
Pathways Behavioral Services, Inc.

Audited Financial Statements

June 30, 2006 and 2005

**BERGAN, PAULSEN
& COMPANY, P.C.**

**CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS**

PATHWAYS BEHAVIORAL SERVICES, INC.

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BERGAN, PAULSEN & COMPANY, P.C.

CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Pathways Behavioral Services, Inc.

We have audited the accompanying statements of financial position of Pathways Behavioral Services, Inc. (a nonprofit organization) as of June 30, 2006 and 2005, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits 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 Pathways Behavioral Services, Inc. as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2006, on our consideration of Pathway Behavioral Service, 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 the internal control

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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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of Pathways Behavioral Services, Inc. taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. In addition, the accompanying schedules of functional expenses are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits 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.

Bergan, Palsen & Company, P.C.

Waterloo, Iowa
November 27, 2006

PATHWAYS BEHAVIORAL SERVICES, INC.

Statements of Financial Position

As of June 30, 2006 and 2005

Assets		
	2006	2005
Current Assets		
Cash and cash equivalents	\$ 373,363	\$ 231,995
Temporary cash investments	176,272	130,950
Client receivables, net	69,398	70,020
Other receivables	350,626	304,591
Other current assets	<u>6,358</u>	<u>8,594</u>
Total Current Assets	<u>976,017</u>	<u>746,150</u>
Beneficial Interest in Assets Held by Community Foundation	7,069	5,307
Cash and Campaign Receivables Restricted for Capital Expenditures	55,681	165,601
Property and Equipment, Net	<u>1,631,591</u>	<u>1,683,458</u>
Total Assets	<u><u>\$ 2,670,358</u></u>	<u><u>\$ 2,600,516</u></u>

Liabilities and Net Assets

Current Liabilities		
Current maturities of long-term debt	\$ 45,753	\$ 29,659
Accounts payable	36,862	23,593
Refundable advance	10,000	
Accrued expenses	<u>189,450</u>	<u>132,307</u>
Total Current Liabilities	<u>282,065</u>	<u>185,559</u>
Long-Term Debt	<u>175,095</u>	<u>441,943</u>
Net Assets		
Unrestricted:		
Operations	286,475	314,781
Board designated - operating reserve	478,234	434,477
Net investment in property and equipment	<u>1,410,743</u>	<u>1,211,856</u>
Total Unrestricted	<u>2,175,452</u>	<u>1,961,114</u>
Temporarily restricted	<u>37,746</u>	<u>11,900</u>
Total Net Assets	<u>2,213,198</u>	<u>1,973,014</u>
Total Liabilities and Net Assets	<u><u>\$ 2,670,358</u></u>	<u><u>\$ 2,600,516</u></u>

PATHWAYS BEHAVIORAL SERVICES, INC.

Statements of Activities

For the years ended June 30, 2006 and 2005

	2006	2005
Unrestricted Net Assets		
Revenue, Gains and Other Support		
Net client service revenue	\$ 246,563	\$ 226,531
Other service revenue	2,507,011	2,383,731
United Way allocations	21,545	9,686
Contributions	38,342	64,346
Investment return	21,251	8,588
Miscellaneous income	243,638	2,151
Net assets released from restrictions net of transfers	<u>5,400</u>	<u>258,158</u>
Total Revenue, Gains and Other Support	<u>3,083,750</u>	<u>2,953,191</u>
Expenses		
Salaries	1,768,317	1,513,334
Payroll taxes	138,057	122,767
Employee benefits	370,934	326,908
Rent	25,728	27,466
Utilities	37,329	36,735
Insurance	25,362	38,179
Repairs and maintenance	39,425	35,768
Telephone	24,382	21,382
Postage and shipping	7,251	9,335
Office supplies and equipment	57,763	52,101
Legal and accounting	13,894	11,463
Contract labor	60,542	134,373
Professional fees	18,826	19,627
Travel and training	35,679	27,639
Dues and subscriptions	11,659	9,819
Educational materials, printing and public information	56,618	30,489
Groceries and household supplies	27,090	32,506
Miscellaneous	29,485	31,827
Interest	21,683	25,098
Depreciation	<u>99,379</u>	<u>100,046</u>
Total Expenses	<u>2,869,403</u>	<u>2,606,862</u>
Excess of Revenues, Gains and Other Support Over Expenses	214,347	346,329
Loss on Disposal of Property and Equipment	<u>(9)</u>	<u>(423)</u>
Increase in Unrestricted Net Assets	<u>214,338</u>	<u>345,906</u>
Temporarily Restricted Net Assets		
United Way allocations	6,900	6,900
Grants	24,346	
Transfer assets to Community Foundation	1,500	
Net assets released from restrictions	<u>(6,900)</u>	<u>(258,158)</u>
Increase (Decrease) in Temporarily Restricted Net Assets	<u>25,846</u>	<u>(251,258)</u>
Increase in Net Assets	240,184	94,648
Net Assets, Beginning of Year	<u>1,973,014</u>	<u>1,878,366</u>
Net Assets, End of Year	<u>\$ 2,213,198</u>	<u>\$ 1,973,014</u>

PATHWAYS BEHAVIORAL SERVICES, INC.

Statements of Cash Flows

For the years ended June 30, 2006 and 2005

	2006	2005
Cash Flows from Operating Activities		
Increase in net assets	\$ 240,184	\$ 94,648
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation	99,379	100,046
Loss on disposal of property and equipment	9	423
Donated property	(2,440)	(5,000)
Contributions restricted for capital expenditures	(53,241)	(160,601)
Changes in:		
Receivables	(45,413)	13,058
Other current assets	2,236	781
Payables	13,269	(117,989)
Refundable advance	10,000	
Accrued expenses	57,143	2,922
	<u>321,126</u>	<u>(71,712)</u>
Net Cash Provided by (Used in) Operating Activities		
Cash Flows from Investing Activities		
Decrease in cash restricted for capital expenditures		4,520
Increase in temporary cash investments	(45,322)	(5,367)
Increase in beneficial interest	(1,762)	(279)
Acquisition of property and equipment	(45,081)	(332,705)
Proceeds from sales of property and equipment		5,089
	<u>(92,165)</u>	<u>(328,742)</u>
Net Cash Used in Investing Activities		
Cash Flows from Financing Activities		
Collections of restricted contributions	163,161	241,438
Principal payments under long-term borrowings	(250,754)	(49,849)
	<u>(87,593)</u>	<u>191,589</u>
Net Cash Provided by (Used in) Financing Activities		
Net Increase (Decrease) in Cash and Cash Equivalents	141,368	(208,865)
Cash and Cash Equivalents at Beginning of Year	231,995	440,860
Cash and Cash Equivalents at End of Year	<u>\$ 373,363</u>	<u>\$ 231,995</u>

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid during the year for:

Interest	<u>\$ 21,683</u>	<u>\$ 25,098</u>
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SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES

As of June 30, 2005, the Organization had a contract receivable in the amount of \$167,006 related to property sold during fiscal year 2005.

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

NATURE OF ORGANIZATION

Pathways Behavioral Services, Inc. (the Organization) is a nonprofit corporation organized to provide education and counseling (individual and group) to the Northeast Iowa area in the prevention and treatment of substance abuse resulting from drug and alcohol addiction, and to provide residential care for adult substance abusers. Presently, the Organization provides services from the following locations:

- (a) Three Waterloo facilities for Black Hawk County, which includes administrative offices, a Recovery House and a Sober Living Unit.
- (b) Waverly for Bremer County.
- (c) New Hampton for Chickasaw County.
- (d) Independence for Buchanan County.
- (e) Allison for Butler County.

BASIS OF PRESENTATION

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-For-Profit Organizations*. Under SFAS No. 117, the Organization 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. There were no permanently restricted net assets as of June 30, 2006 and 2005.

ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

CASH EQUIVALENTS

The Organization considers all highly liquid debt instruments with a maturity of three months or less to be cash equivalents.

TEMPORARY CASH INVESTMENTS

Temporary cash investments consist of certificates of deposit with maturities of less than one year.

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Cont'd.):

CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Organization to concentrations of credit risk consist principally of cash and cash equivalents, temporary cash investments and receivables. The Organization places its cash and cash equivalents and temporary cash investments with high credit quality financial institutions. At various times throughout the year, the Organization's cash and cash equivalents and temporary cash investments are in excess of the FDIC insurance limit.

Concentrations of credit risk with respect to client receivables are limited due to the Organization's large number of clients.

The Organization received 46% and 48% of its total revenue, gains and other support from one source for the years ended June 30, 2006 and 2005, respectively

CLIENT RECEIVABLES

Client receivables arise from services provided to clients based on the Organization's rates for service and a sliding fee scale. The Organization evaluates its need for an allowance for doubtful accounts by performing a review of outstanding receivables, historical collection information, and existing economic conditions. The allowance for doubtful accounts was \$88,253 and \$109,000 as of June 30, 2006 and 2005, respectively.

Normal client receivables are due 30 days after the issuance of the invoice. Receivables past due more than 90 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the customer. It is the Organization's policy not to accrue interest income on impaired client receivables.

NET CLIENT SERVICE REVENUE

Net client service revenue is reported at the estimated net realizable amounts from clients, third-party payers and others for services rendered.

PROPERTY AND EQUIPMENT

Property and equipment is carried at cost or fair value, if donated, with depreciation computed primarily under the straight-line method over the economic useful lives of the assets. The Organization follows the policy of capitalizing all property and equipment expenditures over \$500, unless general contract conditions call for a lower amount.

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Cont'd.):

RESTRICTED AND UNRESTRICTED REVENUE AND SUPPORT

Contributions and grant awards received are recorded as unrestricted or temporarily restricted support, depending on the existence and/or nature of any restrictions. Support that is restricted is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other restricted support is reported as an increase in temporarily restricted net assets. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

BOARD DESIGNATED RESERVE

The operating reserve is intended to assure continued funding of the Organization's operations, and represents two months of operating expenses.

INCOME TAXES

The Organization is a nonprofit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes pursuant to Section 501(a) of the Code.

ADVERTISING

Costs incurred for producing and communicating advertising are expensed when incurred and totaled \$3,202 and \$1,822 for the years ended June 30, 2006 and 2005, respectively.

NOTE 2 - CAMPAIGN RECEIVABLES:

Campaign receivables as of June 30, 2006 and 2005, are as follows:

	2006	2005
Receivable in less than one year	\$ 48,681	\$ 130,213
Receivable in one to five years	<u>7,000</u>	<u>35,388</u>
Total	<u>\$ 55,681</u>	<u>\$ 165,601</u>

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 2 - CAMPAIGN RECEIVABLES (Cont'd.):

The discount related to receivables expected to be collected in future years is not material to the financial statements.

NOTE 3 - PROPERTY AND EQUIPMENT:

A summary of property and equipment as of June 30, 2006 and 2005 follows:

	2006	2005
Land	\$ 320,266	\$ 320,266
Buildings and improvements	1,482,198	1,487,798
Furniture and fixtures	25,665	30,205
Equipment	<u>229,210</u>	<u>220,264</u>
	2,057,339	2,058,533
Less: Accumulated depreciation	<u>425,748</u>	<u>375,075</u>
	<u>\$1,631,591</u>	<u>\$1,683,458</u>

NOTE 4 - SUMMARY OF LONG-TERM DEBT:

	2006	2005
Variable rate mortgage note (interest rate of 4.99% and 6% as of June 30, 2006 and 2005, respectively) payable in monthly installments of \$4,995, including interest to July 1, 2007, collateralized by real estate.	\$ 220,848	\$ 471,602
Less: Current Portion	<u>45,753</u>	<u>29,659</u>
	<u>\$ 175,095</u>	<u>\$ 441,943</u>

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 4 - SUMMARY OF LONG-TERM DEBT (Cont'd.):

Maturities of long-term debt are as follows:

Year Ending	
2007	\$ 45,753
2008	<u>175,095</u>
Total	<u>\$ 220,848</u>

The Organization's variable rate bank note contains, among other provisions, requirements for maintaining a predetermined debt service coverage ratio.

NOTE 5 - TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets are available for the following purposes:

	2006	2005
Future periods	\$ 6,900	\$ 6,900
Assets held by Community Foundation	6,500	5,000
Grants	<u>24,346</u>	<u> </u>
	<u>\$ 37,746</u>	<u>\$ 11,900</u>

NOTE 6 - DESIGNATED AGENCY ENDOWMENT FUND:

The Organization has a beneficial interest in assets held by the Community Foundation of Waterloo and Northeast Iowa (the Foundation) in the amount of \$7,069 and \$5,307 as of June 30, 2006 and 2005, respectively. The Organization transferred \$1,500 to the designated agency endowment fund (the Fund) during 2006. The Organization has granted variance power to the Foundation in the event the Organization terminates or ceases to exist as a legal entity. The Fund's income is available to support the Organization's operations. As of June 30, 2006 and 2005, the Organization had a total of \$10,791 and \$7,389, respectively, in the Fund. No amounts were distributed to the Organization from the Foundation for the years ended June 30, 2006 and 2005.

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 7 - INVESTMENT RETURN:

A summary of the investment return and its classification in the statements of activities for the years ended June 30, 2006 and 2005, follows:

	2006	2005
Interest income	\$ 20,989	\$ 8,309
Net change in beneficial interest in assets held by Community Foundation	<u>262</u>	<u>279</u>
Total investment return	<u>\$ 21,251</u>	<u>\$ 8,588</u>

NOTE 8 - OTHER SERVICE REVENUE:

A summary of other service revenue included in the statements of activities for the years ended June 30, 2006 and 2005, follows:

	2006	2005
Federal, state and local Insurance companies	\$ 2,136,117	\$ 2,020,899
Medicaid	<u>78,713</u>	<u>86,022</u>
	<u>292,181</u>	<u>276,810</u>
	<u>\$ 2,507,011</u>	<u>\$ 2,383,731</u>

These revenues are based on capitation and fee for service rates, and direct cost reimbursement.

NOTE 9 - RETIREMENT PLAN:

The Organization has a 403(b) retirement plan covering substantially all full-time employees. Eligible employees may contribute a portion of their compensation to this Plan. The Organization will contribute an amount ranging from 1.5% to 7.5% of each covered employees' wages. For the years ended June 30, 2006 and 2005, the Organization charged against income \$70,863 and \$58,339, respectively, under this Plan.

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 10 - OPERATING LEASES:

The Organization conducts a portion of its operations from leased facilities under noncancellable operating leases. Certain leases include renewal options at the end of the lease term.

The following is a schedule by years of future minimum lease payments required under noncancellable operating leases as of June 30, 2006:

Year Ending June 30:

2007	\$ 16,340
2008	11,100
2009	<u>3,825</u>
Total Minimum Payments Required	<u>\$ 31,265</u>

Rent expense for all operating leases was \$25,728 and \$27,466 for the years ended June 30, 2006 and 2005, respectively.

NOTE 11 - DONATED MATERIALS AND SERVICES:

Donated materials are reflected as contributions in the accompanying statements at their estimated fair market value at date of receipt. No amounts have been reflected in the financial statements for donated services. The Organization pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the Organization with its operations.

NOTE 12 - CLASSIFICATION OF EXPENSES:

	2006	2005
Program	\$ 2,516,750	\$ 2,213,133
Management and general	327,095	344,430
Fundraising	<u>25,558</u>	<u>49,299</u>
	<u>\$ 2,869,403</u>	<u>\$ 2,606,862</u>

PATHWAYS BEHAVIORAL SERVICES, INC.

Notes to the Financial Statements

NOTE 13 - COMMITMENTS AND CONTINGENCIES:

Financial awards from federal and state governmental entities in the form of grants are subject to special audit. Such audits could result in claims against the Organization for disallowed costs or noncompliance with grantor restrictions. No provision has been made for any liabilities that may arise from such audits since the amounts, if any, cannot be determined at this date.

NOTE 14 - MERGER:

On October 24, 2005, the Board of Directors approved the merger of Cedar Valley Mental Health Center, Inc. into the operations of the Organization effective July 1, 2006.

SUPPLEMENTAL INFORMATION

PATHWAYS BEHAVIORAL SERVICES, INC.

Schedule of Expenditures of Federal Awards

For the year ended June 30, 2006

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<u>Department of Health and Human Services</u>		
Passed through the Iowa Department of Public Health:		
Block Grants for Prevention and Treatment of Substance Abuse	93.959	\$ 209,017 **
State Incentive Grant	93.230	48,841
Prevention of Methamphetamine Abuse	93.243	55,887
Drug Free Communities Support Program Grants	93.276	40,398
Juvenile Accountability Incentive Block Grants	16.523	16,338
Juvenile Justice and Delinquency Prevention Allocation to States	16.540	14,984
Title V Delinquency Prevention Program	16.548	1,955
Enforcing Underage Drinking Laws Program	16.727	15,823
Passed through the Iowa Department of Corrections:		
Byrne Formula Grant Program	16.579	60,455
Drug Court Discretionary Grant Program	16.585	35,646
Passed through Magellan Behavioral Health:		
Block Grants for Prevention and Treatment of Substance Abuse	93.959	1,222,034 **
		<hr/>
		<u>\$ 1,721,378</u>

** Includes federal and state funding

Basis of Presentation

The schedule of expenditures of federal awards includes the federal grant activity of Pathways Behavioral Services, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

PATHWAYS BEHAVIORAL SERVICES, INC.
 Schedule of Functional Expenses
 For the year ended June 30, 2006

	PROGRAM SERVICES					SUPPORT SERVICES				
	Recovery House	Treatment	Prevention	Adolescent Treatment	DECAT	Total Program Expenses	Management & General	Fundraising	Total Support Services	Total Expenses
Salaries and wages	\$ 290,112	\$ 1,020,522	\$ 226,029	\$ 34,571	\$ 11,191	\$ 1,582,425	\$ 171,295	\$ 14,597	\$ 185,892	\$ 1,768,317
Employee benefits & payroll taxes	77,135	307,120	60,764	8,089	3,129	456,237	48,059	4,695	52,754	508,991
Total Salaries and Related Expenses	367,247	1,327,642	286,793	42,660	14,320	2,038,662	219,354	19,292	238,646	2,277,308
Travel and training	2,539	12,317	13,909	3,838	914	33,517	1,946	216	2,162	35,679
Dues and subscriptions	1,340	4,594	492	198		6,624	5,035		5,035	11,659
Rent	35	23,415	280	1,141	857	25,728				25,728
Utilities	18,691	14,310	2,254	279	176	35,710	1,619		1,619	37,329
Telephone	4,401	15,947	1,996	579	367	23,290	1,092		1,092	24,382
Postage and shipping	388	5,173	445	155	114	6,275	351	625	976	7,251
Office supplies and equipment	6,025	32,006	12,812	1,117	89	52,049	3,575	2,139	5,714	57,763
Repairs and maintenance	14,445	15,158	5,307	426	119	35,455	3,970		3,970	39,425
Contract labor	4,480	7,277	45,312	229		57,298	3,000	244	3,244	60,542
Professional fees	839	6,432	83	411		7,765	11,061		11,061	18,826
Insurance	5,981	9,241	3,249	352		18,823	6,539		6,539	25,362
Educational materials, printing and public information	2,200	3,960	48,161			54,321	935	1,362	2,297	56,618
Groceries and household supplies	27,090					27,090				27,090
Miscellaneous	5,321	12,296	6,975	313	26	24,931	2,874	1,680	4,554	29,485
Interest							21,683		21,683	21,683
Legal and accounting		72				72	13,822		13,822	13,894
Total Expenses Before Depreciation	461,022	1,489,840	428,068	51,698	16,982	2,447,610	296,856	25,558	322,414	2,770,024
Depreciation	33,000	28,640	7,400	100		69,140	30,239		30,239	99,379
Total Expenses	\$ 494,022	\$ 1,518,480	\$ 435,468	\$ 51,798	\$ 16,982	\$ 2,516,750	\$ 327,095	\$ 25,558	\$ 352,653	\$ 2,869,403

**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***

To the Board of Directors of
Pathways Behavioral Services, Inc.

We have audited the financial statements of Pathways Behavioral Services, Inc. (a nonprofit organization) as of and for the year ended June 30, 2006, and have issued our report thereon dated November 27, 2006. 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 Pathways Behavioral Services, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways Behavioral Services, 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*.

We noted certain matters that we reported to management of Pathways Behavioral Services, Inc. in a separate letter dated November 27, 2006.

This report is intended solely for the information and use of the finance committee, board of directors, management, and 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.

Berge, Paterson & Company, P.C.

Waterloo, Iowa
November 27, 2006

**BERGAN, PAULSEN
& COMPANY, P.C.**

CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

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

To the Board of Directors of
Pathways Behavioral Services, Inc.

Compliance

We have audited the compliance of Pathways Behavioral Services, Inc. (a nonprofit organization) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2006. Pathways Behavioral Services, Inc.'s major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of Pathways Behavioral Services, Inc.'s management. Our responsibility is to express an opinion on Pathways Behavioral Services, 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, *Audits of States, Local Governments, and Non-Profit Organizations*. 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 Pathways Behavioral Services, 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 Pathways Behavioral Services, Inc.'s compliance with those requirements.

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In our opinion, Pathways Behavioral Services, Inc. complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Pathways Behavioral Services, 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 Pathways Behavioral Services, Inc.'s internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the finance committee, board of directors, management, and 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.

Berg, Pfenner & Company, P.C.

Waterloo, Iowa
November 27, 2006

PATHWAYS BEHAVIORAL SERVICES, INC.

Schedule of Findings and Questioned Costs

For the year ended June 30, 2006

Part I: Summary of Independent Auditor's Results

1. The auditor's report expresses an unqualified opinion on the financial statements of Pathways Behavioral Services, Inc.
2. The audit of the financial statements did not disclose any reportable conditions regarding internal control.
3. No instances of noncompliance material to the financial statements of Pathways Behavioral Services, Inc. were disclosed during the audit.
4. The audit did not disclose any reportable conditions in internal control over the major federal award program.
5. The auditor's report on compliance for the major federal award program for Pathways Behavioral Services, Inc. expresses an unqualified opinion on the major federal program.
6. The audit did not disclose any audit findings relative to the major federal award program which are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
7. The only major program is CFDA Number 93.959 - Comprehensive Treatment and Prevention.
8. The dollar threshold used to distinguish between Type A and Type B programs was \$300,000.
9. Pathways Behavioral Services, Inc. did not qualify as a low-risk auditee.

Part II: Findings Related to the Financial Statements

There were no findings related to the financial statements as of June 30, 2006.

Part III: Findings and Questioned Costs for Federal Awards

The audit did not disclose audit findings which are required to be reported in accordance with OMB Circular A-133.

Part IV: Status of Prior Year Findings and Questioned Costs for Federal Awards

For the year ended June 30, 2005, there were no findings and questioned costs.