

PATHWAY SOCIETY, INC.

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2012
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2011**

**IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS**

**PATHWAY SOCIETY, INC,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2012**

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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, 2012 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 2011 financial statements and, in our report dated October 14, 2011 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, 2012 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 October 4, 2012 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
October 4, 2012

PATHWAY SOCIETY, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2012
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current Assets		
Cash and cash equivalents (Note G)	\$ 1,220,724	\$ 1,159,025
Investments (Note C)	931,582	612,475
Grants Receivable (Note B)	535,883	867,579
Prepaid Assets	<u>137,758</u>	<u>53,832</u>
Total Current Assets	2,825,947	2,692,911
Fixed Assets		
Property and Equipment (Note A)	1,120,558	1,120,558
Less: Accumulated Depreciation	<u>(715,547)</u>	<u>(698,961)</u>
Net Fixed Assets	405,011	421,597
Other Non-Current Assets		
Deposits and Other Assets	<u>288,698</u>	<u>287,920</u>
TOTAL ASSETS	<u>\$ 3,519,656</u>	<u>\$ 3,402,428</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 507,604	\$ 481,426
Accrued pension contribution (Note F)	244,237	227,048
Deferred revenue	113,624	137,625
Deferred compensation payable (Note F)	270,198	275,114
Resident Fund Payable	39,918	39,918
Line of Credit (Note D)	-	-
Current portion of notes payable (Note E)	<u>4,847</u>	<u>8,688</u>
Total Current Liabilities	1,180,428	1,169,819
Long-Term Liabilities		
Notes Payable, net of current portion (Note E)	<u>183,757</u>	<u>194,506</u>
TOTAL LIABILITIES	<u>1,364,185</u>	<u>1,364,325</u>
Net Assets		
Unrestricted	2,155,471	2,038,103
Temporarily restricted	<u>0</u>	<u>0</u>
Total Net Assets	<u>2,155,471</u>	<u>2,038,103</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 3,519,656</u>	<u>\$ 3,402,428</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2012
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total 2012</u>	<u>Total 2011</u>
REVENUE				
Grant Revenue				
County of Santa Clara	\$ 4,512,534	\$ 0	\$ 4,512,534	\$ 3,773,488
City of San Jose (Note H)	176,000	0	176,000	307,140
U.S. District Court	174,799	0	174,799	161,152
Contributions and Other Revenue				
United Way of Santa Clara County	50,000	0	50,000	50,000
Contract Fees	382,024	0	382,024	514,505
Counseling, training, and intake fees	175,716	0	175,716	158,276
Other program income	114,546	0	114,546	105,984
Donated services (Note A)	22,995	0	22,995	19,220
Contributions	5,953	0	5,953	11,232
Investment Income	16,823	0	16,823	12,410
Total Revenue	<u>5,631,390</u>	<u>0</u>	<u>5,631,390</u>	<u>5,113,407</u>
EXPENSES				
Program Services:				
Residential services	3,676,506	0	3,676,506	3,190,496
Outpatient counseling and relapse prevention	575,033	0	575,033	602,641
Youth counseling and intervention	544,647	0	544,647	531,552
Public Awareness & Education	27,652	0	27,652	80,180
Support Services:				
General and administrative	666,199	0	666,199	661,654
Fundraising	18,991	0	18,991	4,314
Total Expenses	<u>5,509,028</u>	<u>0</u>	<u>5,509,028</u>	<u>5,070,837</u>
CHANGE IN NET ASSETS	122,362	0	122,362	42,570
INCREASE/(DECREASE) IN NET ASSETS				
Net Assets - Beginning of Year	2,038,103	0	2,038,103	2,000,527
Depreciation on fixed assets purchased with restricted funds	<u>(4,994)</u>	<u>0</u>	<u>(4,994)</u>	<u>(4,994)</u>
NET ASSETS - END OF YEAR	<u>\$ 2,155,471</u>	<u>\$ 0</u>	<u>\$ 2,155,471</u>	<u>\$ 2,038,103</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012
WITH SUMMARIZED COMPARATIVE FOR 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenue Over Expenses	\$ 122,362	\$ 42,570
Depreciation	11,593	11,654
Unrealized (Gain)/Loss on Investments	(4,473)	819
(Increase)/Decrease In:		
Grants Receivable	331,696	(78,163)
Prepaid Assets	(83,926)	71,593
Deposits and other assets	(778)	(26,854)
Increase/(Decrease) In:		
Accounts Payable and Accrued Expenses	26,177	(7,983)
Accrued Pension contribution	17,189	17,741
Deferred Revenue	(24,001)	(23,906)
Deferred Compensation Payable	(4,916)	29,785
Resident Fund Payable	<u>0</u>	<u>39,918</u>
NET CASH PROVIDED BY/ (USED IN) OPERATING ACTIVITIES	<u>390,923</u>	<u>77,174</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Investments	<u>(314,634)</u>	<u>(613,294)</u>
NET CASH PROVIDED BY/ (USED IN) INVESTING ACTIVITIES	<u>(314,634)</u>	<u>(613,294)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Line of Credit	0	(73,530)
Repayments of Notes Payable	<u>(14,590)</u>	<u>(22,302)</u>
NET CASH PROVIDED BY/ (USED IN) FINANCING ACTIVITIES	<u>(14,590)</u>	<u>(95,832)</u>
NET INCREASE/(DECREASE) IN CASH		
Beginning Cash and Cash Equivalents		
Balance, July 1, 2011 and 2010	<u>1,159,025</u>	<u>1,790,977</u>
ENDING CASH AND CASH EQUIVALENTS BALANCE, JUNE 30, 2012 AND 2011	<u>\$ 1,220,724</u>	<u>\$ 1,159,025</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 10,212</u>	<u>\$ 12,788</u>

See notes to the financial statements.

EXPENSES

Miscellaneous Expenses before depreciation

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011**

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 34-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 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, 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.

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

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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:

- Adolescent treatment program for chemically dependent youth between the ages of 12 and 18 located at the Hank Lopez Community Center and surrounding schools.
- Transitional Age Youth Program providing substance abuse counseling to age 18 – 25 at the Bill Wilson Center – TAY Inn.
- Counseling and chemical dependency treatment programs at the James Ranch in Morgan Hill, CA.

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 Healthy Living”; 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, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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.

Management believes that Pathway Society, Inc. has no uncertain tax positions as of June 30, 2012.

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, 2011, 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, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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.

Investments

Pathway Society, Inc. values its investments at fair value. Unrealized gains or losses (including investments bought, sold, and held during the year) are reflected in the Statement of activities as gain (loss) on investments. Short-term, highly liquid money market deposits and certificates of deposit that are not used for operations are treated as investments.

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>2012</u>	<u>2011</u>
Land	\$ 190,526	\$ 190,526
Buildings	176,571	176,571
Building Improvements	383,715	383,715
Equipment and vehicles	<u>369,746</u>	<u>369,746</u>
Total Fixed Assets	<u>\$ 1,120,558</u>	<u>\$ 1,120,558</u>

Accumulated depreciation for June 30, 2012 and 2011 is \$715,547 and \$698,961, 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 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.

PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Depreciation and Amortization Method – continued

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.

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 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 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 \$22,995 in 2012 and \$19,220 in 2011.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note B: GRANTS RECEIVABLE

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

Program	2012	2011
County of Santa Clara	\$ 439,418	\$ 775,370
City of San Jose	13,200	25,500
U.S. District Court	27,671	13,185
Fees and other	55,594	54,524
TOTAL GRANTS RECEIVABLE	<u>\$ 535,883</u>	<u>\$ 867,579</u>

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

Note C: INVESTMENTS

Investments are quoted on the basis of quoted market prices (all level 1 measurements) and consist of the following at June 30, 2012:

	Cost	Fair Value
Mutual Funds	\$ 900,000	\$ 931,582

Investment return is summarized as follows:

Investment Income	\$ 64
Unrealized Gains	<u>4,473</u>
Total	<u>\$ 4,537</u>

Investments are quoted on the basis of quoted market prices (all level 1 measurements) and consist of the following at June 30, 2011:

	Cost	Fair Value
Mutual Funds	\$ 600,000	\$ 612,475

Investment return is summarized as follows:

Investment Income	\$ 13,294
Unrealized Loss	<u>(819)</u>
Total	<u>\$ 12,475</u>

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note D: LINE OF CREDIT

The Society has a line of credit with a bank providing up to \$150,000 through March 17, 2013. 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, 2012 and 2011, \$0 and \$0 had been drawn down and was outstanding, respectively.

Note E: NOTE PAYABLE

Note payable secured by deed of trust, payable in monthly installments of \$1,181 including interest at a fixed rate of 5.00%, through April 17, 2016, at which time all remaining principal becomes due. The balance as of June 30, 2012 is \$188,604.

Interest expense from the note is \$10,211 and \$12,788 at June 30, 2012 and 2011, respectively.

Future maturities of the note payable are as follows:

Year ending June 30,	
2013	\$ 4,847
2014	5,095
2015	5,355
2016	<u>173,307</u>
	<u>\$ 188,604</u>

Note F: 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 \$244,237 in 2012 and \$227,048 in 2011.

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, 2012 and 2011 were \$270,198 and \$275,114, respectively. The same amount is included in deposits and other assets.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011

Note G: 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 H: 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>2012</u>	<u>2011</u>
San Jose Best	\$ 176,000	\$ 272,140
Tobacco – Family		
Wellness	-	35,000
TOTAL	<u>\$ 176,000</u>	<u>\$ 307,140</u>

Note I: LEASE COMMITMENTS

The Society is the lessee of certain real properties and equipment. As of June 30, 2012, all leases are on a month to month basis. Rent expense for the years ended June 30, 2012 and 2011 was \$233,252 and \$215,344 respectively for non-cancelable operating leases.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2011**

Note J: 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 K: EVALUATION OF SUBSEQUENT EVENTS

The Organization has evaluated all subsequent events through October 4, 2012, the date which the financial statements were available to be issued.

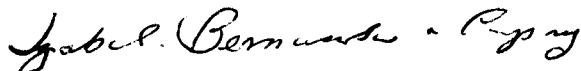
INDEPENDENT AUDITORS' REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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, 2012, and have issued our report thereon dated October 4, 2012. 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
October 4, 2012

PATHWAY SOCIETY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012

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	\$ 570,000
Mariposa - Residential	93.959	N/A	<u>487,225</u>
Subtotal for C.F.D.A. 93.959			1,057,225
Veterans Drug Court - SAMHSA	93.243	N/A	<u>180,000</u>
TOTAL U. S. DEPARTMENT OF HEALTH AND SERVICES			<u><u>1,237,225</u></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	16.804	N/A	176,000
ARRA - Residential	16.804	N/A	<u>11,227</u>
Subtotal for C.F.D.A. 16.804			187,227
Edward Byrne Memorial Justice Assistance Grant (JAG) Program	16.738	N/A	<u>160,000</u>
TOTAL U. S. DEPARTMENT OF JUSTICE			<u><u>347,227</u></u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 1,584,452</u></u>

Note A - Basis of Presentation

The accompanying schedule of expenditures of federal awards 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 Government, and Not-for-Profit Organizations." Therefore, some amounts presented in the 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, 2012, and have issued our report thereon dated October 4, 2012. 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 cursive script, appearing to read "Jacob A. Bernmark".

San Francisco, California
October 4, 2012

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL
EFFECT ON 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, 2012. 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, 2012.

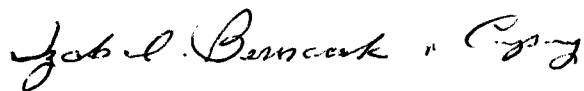
Internal Control over Compliance

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.

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

San Francisco, California
October 4, 2012

PATHWAY SOCIETY, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

A. SUMMARY OF AUDITOR'S RESULTS	
<i>Financial Statements</i>	
1. Type of Financial Statement Report	UNQUALIFIED
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	UNQUALIFIED
3. OMB A-133 Subpart E.510a Audit Finding Disclosed by Audit	NONE REPORTED
4. Major Programs:	JAG Cluster: 16.804 – ARRA Justice Assistance Grant 16.738 – Edward Byrne Memorial JAG 93.959 – Block Grants for Preventative and Treatment of Substance Abuse
5. Dollar Threshold for Type A Programs	\$300,000
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 OMB A-133 Subpart E.510a	NONE REPORTED

PATHWAY SOCIETY, INC.
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

There were no prior year audit findings.