

PATHWAY SOCIETY, INC.

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2013
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2012**

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

**PATHWAY SOCIETY, INC,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2013**

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IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pathway Society, Inc.
San Jose, 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, 2013, 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 2012 financial statements and, in our report dated October 4, 2012 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, 2013, 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 27, 2013, 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.

Johal. Barnum . Papp

San Francisco, California
September 27, 2013

PATHWAY SOCIETY, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2013
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Current Assets		
Cash and cash equivalents (Note G)	\$ 498,582	\$ 1,220,724
Investments (Note C)	1,326,277	931,582
Grants Receivable (Note B)	875,113	535,883
Prepaid Assets	34,381	137,758
Total Current Assets	<u>2,734,353</u>	<u>2,825,947</u>
Fixed Assets		
Property and Equipment (Note A)	1,131,732	1,120,558
Less: Accumulated Depreciation	<u>(734,308)</u>	<u>(715,547)</u>
Net Fixed Assets	397,424	405,011
Other Non-Current Assets		
Deposits and Other Assets	<u>306,002</u>	<u>288,698</u>
TOTAL ASSETS	<u>\$ 3,437,779</u>	<u>\$ 3,519,656</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 355,880	\$ 507,604
Accrued pension contribution (Note F)	258,636	244,237
Deferred revenue	62,168	113,624
Deferred compensation payable (Note F)	287,502	270,198
Resident Fund Payable	39,527	39,918
Line of Credit (Note D)	-	-
Current portion of notes payable (Note E)	<u>5,718</u>	<u>4,847</u>
Total Current Liabilities	1,009,431	1,180,428
Long-Term Liabilities		
Notes Payable, net of current portion (Note E)	<u>165,867</u>	<u>183,757</u>
TOTAL LIABILITIES	<u>1,175,298</u>	<u>1,364,185</u>
Net Assets		
Unrestricted	2,262,481	2,155,471
Temporarily restricted	<u>0</u>	<u>0</u>
Total Net Assets	<u>2,262,481</u>	<u>2,155,471</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 3,437,779</u>	<u>\$ 3,519,656</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2013
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total 2013</u>	<u>Total 2012</u>
REVENUE				
Grant Revenue				
County of Santa Clara	\$ 4,841,035	\$ 0	\$ 4,841,035	\$ 4,512,534
City of San Jose (Note H)	197,416	0	197,416	176,000
U.S. District Court	176,061	0	176,061	174,799
Contributions and Other Revenue				
United Way of Santa Clara County	50,000	0	50,000	50,000
Contract Fees	353,617	0	353,617	382,024
Counseling, training, and intake fees	136,711	0	136,711	175,716
Other program income	91,210	0	91,210	114,546
Donated services (Note A)	26,193	0	26,193	22,995
Contributions	6,257	0	6,257	5,953
Investment Income	(6,666)	0	(6,666)	16,823
Total Revenue	<u>5,871,834</u>	<u>0</u>	<u>5,871,834</u>	<u>5,631,390</u>
EXPENSES				
Program Services:				
Residential services	3,790,132	0	3,790,132	3,676,506
Outpatient counseling and relapse prevention	572,070	0	572,070	575,033
Youth counseling and intervention	636,309	0	636,309	544,647
Public Awareness & Education	7,247	0	7,247	27,652
Support Services:				
General and administrative	727,479	0	727,479	666,199
Fundraising	26,593	0	26,593	18,991
Total Expenses	<u>5,759,830</u>	<u>0</u>	<u>5,759,830</u>	<u>5,509,028</u>
CHANGE IN NET ASSETS	<u>112,004</u>	<u>0</u>	<u>112,004</u>	<u>122,362</u>
INCREASE/(DECREASE) IN NET ASSETS				
Net Assets - Beginning of Year	2,155,471	0	2,155,471	2,038,103
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>\$ 2,262,481</u>	<u>\$ 0</u>	<u>\$ 2,262,481</u>	<u>\$ 2,155,471</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2013
WITH SUMMARIZED COMPARATIVE FOR 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenue Over Expenses	\$ 112,004	\$ 122,362
Depreciation	13,768	11,593
Unrealized (Gain)/Loss on Investments	3,885	(4,473)
(Increase)/Decrease In:		
Grants Receivable	(339,230)	331,696
Prepaid Assets	103,377	(83,926)
Deposits and other assets	(17,304)	(778)
Increase/(Decrease) In:		
Accounts Payable and Accrued Expenses	(151,725)	26,177
Accrued Pension contribution	14,399	17,189
Deferred Revenue	(51,456)	(24,001)
Deferred Compensation Payable	17,304	(4,916)
Resident Fund Payable	(391)	0
NET CASH PROVIDED		
BY/ (USED IN) OPERATING ACTIVITIES	<u>(295,369)</u>	<u>390,923</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(11,174)	0
Purchases of Investments	(398,580)	(314,634)
NET CASH PROVIDED		
BY/ (USED IN) INVESTING ACTIVITIES	<u>(409,754)</u>	<u>(314,634)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Line of Credit	0	0
Repayments of Notes Payable	(17,019)	(14,590)
NET CASH PROVIDED		
BY/ (USED IN) FINANCING ACTIVITIES	<u>(17,019)</u>	<u>(14,590)</u>
NET INCREASE/(DECREASE) IN CASH		
Beginning Cash and Cash Equivalents		
Balance, July 1, 2012 and 2011	<u>1,220,724</u>	<u>1,159,025</u>
ENDING CASH AND CASH EQUIVALENTS		
BALANCE, JUNE 30, 2013 AND 2012	<u>\$ 498,582</u>	<u>\$ 1,220,724</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 9,421</u>	<u>\$ 10,212</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.

	Program Services				Supporting Services				
	Outpatient		Youth Counseling & Intervention	Public Awareness & Education	Total Program Services	General & Administrative	Fundraising	Total 2013	Total 2012
	Residential Services	Counseling & Relapse Prevention							
EXPENSES									
Salaries and Wages	\$ 1,959,967	\$ 309,916	\$ 460,690	\$ 3,384	\$ 2,733,957	\$ 498,988	\$ 0	\$ 3,232,945	\$ 3,052,960
Donated services	26,193	0	0	0	26,193	0	0	26,193	22,995
Fringe benefits	351,349	44,590	54,447	409	450,795	53,302	0	504,097	442,045
Payroll taxes	175,886	30,650	44,392	238	251,166	50,763	0	301,929	279,420
Pension contribution (Note F)	156,797	24,793	36,855	270	218,715	39,921	0	258,636	244,238
Total salaries and related expenses	2,670,192	409,949	596,384	4,301	3,680,826	642,974	0	4,323,800	4,041,658
Professional fees	94,609	73,259	7,058	53	174,979	14,455	7,965	197,399	218,882
Supplies	467,245	7,975	4,494	6	479,720	17,583	18,628	515,931	511,811
Telephone	14,020	8,334	3,218	35	25,607	2,616	0	28,223	25,811
Postage	800	650	84	1	1,535	359	0	1,894	3,520
Occupancy	409,489	61,433	5,101	2,726	478,749	29,482	0	508,231	485,122
Equipment Rental	13,154	934	436	4	14,528	2,622	0	17,150	16,703
Printing and Publications	6,448	1,405	3,417	1	11,271	1,684	0	12,955	12,269
Automotive and Travel	39,245	2,828	7,199	50	49,322	3,205	0	52,527	58,562
Conferences and education	5,076	786	3,747	42	9,651	6,697	0	16,348	13,311
Specific assistance	35,950	1,350	486	0	37,786	0	0	37,786	39,943
Membership dues	10,365	1,530	2,263	14	14,172	3,023	0	17,195	23,935
Insurance	9,771	1,637	2,422	14	13,844	2,779	0	16,623	11,399
Miscellaneous	0	0	0	0	0	0	0	0	34,509
Expenses before depreciation	3,776,364	572,070	636,309	7,247	4,991,990	727,479	26,593	5,746,062	5,497,435
Depreciation	13,768	0	0	0	13,768	0	0	13,768	11,593
Total expenses	\$ 3,790,132	\$ 572,070	\$ 636,309	\$ 7,247	\$ 5,005,758	\$ 727,479	\$ 26,593	\$ 5,759,830	\$ 5,509,028

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**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012**

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 prevention, intervention, and education services for identified "at-risk" youth at various middle and high schools throughout 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 34-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 detoxification for up to six (6) adult women. The primary goal is to provide a safe structured environment to support adult women in their detoxification process—and potentially the first steps of their recovery process.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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. PSI specializes in drug and alcohol, as well as mental health outpatient services.

Training programs are provided to companies, schools, correctional staff, and other practitioners who interact 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 various schools throughout the County.
- 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:

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, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012

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, 2013.

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, 2012, 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, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012**

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>2013</u>	<u>2012</u>
Land	\$ 190,526	\$ 190,526
Buildings	176,571	176,571
Building Improvements	383,715	383,715
Equipment and vehicles	380,920	369,746
Total Fixed Assets	<u>\$ 1,131,732</u>	<u>\$ 1,120,558</u>

Accumulated depreciation for June 30, 2013 and 2012 is \$734,308 and \$715,547, 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, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012

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 \$26,193 in 2013 and \$22,995 in 2012.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012

Note B: GRANTS RECEIVABLE

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

Program	2013	2012
County of Santa Clara	\$ 769,952	\$ 439,418
City of San Jose	21,591	13,200
U.S. District Court	6,435	27,671
Fees and other	77,135	55,594
TOTAL GRANTS RECEIVABLE	<u>\$ 875,113</u>	<u>\$ 535,883</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, 2013:

	Cost	Fair Value
Mutual Funds	\$ 1,298,580	\$ 1,326,277

Investment return is summarized as follows:

Investment Income	\$ 9,945
Unrealized Loss	(16,611)
Total	<u>\$ (6,666)</u>

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 Gain	4,473
Total	<u>\$ 4,537</u>

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012

Note D: LINE OF CREDIT

The Society has a line of credit with a bank providing up to \$150,000 through March 15, 2014. 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, 2013 and 2012, \$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, 2013 is \$171,585.

Interest expense from the note is \$9,421 and \$10,212 at June 30, 2013 and 2012, respectively.

Future maturities of the note payable are as follows:

Year ending June 30,	
2014	\$ 5,718
2015	6,010
2016	<u>159,857</u>
	<u>\$ 171,585</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 \$258,636 in 2013 and \$244,238 in 2012.

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, 2013 and 2012 were \$287,502 and \$270,198, respectively. The same amount is included in deposits and other assets.

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012

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:

Program	2013	2012
San Jose Best	\$ 175,066	\$ 176,000
CalGrip	22,350	-
TOTAL	<u>\$ 197,416</u>	<u>\$ 176,000</u>

Note I: LEASE COMMITMENTS

The Society is the lessee of certain real properties and equipment. As of June 30, 2013, all leases are on a month to month basis. Rent expense for the years ended June 30, 2013 and 2012 was \$282,845 and \$233,252 respectively for non-cancelable operating leases.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2013 WITH SUMMARIZED
COMPARATIVE TOTALS FOR 2012**

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 September 27, 2013, the date which the financial statements were available to be issued.

IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

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**REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
REQUIRED BY OMB CIRCULAR A-133**

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

We have audited the financial statements of Pathway Society, Inc. for the year ended June 30, 2013, and have issued our report thereon dated September 27, 2013, 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 U.S. Office of Management and Budget Circular A-133, and is also 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 other 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 presented in all material respects in relation to the financial statements as a whole.



San Francisco, California
September 27, 2013

PATHWAY SOCIETY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2013

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>490,000</u>
Subtotal for C.F.D.A. 93.959			1,060,000
Veterans Drug Court - SAMHSA	93.243	N/A	<u>35,075</u>
TOTAL U. S. DEPARTMENT OF HEALTH AND SERVICES			<u><u>1,095,075</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	129,344
ARRA - Residential	16.804	N/A	<u>26,196</u>
Subtotal for C.F.D.A. 16.804			155,540
TOTAL U. S. DEPARTMENT OF JUSTICE			<u><u>155,540</u></u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 1,250,615</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.

**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.
San Jose, 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, 2013, 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 27, 2013

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.

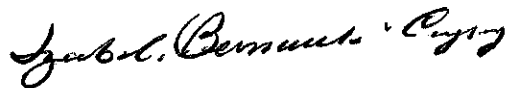
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 black ink, appearing to read "Gabriel Bernabe".

San Francisco, California
September 27, 2013

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

Board of Directors
Pathway Society, Inc.
San Jose, 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 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, 2013. 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 *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (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 compliance requirements referred to above that could have a direct and material effect on the 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, 2013.

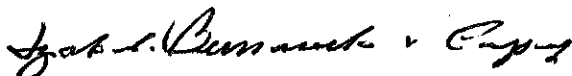
Report on Internal Control Over Compliance

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 *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 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 *OMB Circular A-133*. Accordingly, this report is not suitable for any other purpose.



San Francisco, California
September 27, 2013

PATHWAY SOCIETY, INC.
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

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:	ARRA 16.804 - Justice Assistance Grant 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, 2013

There were no prior year audit findings.