

PATHWAY SOCIETY, INC.

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

**PATHWAY SOCIETY, INC,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pathway Society, Inc.
Santa Clara, California

Report on Financial Statements

We have audited the accompanying financial statements of Pathway Society, Inc., which comprise the statement of financial position as of June 30, 2016, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the organization's 2015 financial statements and, in our report dated September 16, 2015 we expressed an unqualified opinion on those financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pathway Society, Inc. as of June 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2016, on our consideration of Pathway Society, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Pathway Society, Inc.'s internal control over financial reporting and compliance.

Report on Summarized Comparative Information

We have previously audited Pathway Society, Inc.'s 2015 financial statements, and our report dated September 16, 2015, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2015, is consistent, in all material respects, with the audited consolidated financial statements from which it was derived.

Handwritten signature of Gabriel Bernmark in cursive script.

San Francisco, California
September 30, 2016

PATHWAY SOCIETY, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 629,095	\$ 1,319,846
Grants Receivable	1,808,943	1,361,355
Prepaid Assets	<u>112,743</u>	<u>100,440</u>
Total Current Assets	2,550,781	2,781,641
Fixed Assets		
Property and Equipment	1,154,928	1,145,033
Less: Accumulated Depreciation	<u>(800,166)</u>	<u>(777,888)</u>
Net Fixed Assets	354,762	367,145
Other Non-Current Assets		
Deposits and Other Assets	<u>115,330</u>	<u>134,218</u>
TOTAL ASSETS	<u>\$ 3,020,873</u>	<u>\$ 3,283,004</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 510,241	\$ 539,444
Accrued pension contribution	318,224	289,040
Deferred revenue	11,653	11,653
Deferred compensation payable	82,130	98,818
Resident Fund Payable	2,047	2,092
Measure A Refundable Payment	72,159	72,156
Notes Payable	<u>-</u>	<u>134,851</u>
Total Current Liabilities	996,454	1,148,054
Long-Term Liabilities		
Measure A Refundable Payment, net of current portion	<u>-</u>	<u>72,159</u>
TOTAL LIABILITIES	<u>996,454</u>	<u>1,220,213</u>
Net Assets		
Unrestricted	2,024,419	2,062,791
Temporarily restricted	<u>-</u>	<u>-</u>
Total Net Assets	<u>2,024,419</u>	<u>2,062,791</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 3,020,873</u>	<u>\$ 3,283,004</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total 2016</u>	<u>Total 2015</u>
REVENUE				
Grant Revenue				
County of Santa Clara	\$ 6,900,804	\$ -	\$ 6,900,804	\$ 5,938,018
City of San Jose	-	-	-	37,859
U.S. District Court	69,822	-	69,822	263,603
Contributions and Other Revenue				
Contract Fees	33,497	-	33,497	81,893
Counseling, training, and intake fees	264,606	-	264,606	163,407
Other program income	99,476	-	99,476	187,100
Donated services	38,859	-	38,859	26,597
Contributions	10,825	-	10,825	1,698
Net Investment Income/(Loss)	-	-	-	239
Total Revenue	<u>7,417,889</u>	<u>-</u>	<u>7,417,889</u>	<u>6,700,414</u>
EXPENSES				
Program Services:				
Residential services	5,486,361	-	5,486,361	5,010,992
Outpatient counseling and relapse prevention	493,635	-	493,635	541,548
Youth counseling and intervention	274,429	-	274,429	324,698
Public Awareness & Education	172,180	-	172,180	4,047
Support Services:				
General and administrative	963,597	-	963,597	900,779
Fundraising	62,459	-	62,459	19,058
Total Expenses	<u>7,452,661</u>	<u>-</u>	<u>7,452,661</u>	<u>6,801,122</u>
CHANGE IN NET ASSETS	(34,772)	-	(34,772)	(100,708)
INCREASE/(DECREASE) IN NET ASSETS				
Net Assets - Beginning of Year	2,062,791	-	2,062,791	2,168,493
Depreciation on fixed assets purchased with restricted funds	<u>(3,600)</u>	<u>-</u>	<u>(3,600)</u>	<u>(4,994)</u>
NET ASSETS - END OF YEAR	<u>\$ 2,024,419</u>	<u>\$ -</u>	<u>\$ 2,024,419</u>	<u>\$ 2,062,791</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenue Over/(Under) Expenses	\$ (34,772)	\$ (100,708)
Depreciation	18,678	17,749
Realized (Gain)/Loss on Investments	-	239
(Increase)/Decrease In:		
Grants Receivable	(447,588)	287,102
Prepaid Assets	(12,303)	(1,077)
Deposits and Other Assets	18,888	23,592
Increase/(Decrease) In:		
Accounts Payable and Accrued Expenses	(29,203)	(118,192)
Accrued Pension Contribution	29,184	17,220
Deferred Revenue	-	(19,539)
Deferred Compensation Payable	(16,688)	(26,892)
Resident Fund Payable	(45)	(37,269)
Measure A Refundable Payment	<u>(72,156)</u>	<u>144,315</u>
NET CASH PROVIDED BY/ (USED IN) OPERATING ACTIVITIES	<u>(546,005)</u>	<u>186,540</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(9,895)	(12,775)
Proceeds from Sale of Investments	<u>-</u>	<u>766,208</u>
NET CASH PROVIDED BY/ (USED IN) INVESTING ACTIVITIES	<u>(9,895)</u>	<u>753,433</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments of Notes Payable	<u>(134,851)</u>	<u>(18,833)</u>
NET CASH PROVIDED BY/ (USED IN) FINANCING ACTIVITIES	<u>(134,851)</u>	<u>(18,833)</u>
NET INCREASE/(DECREASE) IN CASH		
Beginning Cash and Cash Equivalents		
Balance, July 1, 2015 and 2014	<u>1,319,846</u>	<u>398,706</u>
ENDING CASH AND CASH EQUIVALENTS		
BALANCE, JUNE 30, 2016 AND 2015	\$ <u><u>629,095</u></u>	\$ <u><u>1,319,846</u></u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	\$ <u><u>5,840</u></u>	\$ <u><u>7,596</u></u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

	Program Services					Supporting Services				
	Residential Services	Outpatient Counseling & Relapse Prevention	Youth Counseling & Intervention	Public Awareness & Education	Total Program Services	General & Administrative	Fundraising	Total 2016	Total 2015	
EXPENSES										
Salaries and Wages	\$ 2,772,142	\$ 288,687	\$ 181,367	\$ 101,735	\$ 3,343,931	\$ 633,878	\$ -	\$ 3,977,809	\$ 3,613,004	
Donated services	38,859	-	-	-	38,859	-	-	38,859	26,597	
Fringe benefits	597,311	42,548	38,108	13,762	691,729	73,276	-	765,005	686,557	
Payroll taxes	241,092	25,429	16,511	9,631	292,663	55,248	-	347,911	282,522	
Pension contribution	221,771	23,095	14,510	8,138	267,514	50,710	-	318,224	289,040	
Total salaries and related expenses	3,871,175	379,759	250,496	133,266	4,634,696	813,112	-	5,447,808	4,897,720	
Professional fees	125,173	38,472	8,034	4,135	175,814	48,271	50,518	274,603	332,968	
Supplies	645,696	9,232	5,230	4,999	665,157	24,692	11,805	701,654	614,663	
Telephone	30,450	3,918	1,384	4,064	39,816	6,451	136	46,403	32,833	
Postage	974	515	48	44	1,581	569	-	2,150	2,274	
Occupancy	634,647	52,926	1,563	18,238	707,374	50,112	-	757,486	693,846	
Equipment Rental	17,241	3,605	89	1,186	22,121	3,045	-	25,166	20,930	
Printing and Publications	4,590	131	29	26	4,776	925	-	5,701	5,571	
Automotive and Travel	67,721	433	2,997	2,237	73,388	3,950	-	77,338	65,662	
Conferences and education	11,626	1,591	2,162	2,242	17,621	5,130	-	22,751	12,992	
Specific assistance	30,873	-	-	-	30,873	-	-	30,873	11,689	
Membership dues	7,659	784	616	512	9,571	2,733	-	12,304	19,309	
Insurance	19,858	2,269	1,781	1,231	25,139	4,607	-	29,746	22,252	
Miscellaneous	-	-	-	-	-	-	-	-	50,664	
Expenses before depreciation	5,467,683	493,635	274,429	172,180	6,407,927	963,597	62,459	7,433,983	6,783,373	
Depreciation	18,678	-	-	-	18,678	-	-	18,678	17,749	
Total expenses	\$ 5,486,361	\$ 493,635	\$ 274,429	\$ 172,180	\$ 6,426,605	\$ 963,597	\$ 62,459	\$ 7,452,661	\$ 6,801,122	

See notes to the financial statements

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background

The Pathway Society, Inc., (PSI), is a nonprofit public benefit corporation organized under the Nonprofit Public Benefit Corporation law for charitable and educational purposes. Founded in 1964 and incorporated in 1968, PSI has provided programs and services to residents of Santa Clara County in substance abuse prevention and education, intervention, and treatment. PSI provides a full spectrum of substance abuse services, including inpatient (residential) and outpatient treatment programs and transitional housing. PSI also provides treatment, intervention, and education services for youth within James Ranch Santa Clara County. We work closely with various private and public systems of care and the criminal justice system. Administrative offices are located in Santa Clara, California. Pathway Society's major programs include the following:

Inpatient Residential Services:

Pathway House is a 65-bed inpatient (residential) treatment facility in downtown San Jose, California for chemically dependent adults. Treatment is individualized based on the client's needs. This live-in program provides clients suffering from addiction a chance to rehabilitate and transform their lives in a safe and respectful environment under the guidance of licensed practitioners. The program emphasizes the evidence-based principles necessary for independent, responsible, and productive living, free of the need for substances and alcohol.

Mariposa Lodge is a 54-bed women-only inpatient (residential) treatment facility located in a rural area of South San Jose, California for adults who are chemically dependent. Treatment is individualized based on the client's needs. This live-in program provides clients addicted to drugs and alcohol a chance to rehabilitate their lives and embrace the principles of independent, responsible, and productive living, free from the needs of drugs.

In addition, *Mariposa Lodge* provides non-medical, social model withdrawal management for up to 10 adult women. The primary goal is to provide a safe structured environment to support adult women in their withdrawal process—and potentially the first steps of their recovery process.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Transitional housing is provided for clients who have successfully completed treatment at an inpatient (residential) treatment facility, or who have completed a primary treatment phase at another program for chemical dependency. This housing offers clients an opportunity to initiate an affordable independent living situation in the community before transitioning to future housing on their own.

Outpatient Counseling and Relapse Prevention:

Outpatient counseling provides services on a group, family, or individual basis for adults and adolescents. Assessments and treatment services are provided by California state-licensed therapists and counselors with extensive drug and alcohol treatment experience. Sessions are provided on a number of tracks, including, but not limited to, relapse prevention through outpatient drug-free services. PSI specializes in drug and alcohol, as well as mental health outpatient services.

Youth Treatment Counseling and Intervention:

Pathway Society offers a variety of youth intervention and counseling programs, including alcohol and substance use counseling programs at the James Ranch in Morgan Hill, CA.

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting. Revenue is recognized when earned and expenses are recognized when incurred.

Basis of Presentation

Pathway is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. Pathway has no temporarily restricted net assets or permanently restricted net assets.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Tax Status

Pathway is an exempt organization under Internal Revenue Service Code 501(c)(3) and California Franchise Tax Board code section 23701(d). No provision for income taxes has been made.

Management believes that Pathway has no uncertain tax positions as of June 30, 2016.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses.

Comparative Financial Information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly such information should be read in conjunction with Pathway's financial statements for the year ended June 30, 2015, from which the summarized information was derived.

Allocation of Expenses

Directly identifiable expenses are charged to programs and supporting services. Expenses related to more than one function are charged to programs and supporting services on the basis of periodic time and expense studies. General and administrative expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of Pathway.

Cash and Cash Equivalents

For purposes of the statement of cash flows, Pathway considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Fixed Assets

Pathway capitalizes acquisitions of property and equipment with a cost or value in excess of \$5,000. All fixed assets are valued and capitalized at historical cost or estimated historical cost if historical cost is not available. Donated fixed assets are valued at estimated fair market value as of the date donated. The fixed asset balance is comprised of the following as of June 30:

	2016	2015
Land	\$ 190,526	\$ 190,526
Buildings	176,571	176,571
Building Improvements	383,715	383,715
Equipment and vehicles	404,116	394,221
Total Fixed Assets	<u>\$ 1,154,928</u>	<u>\$ 1,145,033</u>

Accumulated depreciation for June 30, 2016 and 2015 is \$800,166 and \$777,888, respectively.

Depreciation and Amortization Method

Depreciation is provided on the straight-line basis over the estimated useful lives of three to ten years for equipment and vehicles and 20 years for buildings. Leasehold improvements are amortized over the shorter of the remaining lease term or the estimated useful life of the asset.

Assets purchased with unrestricted general funds and assets donated to Pathway are depreciated through the statement of activities. Assets purchased with grant funds are recorded as revenue and expensed in the period of acquisition through the statement of activities.

The corresponding capitalization and depreciation for these grant purchases is accounted for through increases and decreases in net assets in the statement of activities.

Revenue Recognition

A majority of Pathway revenue is derived from cost reimbursement contracts. Advances received on these contracts are deferred as unearned income and recognized as revenue as allowable costs are incurred. Revenue from fee for service contracts is recognized when services are provided.

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Restricted and Unrestricted Revenue

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire (that is, when a stipulated time restriction ends or purpose restricted is accomplished) in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the Statement of Activities as net assets released from restrictions.

Contributions

Pathway accounts for contributions and promises to give in accordance with provisions of FASB topic Not-for-Profit Entities Revenue Recognition Standards. FASB requires that contributions received, including unconditional promises to give (pledges), be recognized as revenue at their fair value in the period the contribution or pledge is made. FASB also requires not-for-profit organizations to distinguish between contributions received that increase any on the three categories of net assets, with recognition being made of the expiration of donor-imposed restrictions in the period which the restrictions expire.

Donated Services

Donated residential client assistance services are an integral part of Pathway's programs, which would otherwise have to be purchased. Accordingly, these specialized services are recorded as both contributions and program service expenses, at their estimated fair values as the services are rendered. Donated services totaled \$38,859 in 2016 and \$26,597 in 2015.

Note B: GRANTS RECEIVABLE

Grants Receivable represents the excess of grant expenditures over grant receipts for the years ended June 30:

Program	2016	2015
County of Santa Clara	\$ 1,797,415	\$ 1,309,970
U.S. District Court	4,678	34,332
Fees and other	6,850	17,053
TOTAL GRANTS RECEIVABLE	<u>\$ 1,808,943</u>	<u>\$ 1,361,355</u>

Grants receivable are considered fully collectible by management; therefore, no reserve for uncollectible accounts has been established.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

Note C: LINE OF CREDIT

Pathway has a line of credit with a bank providing up to \$150,000 through April 15, 2017. Borrowings are at the bank's prime rate plus 1% and are secured by Pathway's assets. The agreement requires Pathway to meet certain financial covenants and ratios. The line of credit is subject to annual bank review. As of June 30, 2016 and 2015, \$0 and \$0 had been drawn down and was outstanding, respectively.

Note D: PENSION PLAN

Pathway has a defined contribution pension plan covering all regular, full-time employees who have been with Pathway for six months and are at least twenty-one years of age and have completed over 1000 hours of service during the plan year. Starting July 2002, employees become 20% vested after two years of employment and are fully vested after six years. Contributions are made at the discretion of the Board of Directors. Contribution expense was \$318,224 in 2016 and \$289,040 in 2015.

A deferred compensation plan has been established under 457b and 457f to augment the existing pension plan. The liability related to this plan as of June 30, 2016 and 2015 were \$82,130 and \$98,818, respectively. The same amount is included in deposits and other assets.

Note E: CONCENTRATION OF CREDIT RISK ARISING FROM CASH DEPOSITS IN EXCESS OF INSURED LIMITS

Pathway maintains its cash balances and money market accounts in several financial institutions. The balances at the financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. While Pathway maintains cash in amounts which at times, exceed the federally insured limits, Pathway has not experienced any losses in such accounts and believes they are not exposed to any significant credit risk on cash.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2015

Note F: LEASE COMMITMENTS

Pathway is the lessee of certain real properties and equipment. Rent expense for the years ended June 30, 2016 and 2015 was \$437,136 and \$416,254 respectively for non-cancelable operating leases.

Future minimum lease payments on non-cancelable leases as of June 30 are as follows:

2017	\$ 16,788
2018	16,788
2019	16,788
2020	16,788
2021	16,788
TOTAL LEASE COMMITMENTS	<u>\$ 83,940</u>

Note G: CONTINGENCIES

Pathway received a substantial amount of its support from federal, state, and county governments. A significant reduction in the level of this support, if this were to occur, may have an effect on Pathway's program and activities.

Grant awards require the fulfillment of certain conditions as set forth in the instrument of grant. Failure to fulfill the conditions could result in the return of the funds to the grantors. Pathway deems this contingency remote since by accepting the grants and their terms, it has accommodated the objectives of Pathway to the provisions of the grants. Pathway's management is of the opinion that Pathway has complied with the terms of all grants.

Note J: EVALUATION OF SUBSEQUENT EVENTS

The Organization has evaluated all subsequent events through September 30, 2016, the date which the financial statements were available to be issued.

REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Board of Directors
Pathway Society, Inc.
Santa Clara, California

We have audited the financial statements of Pathway Society, Inc. for the year ended June 30, 2016, and have issued our report thereon dated September 30, 2016, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and their records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.



San Francisco, California
September 30, 2016

PATHWAY SOCIETY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2016

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number	Grantor Number	Expenditures
U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
<i>Pass Through</i>			
County of Santa Clara			
Block Grants for Preventive and Treatment of Substance Abuse			
Managed Care Services:			
Residential	93.959	N/A	\$ 600,000
Mariposa - Residential	93.959	N/A	900,000
Community Coalition	93.959	N/A	<u>130,000</u>
Subtotal for C.F.D.A. 93.959			1,630,000
Veterans Drug Court - SAMHSA	93.243	N/A	<u>222,655</u>
TOTAL U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			<u>1,852,655</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 1,852,655</u></u>

Note A - Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal award activity of Pathway Society, Inc. under programs of the federal government for the year ended June 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of Pathway Society, Inc., it is not intended to and does not present the financial position, changes in net assets, or cash flows of Pathway Society, Inc.

Note B: Summary of Significant Accounting Policies

(1) Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance and OMB Circular A-122, Cost Principles for Non-profit Organizations, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

(2) Pathway Society, Inc. has not elected to use the 10 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Pathway Society, Inc.
Santa Clara, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Pathway Society, Inc., which comprise the statement of financial position as of June 30, 2016, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated September 30, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Pathway Society, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Pathway Society, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Pathway Society, Inc.'s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.


Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathway Society, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script, appearing to read "Jacob L. Bernhardt".

San Francisco, California
September 30, 2016

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL
EFFECT ON EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE
UNIFORM GUIDANCE**

Board of Directors
Pathway Society, Inc.
Santa Clara, California

Report on Compliance for Each Major Federal Program

We have audited Pathway Society, Inc.'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Pathway Society, Inc.'s major federal programs for the year ended June 30, 2016. Pathway Society, Inc.'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Pathway Society, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types compliance requirements referred to above that could have a direct and material effect on a major federal programs occurred. An audit includes examining, on a test basis, evidence about Pathway Society, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance with each major program. However, our audit does not provide a legal determination of Pathway Society, Inc.'s compliance.

Opinion on Each Major Federal Program

In our opinion, Pathway Society, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs identified above for the year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of Pathway Society, Inc. is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Pathway Society, Inc.'s internal control over compliance with the types of requirements that could have a direct and material effect on each major program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the *Uniform Guidance*, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Pathway Society, Inc.'s internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirements of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a *material weakness* in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be *material weaknesses* or *significant deficiencies*. We did not identify any deficiencies in internal control over compliance that we consider to be *material weaknesses*, as defined above. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of our testing based on the requirements of the *Uniform Guidance*. Accordingly, this report is not suitable for any other purpose.



San Francisco, California
September 30, 2016

PATHWAY SOCIETY, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

A. SUMMARY OF AUDITOR'S RESULTS	
<i>Financial Statements</i>	
1. Type of Financial Statement Report	UNMODIFIED
2. Internal Control over Financial Reporting: Material Weakness(es) Identified Significant Deficiency(ies) Identified	NONE NONE REPORTED
3. Noncompliance Disclosed by Audit Which Is Material to Financial Statements	NONE
<i>Federal Awards</i>	
1. Internal Control Over Major Programs: Material Weakness(es) Identified Significant Deficiency(ies) Identified	NONE NONE REPORTED
2. Type of Compliance Report Major Programs	UNMODIFIED
3. Uniform Guidance Audit Finding Disclosed by Audit	NONE REPORTED
4. Major Programs:	93.959 – Block Grants for Preventative and Treatment of Substance Abuse 93.243 – Substance Abuse and Mental Health Services
5. Dollar Threshold for Type A Programs	\$750,000
6. Auditee Qualification	LOW RISK
B. Findings Relating to the Financial Statements Which Are Required to Be Reported in Accordance with GAGAS	NONE REPORTED
C. Findings and Questioned Costs for Federal Awards Including Audit Findings Defined in the Uniform Guidance	NONE REPORTED

PATHWAY SOCIETY, INC.
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

There were no prior year audit findings.