	4.39%	3.60%	3.27%
Dividend yield	0%	0%	0%
Expected volatility	0.49	0.60	0.62
Expected option life (in years)	4-6	3-5	2-4

Financial Instruments

We used various methods and assumptions in estimating the fair value disclosures for significant financia instruments. Fair values of cash and cash equivalents, short-term investments, accounts receivable and account payable approximate their carrying amount because of the short maturity of those investments. The fair value o long-term debt is determined using market quotes and calculations based on current market rates available to us.

Impact of Recently Issued Accounting Pronouncements

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS 123(R)), *Share-Base Payment*, which is a revision of SFAS 123. SFAS 123(R) supersedes APB 25 and amends SFAS 95, *Statement o Cash Flows*. Generally, the approach to accounting for share-based payments in SFAS 123(R) is similar to th approach described in SFAS 123 which, as discussed above and as allowed by SFAS 123, we have applied for pr forma purposes in the Notes to the Consolidated Financial Statements. However, SFAS 123(R) requires all share based payments to employees, including grants of employee stock options, to be recognized in the financia statements based on their fair values. Pro forma disclosure is no longer an alternative to financial statemen recognition. SFAS 123(R) is effective for public companies at the beginning of the first interim or annual perio beginning after June 15, 2005.

SFAS 123(R) permits public companies to account for share-based payments using one of two methods: modified-prospective method or modified-retrospective method. Under the modified-prospective method, compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

Under the modified-retrospective method, which includes the requirements of the modified prospective method described above, companies are permitted to restate, based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We are adopting SFAS 123(R) effective January 1, 2006 using the modified-prospective method. Currently, we use the Black-Scholes formula to estimate the value of stock options granted to employees and will continue to use this acceptable option valuation model upon the required adoption of SFAS 123(R) for all unvested options at the date of adoption and any option grants subsequent to adoption. The impact of adoption of SFAS 123(R) for the year ending December 31, 2006 and beyond will depend on various factors, including, but not limited to, our future compensation strategy. The pro forma compensation costs presented above and in our prior filings may not be indicative of amounts which should be expected in future years. We currently estimate the adoption of SFAS 123(R) will decrease net income for the year ending December 31, 2006 by approximately $0.8 million, or $0.03 per diluted common share. SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While we cannot estimate what those amounts will be in the future because they depend on, among other things, when employees exercise stock options, the amount of operating cash flows recognized in prior periods for such excess tax deductions were $3.4 million, $2.6 million and $0.4 million in 2005, 2004 and 2003, respectively.

Reclassification

Certain amounts in the 2004 and 2003 financial statements have been reclassified to conform to the 2005 presentation.

2. Acquisitions

During 2005, we acquired the assets of nineteen companies primarily within our Community Services Group. Aggregate consideration for these acquisitions was approximately $42.4 million, including $5.4 million of notes issued. The operating results of the acquisitions are included in the consolidated statements of income from the dates of acquisition. We accounted for the acquisitions under the purchase method of accounting. Accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based upon their respective fair values. The excess of the purchase price over the estimated fair market value of net tangible assets was allocated to specifically identified intangible assets, with the residual being allocated to goodwill. Certain acquisitions contain provisions for additional payments to the sellers if specific earnings targets are met subsequent to the acquisition. The maximum aggregate earn-out payment under the agreements is approximately $9.7 million.

The aggregate purchase price for the acquisitions was allocated as follows:

Other assets, current and long-term	$ 176
Property and equipment	245
Identifiable intangible assets	4,002
Goodwill	38,873
Accounts payable and accrued expenses	(903)
	$ 42,393

3. Goodwill and Intangible Assets

A summary of changes to goodwill during the year follows:

	Community Services	Job Corps Training Services	Employment Training Services	Other	Total
Balance at January 1, 2004	$ 211,999	$ 7,589	$ 10,387	$ 331	$ 230,306
Goodwill added through acquisitions	7,653	—	3,830	—	11,483
Balance at December 31, 2004	219,652	7,589	14,217	331	241,789
Goodwill added through acquisitions	38,873	—	—	—	38,873
Adjustments to previously recorded goodwill	254	—	100	—	354
Balance at December 31, 2005	$ 258,779	$ 7,589	$ 14,317	$ 331	$ 281,016

Intangible assets are as follows:

	December 31, 2005		December 31, 2004	
	Gross	Accumulated Amortization	Gross	Accumulated Amortization
Covenants not to compete	$ 20,877	$ 13,455	$ 16,950	$ 12,208

Covenants not to compete are comprised of contractual agreements with stated values and terms and ar amortized over the term of the agreements.

Amortization expense for the years ended December 31, 2005, 2004 and 2003 was approximately $1.: million, $0.8 million and $1.3 million, respectively. Estimated amortization expense for the next five years is a: follows:

Year Ending December 31	
2006	$ 1,382
2007	1,153
2008	822
2009	781
2010	709

4. Debt

Long-term debt consists of the following:

	December 31 2005	December 31 2004
7.75% senior notes due 2013, net of discount of approximately $1.1 million	$ 148,926	$ —
10.625% senior notes due 2008, paid in 2005	—	150,000
Term loan due 2008, paid in September 2005	—	15,000
5.9% convertible subordinated notes, paid in March 2005	—	12,759
Notes payable and other	6,626	2,202
	155,552	179,961
Less current portion	3,458	13,481
	$ 152,094	$ 166,480

On October 3, 2005, we issued $150 million of 7.75% Senior Notes due October 15, 2013 (the Senior Notes) in a private placement under Rule 144A of the Securities Act of 1933. The Senior Notes, which had an issue price of 99.261% of the principal amount, are unsecured obligations ranking equal to existing and future debt and are subordinate to existing and future secured debt. The effective interest rate for these notes is approximately 7.87%. We used a portion of the proceeds from the offering of the Senior Notes to repurchase our 10.625% Senior Notes due November 15, 2008. The Senior Notes are jointly, severally, fully and unconditionally guaranteed by our 100% owned U.S. subsidiaries. The Senior Notes were registered under the Securities Act of 1933 in February 2006.

Also on October 3, 2005, we amended and restated our existing senior secured credit facility. As amended and restated, the facility consists of $175 million revolving credit facility, which can be increased to $225 million at our option and expires on October 3, 2010. The credit facility will be used primarily for working capital purposes and for letters of credit required under our insurance programs. The amended and restated senior credit facility contains various financial covenants relating to net worth, capital expenditures and rentals and requires us to maintain specified ratios with respect to interest coverage and leverage. The amended and restated senior credit facility is secured by a lien on all of our assets and, through secured guarantees, on all of our domestic subsidiaries' assets. In connection with these refinancing transactions, in September 2005 we repaid our outstanding term loan, which totaled $28 million.

As of December 31, 2005, we had irrevocable standby letters of credit in the principal amount of $60.1 million issued primarily in connection with our insurance programs. As of December 31, 2005, we had $114.9 million available under the revolver. At December 31, 2005, the Company had no borrowings on its revolver other than the standby letters of credit. The letters of credit had a borrowing rate of 1.75% at December 31, 2005.

Maturities of long-term debt are as follows:

Year Ending December 31	
2006	$ 3,458
2007	2,715
2008	258
2009	147
2010	6
Thereafter	150,077
	$ 156,661

5. Income Taxes

Income tax expense attributable to income from continuing operations is summarized as follows:

	Year Ended December 31		
	2005	2004	2003
Current:			
Federal	$ 5,811	$ 8,599	$ 3,71
State	2,181	1,740	87
Foreign	432	289	30
Total current	8,424	10,628	4,89
Deferred:			
Federal	1,633	489	2,26
State	633	156	37
Total deferred	2,266	645	2,63
Total income tax expense	$ 10,690	$ 11,273	$ 7,53

A reconciliation of the U.S. Federal income tax rate of 35% to income tax expense expressed as a percen of pretax income follows:

	Year Ended December 31		
	2005	2004	2003
Federal income tax at the statutory rate	35.0%	35.0%	35.0%
Increase (decrease) in income taxes:			
State taxes, net of federal benefit	5.2	3.9	3.9
Foreign income taxes, net of federal credits	0.7	0.2	0.5
Jobs tax credits, net	(7.2)	(4.4)	(5.0)
Nondeductible expenses and other	1.1	0.7	1.6
Nontaxable income	(1.3)	(1.0)	—
	33.5%	34.4%	36.0%

During the years ended December 31, 2005, 2004 and 2003, we credited additional paid-in capital for th tax benefits associated with the exercise of stock options in the amounts of $3,376, $2,593 and $417, respectively.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are presented below:

	December 31 2005	December 31 2004
Deferred tax assets:		
Accounts receivable	$ 3,744	$ 3,422
Covenants not to compete and other intangible assets	1,723	1,784
Workers' compensation costs	8,949	8,697
Compensated absences	3,302	2,980
Other insurance reserves	5,924	3,589
Other liabilities and reserves	1,705	2,575
Deferred gains and revenues	1,559	1,872
Deferred state income tax net operating loss carryforwards	3,498	2,956
Other	1,008	689
Total gross deferred tax assets	31,412	28,564
Less valuation allowance	2,715	2,080
Net deferred tax assets	28,697	26,484
Deferred tax liabilities:		
Goodwill and other intangible assets	22,294	17,578
Other	325	562
Total deferred tax liabilities	22,619	18,140
Net deferred tax asset	$ 6,078	$ 8,344
Classified as follows:		
Current deferred income tax asset	$ 22,426	$ 20,056
Noncurrent deferred income tax liability	(16,348)	(11,712)
Net deferred tax asset	$ 6,078	$ 8,344

A valuation allowance for deferred tax assets was provided as of December 31, 2005 and 2004 related primarily to deferred state income tax net operating loss carryforwards. The realization of deferred tax assets is dependent upon generating future taxable income when temporary differences become deductible. Based upon the historical and projected levels of taxable income, we believe it is more likely than not that we will realize the benefits of the deductible differences after consideration of the valuation allowance.

6. Detail of Certain Balance Sheet Accounts

Property and equipment is summarized as follows:

	December 31 2005	December 31 2004
Property and Equipment:		
Land and land improvements	$ 7,793	$ 7,784
Furniture and equipment	74,878	65,105
Buildings	41,460	42,179
Leasehold improvements	22,655	19,323
Equipment under capital lease	5,055	5,055
Construction in progress	3,367	4,302
	155,208	143,748
Less accumulated depreciation and amortization	81,033	70,773
Net property and equipment	$ 74,175	$ 72,975

Other assets are as follows:

	December 31 2005	December 31 2004
Long-term receivables and advances to managed facilities	$ 4,211	$ 2,643
Covenants not to compete, net of accumulated amortization	7,422	4,742
Deposits	4,517	5,911
Deferred debt issuance costs	4,776	4,661
Other assets	3,185	1,710
	$ 24,111	$ 19,667

Accrued expenses are summarized as follows:

	December 31 2005	December 31 2004
Wages and payroll taxes	$ 23,269	$ 19,271
Compensated absences	12,750	11,290
Workers' compensation	23,947	22,663
Professional and other liability self-insurance	14,760	8,943
Taxes other than income taxes	5,274	4,318
Interest	3,317	2,225
Other	7,422	9,005
	$ 90,739	$ 77,715

7. Preferred Stock Issuance

On June 23, 2004, ResCare issued 48,095 shares of preferred stock to four investment funds controlled b Onex Corporation (the "Onex Partners"), at a purchase price of $1,050 per share or a total price of $50.5 millior The preferred shares are convertible into approximately 4.8 million shares of ResCare's common stock, based o a value of $10.50 per common share which was contractually agreed to on March 10, 2004. Net proceeds from th transaction were $46.6 million. Issuance costs of approximately $3.9 million, including a $0.5 million transactio fee to Onex Corporation, were recorded as a reduction in shareholders' equity. In addition, we recorded a expense of $0.8 million in 2004 related to payments required under the provisions of the director stock optio: plans as a result of the transaction which was included as other operating expenses in the consolidated statemen of income.

The preferred stock was designated as Series A convertible preferred stock and is entitled to a liquidatio: preference of $1,050 per share plus all unpaid, accrued dividends. Preferred shares vote on an as-converted basi as of the date of issuance. The preferred shareholders also are entitled to certain corporate governance and specia voting rights, as defined in the agreement, and have no preferential dividends. Commencing 18 months after th issuance, the holders of the preferred stock have the right to put the shares to ResCare at $1,050 per share plu accrued dividends, if any, if we close a sale of substantially all of our assets or equity by merger, consolidation o otherwise.

Accounting for this transaction falls primarily under Emerging Issues Task Force (EITF) Issue No. 98-5 *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustabl Conversion Ratios*, and EITF Issue No. 00-27, *Application of Issue 98-5 to Certain Convertible Instruments*. Th beneficial conversion feature assumed in the preferred stock issuance was calculated at $14.8 million and wa determined by multiplying the number of common shares issuable upon conversion of the preferred shares by th difference between the market price of the common stock on the date of closing and the previously agreed upoi conversion price. The beneficial conversion feature was a non-cash item, and was charged to retained earnings with the offsetting credit to additional paid-in capital. Additionally, the beneficial conversion feature was treate as a reduction in determining net income attributable to common shareholders for the year ended December 31, 2004.

The Onex Partners entered into a voting agreement with Ronald G. Geary, our company's chairman, president and chief executive officer. The voting agreement provides that Mr. Geary grant the Onex Partners the sole and exclusive right to vote all of the common shares he beneficially owns and is otherwise entitled to vote in connection with the election of directors and any matter affecting the number of directors or composition of our board of directors. The voting agreement will remain in effect until such time as the agreement is terminated by the mutual consent of the Onex Partners and Mr. Geary, Mr. Geary's employment terminates, or Onex Partners no longer owns a stipulated number of shares of our capital stock. The voting agreement also provides that Mr. Geary may not sell, transfer or otherwise dispose of any common shares during the term of the agreement unless he has first offered to sell the shares to the Onex Partners at a price and on other terms specified by Mr. Geary, and the Onex Partners declines to accept the offer. If the Onex Partners decline to purchase the shares, Mr. Geary would then be entitled to sell the offered shares to a third party at a price and on terms no more favorable to the purchaser than those initially offered to the Onex Partners.

Additionally, in connection with the transaction, we entered into a management services agreement with Onex Corporation whereby Onex Corporation will advise and assist management and the board of directors from time to time on business and financial matters. We have agreed to pay Onex Corporation an annual advisory fee of $350,000 for its services under this agreement effective July 1, 2004. The management services agreement will continue in effect until such time as the Onex Partners no longer holds at least 26,452 shares of preferred stock. During 2005 and 2004, fees of $350,000 and $175,000, respectively, were paid to Onex Corporation under this agreement.

8. Earnings per Share

The following data shows the amounts used in computing earnings per common share and the effect on income and the weighted average number of shares of dilutive potential common stock.

	Year Ended December 31		
	2005	2004	2003
Net income attributable to common shareholders	$ 17,954	$ 6,117	$ 13,387
Weighted average number of common shares used in basic earnings per common share	26,424	25,341	24,500
Effect of dilutive securities:			
Stock options	663	1,353	301
Weighted average number of common shares and dilutive potential common shares used in diluted earnings per common share	27,087	26,694	24,801

The non-cash beneficial conversion feature attributable to preferred stock issued and sold in June 2004 decreased net income attributable to common shareholders by $14.8 million for the year ended December 31, 2004. See further discussion of the non-cash beneficial conversion feature in Note 7.

The average shares listed below were not included in the computation of diluted earnings per common share because to do so would have been antidilutive for the periods presented:

	Year Ended December 31		
	2005	2004	2003
Convertible subordinated notes	103	494	5,319
Stock options	315	128	2,035

9. Segment Information

The following table sets forth information about reportable segment operating results and assets:

As of and for the year ended December 31:	Community Services	Job Corps Training Services	Employment Training Services	All Other	Consolida Totals
2005					
Revenues	$ 864,455	$ 152,749	$ 64,475	$ 7,091	$1,088,7
Operating income	86,065	16,422	5,703	(58,884)	49,3(
Total assets	444,180	33,580	36,309	97,033	611,1(
Capital expenditures	8,427	—	80	5,668	14,1
Depreciation and amortization	8,424	—	105	5,336	13,8(
2004					
Revenues	$ 819,597	$ 145,375	$ 38,341	$ 5,703	$1,009,0
Operating income	76,702	15,853	3,804	(43,829)	52,5
Total assets	389,980	32,670	25,708	138,308	586,6(
Capital expenditures	7,193	—	39	8,785	16,0
Depreciation and amortization	6,882	—	35	5,290	12,2(
2003					
Revenues	$ 787,903	$ 138,786	$ 30,122	$ 4,522	$ 961,3
Operating income	69,738	15,213	3,537	(43,245)	45,2
Total assets	378,791	27,966	18,895	77,374	503,0
Capital expenditures	5,236	—	110	8,795	14,1
Depreciation and amortization	7,950	—	28	4,276	12,2

10. Benefit Plans

We sponsor retirement savings plans which were established to assist eligible employees in providing f(their future retirement needs. Our contributions to the plans were $3.7 million, $3.5 million and $3.3 million i 2005, 2004 and 2003, respectively.

We also sponsor various stock-based employee compensation plans under which we may grant restricte stock awards and options to purchase our common stock to salaried officers, directors and employees for up 1 7,116,095 shares of common stock.

Stock option activity, including options granted to employees and non-employee directors, is show below:

	2005		2004		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weightec Averag Exercis Pric(
Outstanding at beginning of year	2,532,930	$ 7.11	3,053,361	$ 6.63	2,517,766	$ 10.
Granted	357,500	15.78	1,024,310	9.04	1,789,124	4.
Exercised	(1,036,168)	6.14	(1,134,881)	5.95	(359,863)	3.
Canceled or expired	(103,765)	11.11	(409,860)	11.87	(893,666)	14.
Outstanding at end of year	1,750,497	9.22	2,532,930	7.10	3,053,361	6.
Exercisable at end of year	1,282,128	$ 9.46	1,721,887	$ 6.66	2,144,918	$ 6.

The following table summarizes information about stock options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at December 31, 2005	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at December 31, 2005	Weighted-Average Exercise Price
$ 2.79 to 4.99	221,288	2.3 years	$ 3.09	186,660	$ 3.05
5.00 to 9.99	966,959	2.5 years	7.71	598,334	7.39
10.00 to 14.99	324,750	4.3 years	12.00	269,009	11.83
15.00 to 20.00	237,500	5.9 years	17.26	228,125	17.34
	1,750,497	3.3 years	$ 9.22	1,282,128	$ 9.46

Activity for our restricted stock awards was as follows for the year ended December 31, 2005:

Balance at beginning of year	—
Granted	84,783
Vested	(3,000)
Forfeited	—
Balance at end of year	81,783

Restricted stock awards generally vest in one-third increments over three years from the date of grant. Unearned compensation under the restricted stock award plans is amortized over the vesting periods. Compensation expense recognized related to our restricted stock award plans was $0.1 million in 2005. There were no restricted stock awards in 2004 or 2003. The weighted average grant date fair value of the restricted stock granted during 2005 was $15.78.

Options are awarded at a price equal to the market price of our stock on the date of grant, and an option's maximum term is normally five years. Generally all options have varied vesting schedules, varying between 20% and 50% at date of grant with the remaining options vesting over one to four years.

11. Lease Arrangements

We lease certain residential and operating facilities, office space, vehicles and equipment under operating leases which expire at various dates. Total rent expense was approximately $49.6 million, $46.6 million and $45.5 million for the years ended December 31, 2005, 2004 and 2003, respectively. Facility rent, defined as land and building lease expense less amortization of any deferred gain on applicable lease transactions, was approximately $40.6 million, $37.5 million and $35.4 million for the years ended December 31, 2005, 2004 and 2003, respectively. We also lease certain land and buildings used in operations under capital leases. These leases expire at various dates through 2020 (including renewal options) and generally require us to pay property taxes, insurance and maintenance costs.

Future minimum lease payments under capital leases, together with the minimum lease payments requir‹ under operating leases that have initial or remaining non-cancelable lease terms in excess of one year at Decemb‹ 31, 2005, are as follows:

Year Ended December 31	Capital Leases	Operating Leases
2006	$ 1,210	$ 34,3?
2007	272	27,91
2008	112	22,32
2009	106	18,38
2010	63	15,40
Thereafter	4	31,05
Total minimum lease payments	1,767	$ 149,46
Less amounts representing interest	181	
Present value of minimum lease payments	1,586	
Less current maturities	1,096	
Total long-term obligations under capital leases	$ 490	

12. Financial Instruments

At December 31, 2005 and 2004, the fair values of cash and cash equivalents, short-term investment‹ accounts receivable and accounts payable approximated carrying value because of the short-term nature of thes instruments. The fair value of our other financial instruments subject to fair value disclosures are as follows:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt:				
7.75% senior notes	$ 148,926	$ 150,375	$ —	$ –
10.625% senior notes	—	—	150,000	164,55‹
Term loan	—	—	15,000	15,00‹
5.9% convertible subordinated notes	—	—	12,759	12,75‹
Notes payable and other	6,626	6,626	2,202	2,20‹

We estimated the fair value of the debt instruments using market quotes and calculations based on curren market rates available to us.

13. Commitments and Contingencies

From time to time, we, or a provider with whom we have a management agreement, become a party t‹ legal and/or administrative proceedings that, in the event of unfavorable outcomes, may adversely affect revenue‹ and period to period comparisons.

In July 2000, American International Specialty Lines Insurance Company, or AISL, filed a Complaint fo‹ Declaratory Judgment against us and certain of our subsidiaries in the U.S. District Court for the Southern Distric‹ of Texas, Houston Division. In the Complaint, AISL sought a declaration of what insurance coverage wa‹ available to ResCare in the case styled *In re: Estate of Trenia Wright, Deceased, et al. v. Res-Care, Inc., et al.*, which was filed in Probate Court No. 1 of Harris County, Texas (the Lawsuit). After the filing, we entered into a‹ agreement with AISL whereby any settlement reached in the Lawsuit would not be dispositive of whether th‹ claims in the Lawsuit were covered under the insurance policies issued by AISL. AISL thereafter settled th‹ Lawsuit for $9.0 million. It is our position that: (i) the Lawsuit initiated coverage under policies of insurance in more than one policy year, thus affording adequate coverage to settle the Lawsuit within coverage and policy limits, (ii) AISL waived any applicable exclusions for punitive damages by its failure to send a timely reservation of rights letter and (iii) the decision by the Texas Supreme Court in *King v. Dallas Fire Insurance Company*, 85 S.W.3d 185 (Tex. 2002) controls. Prior to the Texas Supreme Court's decision in the *King* case, summary judgment was granted in favor of AISL but the scope of the order was unclear. Based on the *King* decision, the summary judgment was set aside. Thereafter, subsequent motions for summary judgment filed by both AISL and ResCare were denied. The case was tried, without a jury, in late December 2003. On March 31, 2004, the Court entered a judgment in favor of AISL in the amount of $5.0 million. It is our belief that the Court improperly limited the evidence ResCare could place in the record at trial and the type of claims it could present. Accordingly, an appeal of the Court's decision has been filed with the Fifth Circuit Court of Appeals and a supersedeas bond has been filed with the Court of $6.0 million. Oral arguments were held on August 31, 2005. We have not made any provision in our consolidated financial statements for the potential liability that may result from final adjudication of this matter, as we do not believe it is probable that an unfavorable outcome will result from this matter. Based on the advice of counsel, we do not believe it is probable that the ultimate resolution of this matter will result in a material liability to us nor have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

On September 2, 2001, in a case styled *Nellie Lake, Individually as an Heir-at-Law of Christina Zellner, deceased; and as Personal Representative of the Estate of Christina Zellner v. Res-Care, Inc., et al.,* in the U.S. District Court of the District of Kansas at Wichita, a jury awarded noneconomic damages to Ms. Lake in the amount of $100,000, the statutory maximum, as well as $5,000 for economic loss. In addition, the jury awarded the Estate of Christina Zellner $5,000 of noneconomic damages and issued an advisory opinion recommending an award of punitive damages. On February 4, 2002, the jury awards were entered by the Court, along with an award of punitive damages in the amount of $1 million. We appealed based on numerous appealable errors at trial and settled the case without any contribution from AISL, for approximately $750,000. Prior to settlement, in July 2002, we filed a Declaratory Judgment action against AISL in the United States District Court for the Western District of Kentucky alleging that the policy should be interpreted under Kentucky law, thus affording us coverage for $650,000 that AISL contends is not covered by insurance. We have since sought leave of court to amend our complaint for breach of contract, bad faith insurance practices, as well as unfair claims practices under applicable Kentucky statutes. In the interim, AISL filed a motion to transfer this action to the U.S. District Court of the District of Kansas which was granted. AISL filed a motion for summary judgment, which was denied, our motion to amend our pleadings was granted and we filed a motion for partial summary judgment which is pending. Based on the advice of counsel, we believe any damages resulting from this matter are covered by insurance. During 2005, we established a reserve in our consolidated financial statements for the potential liability that may reasonably result from final adjudication of this matter. Further, we believe that recovery of the settlement is probable and, therefore we do not believe that the ultimate resolution of this matter will have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

In August 1998, with the approval of the State of Indiana, we relocated approximately 100 individuals from three of our larger facilities to community-based settings. In June 1999, in a lawsuit styled *Omega Healthcare Investors, Inc. v. Res-Care Health Services, Inc.,* the lessor of these facilities filed suit against us in U.S. District Court, Southern District of Indiana, alleging in connection therewith breach of contract, conversion and fraudulent concealment. In January 2001, January 2002 and July 2002, Omega filed amended complaints alleging wrongful conduct in the appraisal process for the 1999 purchase of three other facilities located in Indiana, for conversion of the Medicaid certifications of the 1998 Indiana facilities and a facility in Kentucky that downsized in 1999, and for breach of contract in allowing the Kentucky facility to be closed. The parties had filed various motions for partial summary judgment. The Court denied Omega's motion seeking summary judgment on breach of contract on the termination of the three Indiana facility leases in 1998, the Kentucky lease termination and the 1999 purchase of three facilities in Indiana. In addition, the Court has granted ResCare's motion on the "unjust enrichment" and "conversion" of the Medicaid certifications, as well as the breach of contract claim in terminating the lease of the Kentucky facility and the alleged wrongful conduct in the appraisal process. The case previously set for trial in October 2005 was rescheduled for December 2005. We previously established a reserve in our consolidated financial statements for the potential liability that may reasonably result from final adjudication of this matter and in November 2005 the case, except for the breach of contract claim in allowing the Kentucky facility to be closed, was settled within the reserved amounts. In January 2006, Omega filed a Notice of Appeal on the Kentucky breach of contract claim with the U.S. Court of Appeals for the Seventh Circu claiming nearly $3.7 million in compensatory damages. We believe that this appeal is without merit and wi defend it vigorously. We have not made any provision in our consolidated financial statements for any potenti liability that may result from this appeal. We do not believe that the ultimate resolution of this matter will have material adverse effect on our consolidated financial condition, results of operations or liquidity.

In addition, we are a party to various other legal and/or administrative proceedings arising out of th operation of our facilities and programs and arising in the ordinary course of business. We believe that, generall these claims are without merit. Further, many of such claims may be covered by insurance. We do not believe th results of these proceedings or claims, individually or in the aggregate, will have a material adverse effect on ou consolidated financial condition, results of operations or liquidity.

14. Related Party Transactions

We lease certain of our facilities under an operating lease with a real estate investment trust in which ou chairman is a member of the trust's board of directors. The lease commenced in October 1998 and extend through 2010. Lease payments to the trust approximated $0.9 million for the year ended December 31, 2005, an $0.8 million for the years ended December 31, 2004 and 2003. Aggregate future rentals are estimated to b approximately $4.7 million, subject to annual increases based on the consumer price index.

During 2005, with the review and approval of the Audit Committee, ResCare used an airplane from a entity owned by Ronald G. Geary, ResCare's chairman, chief executive officer and president, for certai corporate travel, primarily related to the recent debt offering and the acquisition of ACS Workforce Service Total costs incurred as of December 31, 2005 were approximately $0.1 million.

15. Quarterly Data (unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2005					
Revenues	$ 258,660	$ 269,642	$ 279,421	$ 281,047	$1,088,77
Facility and program contribution	26,221	29,438	30,510	31,101	117,27
Net income	5,671	7,326	7,629	596	21,22
Net income attributable to common shareholders	4,790	6,196	6,460	505	17,95
Basic earnings per common share	0.18	0.24	0.24	0.02	0.6
Diluted earnings per common share	0.18	0.23	0.24	0.02	0.6
2004					
Revenues	$ 245,182	$ 250,844	$ 255,485	$ 257,505	$1,009,01
Facility and program contribution	24,720	25,711	26,877	26,495	103,80
Net income	4,425	4,530	5,646	6,906	21,50
Net income (loss) attributable to common shareholders [1]	4,425	(10,254)	4,748	5,814	6,11
Basic earnings (loss) per common share	0.18	(0.40)	0.19	0.23	0.24
Diluted earnings (loss) per common share	0.17	(0.40)	0.18	0.22	0.23

(1) Under the accounting treatment for the Onex transaction, the non-cash beneficial conversion feature assumed in the preferred stock issuance was calculated at $14.8 million and is a deduction from net income in computing basic and diluted earnings per share attributable to common shareholders in 2004. The beneficial conversion feature does not affect net income, cash flows, total shareholders' equity, or compliance with our debt covenants.

During the periods presented, we recorded the following significant items:

	Statement of Income Line Item Impacted	Quarter Recorded		Pre-tax Income Impact		Net Income Impact		Diluted Earnings per Share Impact (For the year ended)
Year Ended December 31, 2005:								
Refinancing charge [1]	Refinancing charge	4th	$	(11,914)	$	(7,923)	$	(0.25)

[1] We recorded a pre-tax charge of $11.9 million related to the refinancing and redemption of our 10.625% senior notes, including write-off of unamortized debt issuance costs, premiums paid to note holders for early redemption, and costs of a related consent solicitation.

16. Subsequent Event

On January 3, 2006, our Employment Training Services segment completed the purchase of the operating assets and business of the Workforce Services Group of Affiliated Computer Services, Inc. (ACS Workforce Services). ACS Workforce Services has contracts in 15 states and Washington, D.C. and provides services to adults who have lost their jobs or face some barrier to employments. ACS Workforce Services offers job development, training and placement through federally funded programs administered by state and local governments and is the largest private provider of these services in the U.S. These training services are provided primarily through "one-stop" programs which are convenient service sites that enable job seekers and employers to receive government assistance, employment or training-related services at a single location. The purchase price of $69 million plus transaction costs was funded with existing cash, short-term investments and borrowings on our revolver.

17. Subsidiary Guarantors

The Senior Notes are jointly, severally, fully and unconditionally guaranteed by our 100% owned U.S. subsidiaries. There are no restrictions on our ability to obtain funds from our U.S. subsidiaries by dividends or other means. The following are condensed consolidating financial statements of our company, including the guarantors. This information is provided pursuant to Rule 3 – 10 of Regulation S-X in lieu of separate financial statements of each subsidiary guaranteeing the Senior Notes. The following condensed consolidating financial statements present the balance sheet, statement of income and cash flows of (i) Res-Care, Inc. (in each case, reflecting investments in its consolidated subsidiaries under the equity method of accounting), (ii) the guarantor subsidiaries, (iii) the nonguarantor subsidiaries, and (iv) the eliminations necessary to arrive at the information for our company on a consolidated basis. The condensed consolidating financial statements should be read in conjunction with the accompanying Consolidated Financial Statements.

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2005
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS					
Current assets:					
Cash and cash equivalents	$ 5,192	$ 1,927	$ 2,775	$ —	$ 9,894
Short-term investments	27,650	—	—	—	27,650
Accounts receivable, net	37,512	122,673	636	—	160,821
Refundable income taxes	416	—	(73)	—	343
Deferred income taxes	22,426	—	—	—	22,426
Prepaid expenses and other current assets	7,591	3,001	74	—	10,666
Total current assets	100,787	127,601	3,412	—	231,800
Property and equipment, net	28,430	45,288	457	—	74,175
Goodwill	66,405	210,002	4,609	—	281,016
Investment in subsidiaries	300,809	—	—	(300,809)	—
Other assets	9,866	14,245	—	—	24,111
	$ 506,297	$ 397,136	$ 8,478	$(300,809)	$ 611,102
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Trade accounts payable	$ 29,360	$ 11,127	$ 105	$ —	$ 40,592
Accrued expenses	56,529	33,954	256	—	90,739
Current portion of long-term debt	34	3,256	168	—	3,458
Current portion of obligations under capital leases	1,012	84	—	—	1,096
Total current liabilities	86,935	48,421	529	—	135,885
Intercompany	(49,227)	48,728	499	—	—
Long-term liabilities	157	265	—	—	422
Long-term debt	148,926	2,943	225	—	152,094
Obligations under capital leases	152	338	—	—	490
Deferred gains	1,004	2,861	—	—	3,865
Deferred income taxes	16,352	—	(4)	—	16,348
Total liabilities	204,299	103,556	1,249	—	309,104
Total shareholders' equity	301,998	293,580	7,229	(300,809)	301,998
	$ 506,297	$ 397,136	$ 8,478	$(300,809)	$ 611,102

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2004
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS					
Current assets:					
Cash and cash equivalents	$ 22,080	$ 3,590	$ 2,734	$ —	$ 28,404
Short-term investments	53,235	—	—	—	53,235
Accounts receivable, net	35,713	102,025	464	—	138,202
Deferred income taxes	20,056	—	—	—	20,056
Prepaid expenses and other current assets	10,870	1,440	28	—	12,338
Total current assets	141,954	107,055	3,226	—	252,235
Property and equipment, net	29,303	43,608	64	—	72,975
Goodwill	66,404	170,906	4,479	—	241,789
Investment in subsidiaries	238,571	—	—	(238,571)	—
Other assets	10,315	9,390	(38)	—	19,667
	$ 486,547	$ 330,959	$ 7,731	$(238,571)	$ 586,666
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Trade accounts payable	$ 28,184	$ 9,453	$ 136	$ —	$ 37,773
Current portion of long-term debt	12,766	715	—	—	13,481
Current portion of obligations under capital leases	908	81	—	—	989
Accrued expenses	48,006	29,515	194	—	77,715
Accrued income taxes	1,099	—	559	—	1,658
Total current liabilities	90,963	39,764	889	—	131,616
Intercompany	(55,890)	49,649	6,241	—	—
Long-term liabilities	90	109	—	—	199
Long-term debt	165,000	1,480	—	—	166,480
Obligations under capital leases	1,165	421	—	—	1,586
Deferred gains	769	3,761	—	—	4,530
Deferred income taxes	13,907	(2,190)	(5)	—	11,712
Total liabilities	216,004	92,994	7,125	—	316,123
Total shareholders' equity	270,543	237,965	606	(238,571)	270,543
	$ 486,547	$ 330,959	$ 7,731	$(238,571)	$ 586,666

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF INCOME
Year Ended December 31, 2005
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidat Total
Revenues	$ 243,593	$ 839,193	$ 5,984	$ —	$1,088,77
Operating expenses	252,164	781,969	5,331	—	1,039,46
Operating (loss) income	(8,571)	57,224	653	—	49,30
Other (income) expenses:					
Interest, net	8,279	8,906	209	—	17,39
Equity in earnings of subsidiaries	(32,427)	—	—	32,427	-
Total other expenses	(24,148)	8,906	209	32,427	17,39
Income before income taxes	15,577	48,318	444	(32,427)	31,91
Income tax (benefit) expense	(5,645)	16,186	149	—	10,69
Net income	$ 21,222	$ 32,132	$ 295	$ (32,427)	$ 21,22

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF INCOME
Year Ended December 31, 2004
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues	$ 241,649	$ 763,023	$ 4,521	$ (177)	$1,009,016
Operating expenses	245,997	706,802	3,864	(177)	956,486
Operating (loss) income	(4,348)	56,221	657	—	52,530
Other (income) expenses:					
Interest, net	9,954	9,796	—	—	19,750
Equity in earnings of subsidiaries	(30,886)	—	—	30,886	—
Total other expenses	(20,932)	9,796	—	30,886	19,750
Income before income taxes	16,584	46,425	657	(30,886)	32,780
Income tax (benefit) expense	(4,923)	15,970	226	—	11,273
Net income	$ 21,507	$ 30,455	$ 431	$ (30,886)	$ 21,507

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF INCOME
Year Ended December 31, 2003
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidate Total
Revenues	$ 230,213	$ 727,348	$ 3,967	$ (195)	$ 961,33
Operating expenses	241,135	671,841	3,309	(195)	916,09
Operating (loss) income	(10,922)	55,507	658	—	45,24
Other (income) expenses:					
Interest, net	10,718	13,526	82	—	24,32
Equity in earnings of subsidiaries	(27,237)	—	—	27,237	–
Total other expenses	(16,519)	13,526	82	27,237	24,32
Income before income taxes	5,597	41,981	576	(27,237)	20,91
Income tax (benefit) expense	(7,790)	15,113	207	—	7,53
Net income	$ 13,387	$ 26,868	$ 369	$ (27,237)	$ 13,38

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2005
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
Operating activities:					
Net income	$ 21,222	$ 32,132	$ 295	$ (32,427)	$ 21,222
Adjustments to reconcile net income to cash provided by (used in) operating activities:					
Depreciation and amortization	6,395	7,438	32	—	13,865
Amortization of discount and deferred debt issuance costs on notes	1,228	—	—	—	1,228
Restricted stock compensation	141	—	—	—	141
Deferred income taxes, net	75	2,190	1	—	2,266
Provision for losses on accounts receivable	—	4,789	—	—	4,789
Tax benefit from exercise of stock options	3,376	—	—	—	3,376
Loss on sale of assets	—	377	—	—	377
Equity in earnings of subsidiaries	(32,427)	—	—	32,427	—
Loss on refinancing	11,914	—	—	—	11,914
Changes in operating assets and liabilities	16,939	(24,980)	(6,583)	—	(14,624)
Cash provided by (used in) operating activities	28,863	21,946	(6,255)	—	44,554
Investing activities:					
Purchases of property and equipment	(5,063)	(8,687)	(425)	—	(14,175)
Acquisitions of businesses, net of cash acquired	—	(36,959)	—	—	(36,959)
Proceeds from sale of assets	—	64	—	—	64
Purchases of short-term investments	(409,900)	—	—	—	(409,900)
Redemptions of short-term investments	435,485	—	—	—	435,485
Cash provided by (used in) investing activities	20,522	(45,582)	(425)	—	(25,485)
Financing activities:					
Long-term debt repayments	(191,580)	(1,510)	—	—	(193,090)
Borrowings of long-term debt	161,830	—	393	—	162,223
Net payments relating to intercompany financing	(29,811)	23,483	6,328	—	—
Proceeds received from exercise of stock options	6,504	—	—	—	6,504
Debt issuance costs	(4,131)	—	—	—	(4,131)
Tender premium costs	(9,085)	—	—	—	(9,085)
Cash (used in) provided by financing activities	(66,273)	21,973	6,721	—	(37,579)
(Decrease) increase in cash and cash equivalents	(16,888)	(1,663)	41	—	(18,510)
Cash and cash equivalents at beginning of period	22,080	3,590	2,734	—	28,404
Cash and cash equivalents at end of period	$ 5,192	$ 1,927	$ 2,775	$ —	$ 9,894

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2004
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidat Total
Operating activities:					
Net income	$ 21,507	$ 30,455	$ 431	$ (30,886)	$ 21,5
Adjustments to reconcile net income to cash provided by operating activities:					
Depreciation and amortization	6,303	5,853	51	—	12,2
Amortization of discount and changes in deferred debt issuance costs on notes	1,173	—	—	—	1,1
Deferred income taxes, net	2,138	(2,190)	(1)	—	(5
Provision for losses on accounts receivable	—	5,283	—	—	5,2
Tax benefit from exercise of stock options	2,593	—	—	—	2,5
Loss on sale of assets	—	207	—	—	2
Equity in earnings of subsidiaries	(30,886)	—	—	30,886	
Changes in operating assets and liabilities	17,912	(21,068)	2,012	—	(1,14
Cash provided by operating activities	20,740	18,540	2,493	—	41,7
Investing activities:					
Purchases of property and equipment	(6,881)	(9,117)	(19)	—	(16,01
Acquisitions of businesses, net of cash acquired	—	(11,249)	—	—	(11,24
Proceeds from sale of assets	—	32	—	—	
Purchases of short-term investments	(217,750)	—	—	—	(217,75
Redemptions of short-term investments	164,515	—	—	—	164,5
Cash used in investing activities	(60,116)	(20,334)	(19)	—	(80,46
Financing activities:					
Long-term debt repayments	(8,483)	(742)	(285)	—	(9,51
Net payments relating to intercompany financing	(3,623)	3,836	(213)	—	
Proceeds received from exercise of stock options	6,561	—	—	—	6,5
Proceeds from issuance of preferred stock	46,609	—	—	—	46,6
Cash provided by (used in) financing activities	41,064	3,094	(498)	—	43,6
Increase in cash and cash equivalents	1,688	1,300	1,976	—	4,9
Cash and cash equivalents at beginning of period	20,392	2,290	758	—	23,4
Cash and cash equivalents at end of period	$ 22,080	$ 3,590	$ 2,734	$ —	$ 28,4

RES-CARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2003
(In thousands)

	ResCare, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
Operating activities:					
Net income	$ 13,387	$ 26,868	$ 369	$ (27,237)	$ 13,387
Adjustments to reconcile net income to cash provided by operating activities:					
Depreciation and amortization	5,598	6,596	60	—	12,254
Amortization of discount and changes in deferred debt issuance costs on notes	1,908	—	—	—	1,908
Deferred income taxes, net	2,639	—	(1)	—	2,638
Provision for losses on accounts receivable	—	7,328	—	—	7,328
Tax benefit from exercise of stock options	417	—	—	—	417
Loss on sale of assets	—	195	—	—	195
Equity in earnings of subsidiaries	(27,237)	—	—	27,237	—
Loss on extinguishment of debt	1,330	—	—	—	1,330
Changes in operating assets and liabilities	(32,030)	42,513	1,530	—	12,013
Cash (used in) provided by operating activities	(33,988)	83,500	1,958	—	51,470
Investing activities:					
Purchases of property and equipment	(10,355)	(3,959)	173	—	(14,141)
Acquisitions of businesses, net of cash acquired	—	(9,758)	—	—	(9,758)
Purchases of short-term investments	(400)	—	—	—	(400)
Redemptions of short-term investments	15,515	—	—	—	15,515
Proceeds from sale of assets	—	405	—	—	405
Cash provided by (used in) investing activities	4,760	(13,312)	173	—	(8,379)
Financing activities:					
Long-term debt borrowings	20,351	—	—	—	20,351
Long-term debt repayments	(95,479)	(972)	(1,833)	—	(98,284)
Net payments relating to intercompany financing	68,626	(68,554)	(72)	—	—
Proceeds from exercise of stock options	1,308	—	—	—	1,308
Cash used in financing activities	(5,194)	(69,526)	(1,905)	—	(76,625)
(Decrease) increase in cash and cash equivalents	(34,422)	662	226	—	(33,534)
Cash and cash equivalents at beginning of period	54,814	1,628	532	—	56,974
Cash and cash equivalents at end of period	$ 20,392	$ 2,290	$ 758	$ —	$ 23,440

ResCare, Inc.
Schedule II – Valuation and Qualifying Accounts
For the Years Ended December 31, 2005, 2004 and 2003
(In thousands)

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions: Write-offs	Deductions: Reclassifications	Balance at End of Period
Allowance for doubtful accounts receivable:					
Year ended December 31, 2005	$ 8,806	$ 4,789	$ (4,316)	$ —	$ 9,279
Year ended December 31, 2004	9,464	5,283	(5,941)	—	8,806
Year ended December 31, 2003	7,665	7,328	(5,529)	—	9,464

Board of Directors

Ronald G. Geary
Chairman, President and Chief Executive Officer, ResCare
Director and President since 1990, CEO since 1993 and *Chairman since 1998*

E. Halsey Sandford
Former Senior Executive, ResCare
Director of ResCare since 1984

Olivia F. Kirtley, C.P.A.
Business Consultant
Director of ResCare since 1998

Steven S. Reed
Managing Member, Reed Wicker PLLC
Director of ResCare since 2003

Robert M. Le Blanc
Managing Director, Onex Corporation
Director of ResCare since 2004

Nigel S. Wright
Managing Director, Onex Corporation
Director of ResCare since 2004

Robert E. Hallagan
Vice Chairman, Heidrick & Struggles
Director of ResCare since 2004

David Braddock, Ph.D.
Associate Vice President, University of Colorado System; Executive Director, Coleman Institute
Director of ResCare since 2004

William E. Brock
Chairman, The Brock Offices; Former U. S. Secretary of Labor
Director of ResCare since 2006

Leadership Team

Ronald G. Geary
Chairman, President and Chief Executive Officer

David W. Miles
Chief Financial Officer

Ralph G. Gronefeld
President, Community Services Group

Vincent F. Doran
President, Employment & Training Services Group

Paul G. Dunn
President, Arbor
Executive Vice President of the Western Division

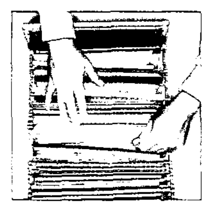
Katherine W. Gilchrist
Senior Vice President of Accounts Receivable
Chief Project Management Officer

David S. Waskey
General Counsel
Chief Compliance Officer

Nina P. Seigle
Chief People Officer

Nel Taylor
Chief Communication Officer

George Watts
Chief Information Officer



Our Mission

We at ResCare are dedicated and caring people who together form a human service company providing quality supports to enhance the lives of individuals.

We commit to effectively manage our resources in order to fulfill our responsibilities to the people we support, our employees, our customers and our communities.

We serve with respect, compassion and skill. Building Lives, Reaching Potential.

ResCare

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