

PATHWAY SOCIETY, INC.

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

IZABAL, BERNACIAK & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

**PATHWAY SOCIETY, INC,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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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, 2014, 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 2013 financial statements and, in our report dated September 27, 2013 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.

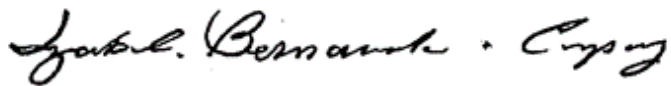
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2014, 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 14, 2014, 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.

A handwritten signature in black ink, reading "Jacob L. Bernhardt & Company". The signature is written in a cursive, flowing style.

San Francisco, California
September 14, 2014

PATHWAY SOCIETY, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Current Assets		
Cash and cash equivalents (Note G)	\$ 398,706	\$ 498,582
Investments (Note C)	766,447	1,326,277
Grants Receivable (Note B)	1,648,457	875,113
Prepaid Assets	<u>99,363</u>	<u>34,381</u>
Total Current Assets	2,912,973	2,734,353
Fixed Assets		
Property and Equipment (Note A)	1,131,732	1,131,732
Less: Accumulated Depreciation	<u>(754,619)</u>	<u>(734,308)</u>
Net Fixed Assets	377,113	397,424
Other Non-Current Assets		
Deposits and Other Assets	<u>157,810</u>	<u>306,002</u>
TOTAL ASSETS	\$ <u>3,447,896</u>	\$ <u>3,437,779</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 657,636	\$ 355,880
Accrued pension contribution (Note F)	271,820	258,636
Deferred revenue	31,192	62,168
Deferred compensation payable (Note F)	125,710	287,502
Resident Fund Payable	39,361	39,527
Current portion of notes payable (Note E)	<u>6,633</u>	<u>5,718</u>
Total Current Liabilities	1,132,352	1,009,431
Long-Term Liabilities		
Notes Payable, net of current portion (Note E)	<u>147,051</u>	<u>165,867</u>
TOTAL LIABILITIES	<u>1,279,403</u>	<u>1,175,298</u>
Net Assets		
Unrestricted	2,168,493	2,262,481
Temporarily restricted	<u>-</u>	<u>-</u>
Total Net Assets	<u>2,168,493</u>	<u>2,262,481</u>
TOTAL LIABILITIES AND NET ASSETS	\$ <u>3,447,896</u>	\$ <u>3,437,779</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total 2014</u>	<u>Total 2013</u>
REVENUE				
Grant Revenue				
County of Santa Clara	\$ 5,110,412	\$ -	\$ 5,110,412	\$ 4,841,035
City of San Jose (Note H)	106,541	-	106,541	197,416
U.S. District Court	160,800	-	160,800	176,061
Contributions and Other Revenue				
United Way of Santa Clara County	-	-	-	50,000
Contract Fees	328,547	-	328,547	353,617
Counseling, training, and intake fees	147,761	-	147,761	136,711
Other program income	128,513	-	128,513	91,210
Donated services (Note A)	24,922	-	24,922	26,193
Contributions	3,595	-	3,595	6,257
Net Investment Income/(Loss)	(213)	-	(213)	(6,666)
Total Revenue	<u>6,010,878</u>	<u>-</u>	<u>6,010,878</u>	<u>5,871,834</u>
EXPENSES				
Program Services:				
Residential services	4,209,119	-	4,209,119	3,790,132
Outpatient counseling and relapse prevention	514,662	-	514,662	572,070
Youth counseling and intervention	591,114	-	591,114	636,309
Public Awareness & Education	6,623	-	6,623	7,247
Support Services:				
General and administrative	749,154	-	749,154	727,479
Fundraising	29,199	-	29,199	26,593
Total Expenses	<u>6,099,871</u>	<u>-</u>	<u>6,099,871</u>	<u>5,759,830</u>
CHANGE IN NET ASSETS	(88,993)	-	(88,993)	112,004
INCREASE/(DECREASE) IN NET ASSETS				
Net Assets - Beginning of Year	2,262,481	-	2,262,481	2,155,471
Depreciation on fixed assets purchased with restricted funds	<u>(4,994)</u>	<u>-</u>	<u>(4,994)</u>	<u>(4,994)</u>
NET ASSETS - END OF YEAR	<u>\$ 2,168,494</u>	<u>\$ -</u>	<u>\$ 2,168,494</u>	<u>\$ 2,262,481</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenue Over/(Under) Expenses	\$ (88,993)	\$ 112,004
Depreciation	15,317	13,768
Unrealized (Gain)/Loss on Investments	6,137	16,611
Realized (Gain)/Loss on Investments	(8,608)	(12,726)
(Increase)/Decrease In:		
Grants Receivable	(773,344)	(339,230)
Prepaid Assets	(64,982)	103,377
Deposits and other assets	148,192	(17,304)
Increase/(Decrease) In:		
Accounts Payable and Accrued Expenses	301,755	(151,725)
Accrued Pension contribution	13,184	14,399
Deferred Revenue	(30,976)	(51,456)
Deferred Compensation Payable	(161,792)	17,304
Resident Fund Payable	(166)	(391)
NET CASH PROVIDED		
BY/ (USED IN) OPERATING ACTIVITIES	<u>(644,276)</u>	<u>(295,369)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	-	(11,174)
Proceeds from Sale of Investments	712,301	
Purchases of Investments	(150,000)	(398,580)
NET CASH PROVIDED		
BY/ (USED IN) INVESTING ACTIVITIES	<u>562,301</u>	<u>(409,754)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of Notes Payable	(17,901)	(17,019)
NET CASH PROVIDED		
BY/ (USED IN) FINANCING ACTIVITIES	<u>(17,901)</u>	<u>(17,019)</u>
NET INCREASE/(DECREASE) IN CASH		
Beginning Cash and Cash Equivalents		
Balance, July 1, 2013 and 2012	<u>498,582</u>	<u>1,220,724</u>
ENDING CASH AND CASH EQUIVALENTS		
BALANCE, JUNE 30, 2014 AND 2013	<u>\$ 398,706</u>	<u>\$ 498,582</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 8,633</u>	<u>\$ 9,421</u>

See notes to the financial statements.

PATHWAY SOCIETY, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013

	Program Services					Supporting Services			Total 2014	Total 2013
	Residential Services	Outpatient Counseling & Relapse Prevention	Youth Counseling & Intervention	Public Awareness & Education	Total Program Services	General & Administrative	Fundraising			
EXPENSES										
Salaries and Wages	\$ 2,173,875	\$ 298,988	\$ 404,715	\$ 2,981	\$ 2,880,559	\$ 500,029	\$ 17,164	\$ 3,397,752	\$ 3,232,945	
Donated services	24,923	-	-	-	24,923	-	-	24,923	26,193	
Fringe benefits	379,912	41,257	69,183	196	490,548	56,584	-	547,132	504,097	
Payroll taxes	181,895	25,434	35,849	249	243,427	42,195	1,312	286,934	301,929	
Pension contribution (Note F)	173,909	23,919	32,378	239	230,445	40,002	1,373	271,820	258,636	
Total salaries and related expenses	2,934,514	389,598	542,125	3,665	3,869,902	638,810	19,849	4,528,561	4,323,800	
Professional fees	86,481	37,607	14,413	34	138,535	30,078	183	168,796	197,399	
Supplies	502,563	14,208	10,802	5	527,578	23,839	9,042	560,459	515,931	
Telephone	15,771	5,511	3,005	10	24,297	4,690	125	29,112	28,223	
Postage	1,355	624	72	1	2,052	789	-	2,841	1,894	
Occupancy	457,805	58,679	3,780	2,772	523,036	35,059	-	558,095	508,231	
Equipment Rental	15,039	836	416	7	16,298	3,607	-	19,905	17,150	
Printing and Publications	5,134	420	1,467	1	7,022	574	-	7,596	12,955	
Automotive and Travel	48,995	2,076	4,297	43	55,411	2,369	-	57,780	52,527	
Conferences and education	10,437	1,217	2,858	50	14,562	3,085	-	17,647	16,348	
Specific assistance	31,422	-	595	-	32,017	-	-	32,017	37,786	
Membership dues	12,967	1,853	3,473	17	18,310	3,022	-	21,332	17,195	
Insurance	12,766	2,033	3,811	18	18,628	3,232	-	21,860	16,623	
Miscellaneous	58,553	-	-	-	58,553	-	-	58,553	-	
Expenses before depreciation	4,193,802	514,662	591,114	6,623	5,306,201	749,154	29,199	6,084,554	5,746,062	
Depreciation	15,317	-	-	-	15,317	-	-	15,317	13,768	
Total expenses	\$ 4,209,119	\$ 514,662	\$ 591,114	\$ 6,623	\$ 5,321,518	\$ 749,154	\$ 29,199	\$ 6,099,871	\$ 5,759,830	

See notes to the financial statements

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

Note A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

Outpatient Counseling and Relapse Prevention:

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

Training programs are provided to schools, correctional staff, and other practitioners who interact with “at-risk” individuals.

Youth Counseling and Intervention:

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

- Adolescent intervention and counseling 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.
- Chemical dependency counseling programs at the James Ranch in Morgan Hill, CA.

Public Awareness & Education:

Public Awareness Education Program: a cable television show, “Perspectives on Healthy Living.” PSI also provides 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, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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, 2014.

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, 2013, 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, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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:

	2014	2013
Land	\$ 190,526	\$ 190,526
Buildings	176,571	176,571
Building Improvements	383,715	383,715
Equipment and vehicles	380,920	380,920
Total Fixed Assets	<u>\$ 1,131,732</u>	<u>\$ 1,131,732</u>

Accumulated depreciation for June 30, 2014 and 2013 is \$754,619 and \$734,308, 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, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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 \$24,923 in 2014 and \$26,193 in 2013.

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

Note B: GRANTS RECEIVABLE

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

Program	2014	2013
County of Santa Clara	\$ 1,527,303	\$ 769,952
City of San Jose	9,556	21,591
U.S. District Court	49,200	6,435
Fees and other	62,398	77,135
TOTAL GRANTS RECEIVABLE	<u>\$ 1,648,457</u>	<u>\$ 875,113</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, 2014:

	Cost	Fair Value
Mutual Funds	\$ 736,279	\$ 766,447

Investment return is summarized as follows:

Net Investment Income	\$ 5,924
Unrealized Loss	(6,137)
Total	<u>\$ (213)</u>

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>

PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013

Note D: LINE OF CREDIT

The Society has a line of credit with a bank providing up to \$150,000 through April 10, 2015. 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, 2014 and 2013, \$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, 2014 is \$153,684.

Interest expense from the note is \$8,266 and \$9,147 at June 30, 2014 and 2013, respectively.

Future maturities of the note payable are as follows:

Year ending June 30,	
2015	\$ 6,633
2016	<u>147,051</u>
	\$ <u>153,684</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 \$271,820 in 2014 and \$258,636 in 2013.

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, 2014 and 2013 were \$125,710 and \$287,502, respectively. The same amount is included in deposits and other assets.

**PATHWAY SOCIETY, INC.,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

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	2014	2013
San Jose Best	\$ 26,666	\$ 175,066
CalGrip	79,875	22,350
TOTAL	<u>\$ 106,541</u>	<u>\$ 197,416</u>

Note I: LEASE COMMITMENTS

The Society is the lessee of certain real properties and equipment. As of June 30, 2014, all leases are on a month to month basis. Rent expense for the years ended June 30, 2014 and 2013 was \$345,530 and \$282,845 respectively for non-cancelable operating leases.

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.

**PATHWAY SOCIETY, INC,
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014
WITH SUMMARIZED COMPARATIVE TOTALS FOR 2013**

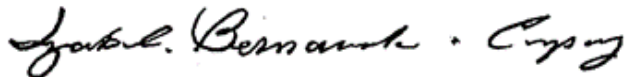
Note K: EVALUATION OF SUBSEQUENT EVENTS

The Organization has evaluated all subsequent events through September 14, 2014, the date which the financial statements were available to be issued.

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, 2014, and have issued our report thereon dated September 14, 2014, 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 14, 2014

PATHWAY SOCIETY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2014

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	\$ 600,000
Mariposa - Residential	93.959	N/A	<u>900,000</u>
Subtotal for C.F.D.A. 93.959			1,500,000
Veterans Drug Court - SAMHSA	93.243	N/A	<u>131,798</u>
TOTAL U. S. DEPARTMENT OF HEALTH AND SERVICES			<u>1,631,798</u>
U. S. DEPARTMENT OF JUSTICE			
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ <u><u>1,631,798</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, 2014, 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 14, 2014.

Internal Control Over Financial Reporting

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

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

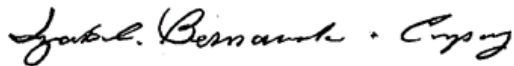
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

Compliance and Other Matters

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

Purpose of this Report

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

A handwritten signature in cursive script, appearing to read "Gabriel Bernabeu".

San Francisco, California
September 14, 2014

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, 2014. 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, 2014.

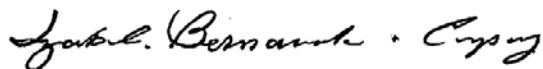
Report on Internal Control Over Compliance

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 14, 2014

PATHWAY SOCIETY, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2014

A. SUMMARY OF AUDITOR'S RESULTS	
<i>Financial Statements</i>	
1. Type of Financial Statement Report	UNMODIFIED
2. Internal Control over Financial Reporting: Material Weakness(es) Identified Significant Deficiency(ies) Identified	NONE NONE REPORTED
3. Noncompliance Disclosed by Audit Which Is Material to Financial Statements	NONE
<i>Federal Awards</i>	
1. Internal Control Over Major Programs: Material Weakness(es) Identified Significant Deficiency(ies) Identified	NONE NONE REPORTED
2. Type of Compliance Report Major Programs	UNMODIFIED
3. OMB A-133 Subpart E.510a Audit Finding Disclosed by Audit	NONE REPORTED
4. Major Programs:	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, 2014

There were no prior year audit findings.