

PATHWAY SOCIETY, INC.

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2010
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2009**

**PATHWAY SOCIETY, INC,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2010**

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IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

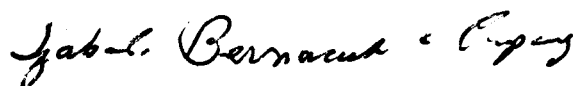
Board of Directors
Pathway Society, Inc.
San Jose, California

We have audited the accompanying statement of financial position of the Pathway Society, Inc. as of June 30, 2010 and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Pathway Society, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the organization's 2009 financial statements and, in our report dated October 23, 2009 we expressed an unqualified opinion on those financial statements.

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 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 audit provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pathway Society, Inc. as of June 30, 2010 and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Accounting Standards*, we have also issued a report dated November 1, 2010 on our consideration of Pathway Society, Inc.'s internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



San Francisco, California
November 1, 2010

PATHWAY SOCIETY, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2010
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 1,790,977	\$ 1,631,836
Grants Receivable (Note B)	789,416	868,413
Prepaid Assets	125,425	98,038
Total Current Assets	<u>2,705,818</u>	<u>2,598,287</u>
Fixed Assets		
Property and Equipment (Note A)	1,120,557	1,120,557
Less: Accumulated Depreciation	<u>(682,311)</u>	<u>(662,608)</u>
Net Fixed Assets	438,246	457,949
Other Non-Current Assets		
Deposits and Other Assets	<u>261,066</u>	<u>315,528</u>
TOTAL ASSETS	<u>\$ 3,405,130</u>	<u>\$ 3,371,764</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 489,410	\$ 444,029
Accrued pension contribution (Note E)	209,307	202,618
Deferred revenue	161,531	115,974
Deferred compensation payable (Note E)	245,329	296,659
Line of Credit (Note C)	73,530	56,118
Current portion of notes payable (Note D)	210,915	15,514
Total Current Liabilities	<u>1,390,022</u>	<u>1,130,912</u>
Long-Term Liabilities		
Notes Payable, net of current portion (Note D)	<u>14,581</u>	<u>237,912</u>
TOTAL LIABILITIES	<u>1,404,603</u>	<u>1,368,824</u>
Net Assets		
Unrestricted	2,000,527	2,002,940
Temporarily restricted	0	0
Total Net Assets	<u>2,000,527</u>	<u>2,002,940</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 3,405,130</u>	<u>\$ 3,371,764</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2009

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total 2010</u>	<u>Total 2009</u>
REVENUE				
Grant Revenue				
County of Santa Clara	\$ 3,227,740	\$ 0	\$ 3,227,740	\$ 3,210,823
City of San Jose (Note G)	368,650	0	368,650	337,837
U.S. District Court	288,323	0	288,323	381,110
Contributions and Other Revenue				
United Way of Santa Clara County	50,000	0	50,000	50,000
Contract Fees	536,042	0	536,042	351,958
Counseling, training, and intake fees	194,729	0	194,729	211,045
Other program income	66,246	0	66,246	66,151
Donated services (Note A)	21,800	0	21,800	42,977
Contributions	6,230	0	6,230	6,915
Interest Income	7,326	0	7,326	7,946
Total Revenue	<u>4,767,086</u>	<u>0</u>	<u>4,767,086</u>	<u>4,666,762</u>
EXPENSES				
Program Services:				
Residential services	2,678,699	0	2,678,699	2,208,643
Outpatient counseling and relapse prevention	767,904	0	767,904	1,148,161
Youth counseling and intervention	581,504	0	581,504	580,295
Public Awareness & Education	82,480	0	82,480	77,894
Support Services:				
General and administrative	625,784	0	625,784	578,816
Fundraising	27,740	0	27,740	25,794
Total Expenses	<u>4,764,111</u>	<u>0</u>	<u>4,764,111</u>	<u>4,619,603</u>
CHANGE IN NET ASSETS	2,975	0	2,975	47,159
INCREASE/(DECREASE) IN NET ASSETS				
Net Assets - Beginning of Year	2,002,940	0	2,002,940	1,961,170
Depreciation on fixed assets purchased with restricted funds	<u>(5,388)</u>	<u>0</u>	<u>(5,388)</u>	<u>(5,389)</u>
NET ASSETS - END OF YEAR	<u>\$ 2,000,527</u>	<u>\$ 0</u>	<u>\$ 2,000,527</u>	<u>\$ 2,002,940</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2010
WITH SUMMARIZED COMPARATIVE FOR 2009

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenue Over Expenses	\$ 2,975	\$ 47,159
Depreciation	14,315	16,064
(Increase)/Decrease In:		
Grants Receivable	78,997	63,640
Prepaid Assets	(27,387)	(77,717)
Deposits and other assets	54,462	(50,145)
Increase/(Decrease) In:		
Accounts Payable and Accrued Expenses	45,381	13,292
Accrued Pension contribution	6,689	8,389
Deferred Revenue	45,557	(19,811)
Deferred Compensation Payable	<u>(51,330)</u>	<u>51,019</u>
NET CASH PROVIDED		
BY/ (USED IN) OPERATING ACTIVITIES	<u>169,659</u>	<u>51,890</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from Line of Credit	17,412	56,118
Repayments of Notes Payable	<u>(27,930)</u>	<u>(22,639)</u>
NET CASH PROVIDED		
BY/ (USED IN) FINANCING ACTIVITIES	<u>(10,518)</u>	<u>33,479</u>
NET INCREASE/(DECREASE) IN CASH		
Beginning Cash and Cash Equivalents		
Balance, July 1, 2009 and 2008	<u>1,631,836</u>	<u>1,546,467</u>
ENDING CASH AND CASH EQUIVALENTS		
BALANCE, JUNE 30, 2010 AND 2009	<u>\$ 1,790,977</u>	<u>\$ 1,631,836</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 10,108</u>	<u>\$ 12,971</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED COMPARATIVE TOTALS FOR 2009

	Program Services			Supporting Services		
	Outpatient	Residential Services	Program Services	General & Administrative	Fundraising	Total
	Counseling & Relapse Prevention		Youth Counseling & Intervention			2010
						2009
EXPENSES						
Salaries and Wages	\$ 403,132	\$ 1,350,323	\$ 410,369	\$ 29,133	\$ 0	\$ 2,616,341
Donated services	0	21,800	0	0	0	21,800
Fringe benefits	53,263	202,050	58,636	1,150	0	362,622
Payroll taxes	38,429	125,077	37,786	2,723	0	243,493
Pension contribution (Note E)	32,251	108,025	32,830	2,331	0	209,308
Total salaries and related expenses						
Professional fees	527,075	1,807,275	539,621	35,337	0	3,453,564
Supplies	115,966	70,020	8,835	43,165	24,707	285,100
Telephone	19,669	346,487	7,069	151	2,994	392,719
Postage	12,519	16,930	1,759	147	0	36,538
Occupancy	1,272	596	325	33	39	3,367
Equipment Rental	74,792	325,342	10,010	3,070	0	432,852
Printing and Publications	1,955	10,969	638	20	0	15,129
Travel	2,129	4,678	716	30	0	8,872
Conferences and education	2,698	34,988	4,807	67	0	45,489
Specific assistance	745	3,666	2,248	63	0	10,871
Membership dues	3,150	25,045	0	0	0	28,195
Insurance	3,341	10,467	3,043	223	0	21,220
Expenses before depreciation	2,593	7,921	2,433	174	0	15,880
Depreciation	767,904	2,664,384	581,504	82,480	27,740	4,749,796
Total expenses	0	14,315	0	0	0	14,315
	\$ 767,904	\$ 2,678,699	\$ 581,504	\$ 82,480	\$ 27,740	\$ 4,764,111
						\$ 4,619,603

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background

The Pathway Society, Inc., (the Society), is a nonprofit public benefit corporation organized under the Nonprofit Public Benefit Corporation law for charitable and educational purposes. Since its incorporation in 1968, the Society has provided programs and services to residents of Santa Clara County in substance abuse prevention and education, intervention, and treatment. The Society provides a full spectrum of substance abuse services, including prevention and education services for kindergarten through twelfth grade schools, colleges, universities, businesses, and industry, intervention programs for identified "at-risk" youth, and residential and outpatient treatment. Administrative offices are located in Santa Clara, California.

The Society's major programs include the following:

Residential Services:

Pathway House is a 65-bed residential treatment facility in downtown 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 of the need for drugs.

Pathway Society-Mariposa Lodge is a 24-bed women-only 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 need. This live-in program provides clients addicted to alcohol and other drugs a chance to rehabilitate their lives and embrace the principles of independent, responsible, and productive living, free from the needs for drugs.

In addition, Pathway Society-Mariposa Lodge provides non-medical, social model detoxification for up to 6 adult women. The primary goal is to offer a safe structured facility to help support adult women in their detoxification process. Pathway Society, Inc. was awarded this contract beginning September 1, 2009 and the Residential and Detoxification services began November 30, 2009.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009

Transitional housing is provided for clients who have completed treatment at the 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 intensive outpatient services. The Society specializes in drug and alcohol, as well as mental health, outpatient services.

Training programs are provided to companies, schools, correctional staff, and other "gatekeepers" who have contact with "at-risk" individuals. Drug testing is also offered through this program.

Youth Counseling and Intervention:

The Society offers a variety of youth treatment and intervention programs, including:

- Day treatment programs for chemically dependent youth between the ages of 15 and 18 at three area high schools;
- Youth Prevention/Early Intervention programs provide multicultural prevention and intervention services at one middle school;
- Counseling and chemical dependency treatment programs at the James Ranch in Morgan Hill, and the Muriel Wright Center in San Jose.

Public Awareness & Education:

The Society provides three basic components to the Public Awareness Education program: a newsletter sent to schools, industry, public leaders, and community organizations; a cable television show, "Perspectives on Health"; and community outreach services, such as health fairs and presentations to parent groups, civic organizations, school staff, and businesses.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009**

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.

Tax Status

Pathway Society, Inc. 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.

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 the Society's financial statements for the year ended June 30, 2009, 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 the Society.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009

Cash and Cash Equivalents

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

Fixed Assets

The Society 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:

	<u>2010</u>	<u>2009</u>
Land	\$190,526	\$190,526
Buildings	176,571	176,571
Building Improvements	383,715	383,715
Equipment and vehicles	<u>369,745</u>	<u>369,745</u>
Total Fixed Assets	<u>\$1,120,557</u>	<u>\$1,120,557</u>

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 the Agency 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 the Society 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, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009

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

The Society accounts for contributions and promises to give in accordance with provisions of Statement of Financial Accounting Standards, *Accounting for Contributions Received and Contributions Made*. SFAS 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. SFAS 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 the Society'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 \$21,800 in 2010 and \$42,977 in 2009.

Note B: GRANTS RECEIVABLE

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

<u>Program</u>	<u>2010</u>	<u>2009</u>
County of Santa Clara	\$686,650	\$751,718
City of San Jose	29,570	28,570
U.S. District Court	25,967	35,452
Fees and other	<u>47,229</u>	<u>53,310</u>
Subtotal	789,416	869,050
Less: Contract Adjustments	<u>0</u>	<u>(637)</u>
Total Grants Receivable	<u>\$789,416</u>	<u>\$868,413</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, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009

Note C: LINE OF CREDIT

The Society has a line of credit with a bank providing up to \$100,000 through August 2012. Borrowings are at the bank's prime rate plus 1% and are secured by the Society's assets. The agreement requires the Society to meet certain financial covenants and ratios. The line of credit is subject to annual bank review. As of June 30, 2010 and 2009, \$73,530 and \$56,118 had been drawn down and was outstanding, respectively.

Note D: NOTES PAYABLE

Notes Payable consists of the following at June 30, 2010:

Note payable secured by deed of trust, payable in monthly installments of \$1,545 including interest at the lender's prime rate plus .5% (3.75% at June 30, 2010), through November 2010, at which time all remaining principal becomes due	\$205,408
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Mortgage note payable secured by deed of trust, adjustable interest rate (6.50% at June 30, 2010), payable in monthly installments of \$554 including interest, through February 2013	<u>20,088</u>
Total Notes Payable	225,496
Less: Current Maturities	<u>210,915</u>
Notes Payable, net of current portion	<u>\$ 14,581</u>

Future maturities of notes payable are as follows:

Year ending June 30,	
2011	\$ 210,915
2012	5,876
2013	6,269
2014	<u>2,436</u>
	<u>\$ 225,496</u>

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009**

Note E: PENSION PLAN

The Society has a defined contribution pension plan covering all regular, full-time employees who have been with the Society 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 \$209,307 in 2010, which is made up of \$209,307 for pension and \$0 for Supplemental Employee Retirement Plan (SERP), and \$202,618 in 2009, which consist of \$191,168 for pension and \$11,450 for SERP.

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, 2010 and 2009 were \$245,329 and \$296,659, respectively. The same amount is included in deposits and other assets.

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

The Society 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 the Society maintains cash in amounts which at times, exceed the federally insured limits, the Society has not experienced any losses in such accounts and believes they are not exposed to any significant credit risk on cash.

Note G: GRANT REVENUE – CITY OF SAN JOSE

The following City of San Jose Grant Revenue was recognized for the years ended June 30:

<u>Program</u>	<u>2010</u>	<u>2009</u>
San Jose Best	\$322,837	\$312,837
Unity to All	10,813	0
Tobacco – Family Wellness	<u>35,000</u>	<u>25,000</u>
TOTAL	<u>\$368,650</u>	<u>\$337,837</u>

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2010 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2009**

Note H: LEASE COMMITMENTS

The Society is the lessee of certain real properties and equipment. As of June 30, 2010, all leases are on a month to month basis.

Rent expense for the years ended June 30, 2010 and 2009 was \$223,746 and \$252,706 respectively for non-cancelable operating leases.

Note I: CONTINGENCIES

The Society 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 the Society'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. The Society deems this contingency remote since by accepting the grants and their terms, it has accommodated the objectives of the Society to the provisions of the grants. The Society's management is of the opinion that the Society has complied with the terms of all grants

Note J: SUBSEQUENT EVENTS

The Organization's management has evaluated its subsequent events through November 1, 2010, the date the financial statements were available to be issued, and concluded that no additional adjustments to the financial statements or disclosures are required.

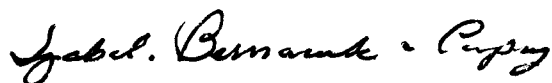
INDEPENDENT AUDITORS' REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors
Pathway Society, Inc.
San Jose, California

We have audited the general purpose financial statements of Pathway Society, Inc. for the year ended June 30, 2010, and have issued our report thereon dated November 1, 2010. These general purpose financial statements are the responsibility of Pathway Society, Inc.'s management. 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, *Government Auditing Standards* and Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. 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 in accordance with these standards includes examining, on a test basis, evidence supporting the amounts and disclosures in the general-purpose financial statements. An audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the basic financial statements of Pathway Society, Inc. taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. The information in this schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



San Francisco, California
November 1, 2010

PATHWAY SOCIETY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number	Grantor Number	Expenditures
U. S. DEPARTMENT OF HEALTH AND 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	\$ 397,959
Mariposa - Residential	93.959	n/a	250,000
Outpatient	93.959	n/a	101,061
Outpatient - South County	93.959	n/a	<u>65,011</u>
Subtotal for C.F.D.A. 93.959			814,031
Adolescent - SAMHSA	93.243	n/a	<u>56,250</u>
TOTAL U. S. DEPARTMENT OF HEALTH AND SERVICES			<u>870,281</u>
U. S. DEPARTMENT OF JUSTICE			
<i>Pass Through</i>			
County of Santa Clara			
Recovery Act - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to State and Territories			
ARRA - Residential	16.803	n/a	209,931
ARRA - Mariposa - Residential	16.803	n/a	183,909
ARRA - Mariposa - Detox	16.803	n/a	81,639
ARRA - THU	16.803	n/a	54,743
ARRA - Outpatient	16.803	n/a	<u>120,206</u>
Subtotal for C.F.D.A. 16.803			650,428
Edward Byrne Memorial Justice Assistance Grant (JAG) Grant Program	16.768	n/a	<u>115,021</u>
TOTAL U. S. DEPARTMENT OF JUSTICE			<u>765,449</u>
TOTAL FEDERAL AWARDS			<u>\$ 1,635,730</u>

Note A - Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the cost reimbursement contract activity of Pathway Society, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Pathway Society, Inc.
San Jose, California

We have audited the financial statements of Pathway Society, Inc. as of and for the year ended June 30, 2010, and have issued our report thereon dated November 1, 2010. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Pathway Society, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Pathway Society, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Pathway Society, Inc.'s internal control over financial reporting.

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.

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

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*.

This report is intended solely for the information and use of management, Board of Directors, federal awarding agencies and pass-through entities and is not intended and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Gabriel Bernhardt".

San Francisco, California
November 1, 2010

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Board of Directors
Pathway Society, Inc.
San Jose, California

Compliance

We have audited Pathway Society, Inc.'s compliance with the types of compliance requirements described in the *OMB Circular A-133 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, 2010. 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. Compliance with the requirements of law, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Pathway Society, Inc.'s management. Our responsibility is to express an opinion on Pathway Society, Inc.'s compliance based on our audit.

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 OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program 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. Our audit does not provide a legal determination of Pathway Society, Inc.'s compliance with those requirements.

In our opinion, Pathway Society, Inc. complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control over Compliance

Management of Pathway Society, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Pathway Society, Inc.'s internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 Pathway Society, Inc.'s internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance 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 requirement 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 type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Board of Directors, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



San Francisco, California
November 1, 2010

PATHWAY SOCIETY, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

A. SUMMARY OF AUDITOR'S RESULTS	
1. Type of Financial Statement Report	UNQUALIFIED
2. Significant Deficiencies in Internal Control Disclosed by Audit of Financial Statements	NONE
3. Noncompliance Disclosed by Audit Which Is Material to Financial Statements	NONE
4. Significant Deficiencies in Internal Control over Major Programs Disclosed by Audit	NONE
5. Type of Compliance Report Major Programs	UNQUALIFIED
6. OMB A-133 Subpart E.510a Audit Finding Disclosed by Audit	NONE
7. Major Programs:	16.803 – ARRA Justice Assistance Grant
8. Dollar Threshold for Type A Programs	\$300,000
9. Auditee Qualification	LOW RISK
B. Findings Relating to the Financial Statements Which Are Required to Be Reported in Accordance with GAGAS	CURRENT YEAR - NONE PRIOR YEAR - NONE
C. Findings and Questioned Costs for Federal Awards Including Audit Findings Defined in OMB A-133 Subpart E.510a	CURRENT YEAR - NONE PRIOR YEAR - NONE