

Neighborhood House Association

**Financial Statements
and Supplementary Information in
Accordance with Office of Management
and Budget Circular A-133**

**Year Ended June 30, 2010
(with summarized financial information for 2009)**

NEIGHBORHOOD HOUSE ASSOCIATION

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Report of Independent Public Accountants

To the Audit Committee
Neighborhood House Association


We have audited the accompanying statement of financial position of Neighborhood House Association ("NHA") as of June 30, 2010, and the related statements of activities, cash flows and functional expenses for the year then ended. These financial statements are the responsibility of NHA's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative financial information has been derived from NHA's 2009 financial statements, and in our report dated November 12, 2009, we expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated November 3, 2010, on our consideration of NHA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or 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 audit was conducted for the purpose of forming an opinion on the 2010 basic financial statements taken as a whole. The accompanying schedule of expenditures of Federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations* and is not a required part of the 2010 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2010 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the 2010 basic financial statements taken as a whole.


San Diego, California
November 3, 2010

NEIGHBORHOOD HOUSE ASSOCIATION
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2010
(with comparative financial information for 2009)

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
Current assets:		
Cash and cash equivalents (Note 12)	\$ 6,219,762	\$ 4,685,356
Investments (Notes 2 and 16)	39,752	39,752
Grants and contracts receivable (Note 3)	5,221,121	1,888,653
Other accounts receivable	210,474	1,831,401
Operating advances	557,315	290,333
Prepaid expenses	403,604	200,030
Total current assets	<u>12,652,028</u>	<u>8,935,525</u>
Property and equipment (Note 4):		
Property and equipment	24,777,144	25,593,043
Less: accumulated depreciation and amortization	<u>(17,647,840)</u>	<u>(17,741,987)</u>
Total property and equipment	7,129,304	7,851,056
Deposits	<u>69,435</u>	<u>69,435</u>
Total assets	<u>\$ 19,850,767</u>	<u>\$ 16,856,016</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accrued payroll and related liabilities	\$ 743,304	\$ 585,731
Accounts payable and accrued expenses	4,778,726	1,613,880
Deferred revenue	20,808	23,168
Accrued annual leave	2,407,229	1,790,692
Current portion of long-term debt (Note 6)	248,168	238,890
Current portion of capital lease obligations	-	165,395
Other current liabilities	393,791	309,206
Total current liabilities	<u>8,592,026</u>	<u>4,726,962</u>
Long-term debt, net of current portion (Note 6)	<u>2,734,744</u>	<u>2,982,437</u>
Total non-current liabilities	<u>2,734,744</u>	<u>2,982,437</u>
Total liabilities	<u>11,326,770</u>	<u>7,709,399</u>
Commitments and contingencies (Notes 7 and 8)		
Net assets:		
Unrestricted	<u>8,523,997</u>	<u>9,146,617</u>
Total net assets	<u>8,523,997</u>	<u>9,146,617</u>
Total liabilities and net assets	<u>\$ 19,850,767</u>	<u>\$ 16,856,016</u>

See Notes to Financial Statements.

NEIGHBORHOOD HOUSE ASSOCIATION
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2010
(with comparative financial information for 2009)

	2010	2009
Changes in unrestricted net assets:		
Revenues and support:		
Grants and contracts (Note 9)	\$ 81,560,914	\$ 75,437,547
Food reimbursements	1,200,961	1,643,966
Reimbursements from partners	943,837	1,190,568
Contributions and donations	615,928	538,637
Service fees	912,529	972,854
Special events	140,302	101,700
Investment return and interest income	10,688	51,606
Other revenues	449,197	2,671,806
In-kind rental income	-	699,306
Total unrestricted revenues and support	85,834,356	83,307,990
Expenses:		
Program services	78,785,568	75,611,492
Supporting services:		
Fundraising	695	1,021
Management and general	7,586,128	7,921,912
Total expenses	86,372,391	83,534,425
Change in unrestricted net assets from continuing operations before loss on interest rate swap	(538,035)	(226,435)
Loss on mark-to-market of interest rate swap	(84,585)	(169,873)
Change in unrestricted net assets from continuing operations:	(622,620)	(396,308)
Discontinued operations:		
Loss on disposal of discontinued operations (Note 15)	-	(2,874,430)
Total discontinued operations	-	(2,874,430)
Change in unrestricted net assets	(622,620)	(3,270,738)
Change in net assets	(622,620)	(3,270,738)
Net assets at beginning of year	9,146,617	12,417,355
Net assets at end of year	\$ 8,523,997	\$ 9,146,617

See Notes to Financial Statements.

NEIGHBORHOOD HOUSE ASSOCIATION
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2010
(with comparative financial information for 2009)

	2010	2009
Operating activities:		
Change in net assets	\$ (622,620)	\$ (3,270,738)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	918,235	1,330,617
Bad debt expense	-	207
Loss on mark-to-market of interest rate swap	84,585	169,873
Loss on disposal of equipment	7,402	-
Loss on disposal of discontinued operations	-	2,874,430
Change in operating assets and liabilities:		
Grants and contracts receivable	(3,332,468)	1,975,251
Other accounts receivable	1,620,927	(1,692,070)
Prepaid expenses	(203,574)	(123,553)
Operating advances	(266,982)	(36,745)
Deposits	-	82,739
Accounts payable and accrued expenses	3,164,846	(804,395)
Accrued payroll and related liabilities	157,573	(1,011,629)
Accrued annual leave	616,537	(1,562,134)
Deferred revenue	(2,360)	(274,243)
Net cash provided by (used in) operating activities	2,142,101	(2,342,390)
Investing activities:		
Purchases of property and equipment	(203,885)	(77,303)
Proceeds from maturity of certificates of deposit	-	2,544,801
Proceeds from sale of property	-	4,124,271
Net cash provided by (used in) investing activities	(203,885)	6,591,769
Financing activities:		
Principal repayments on capital lease obligations	(165,395)	(276,004)
Repayments on long-term debt	(238,415)	(3,792,058)
Net cash used in financing activities	(403,810)	(4,068,062)
Net increase in cash and cash equivalents	1,534,406	181,317
Cash and cash equivalents at beginning of year	4,685,356	4,504,039
Cash and cash equivalents at end of year	\$ 6,219,762	\$ 4,685,356
Cash paid for interest	\$ 128,891	\$ 248,016

See Notes to Financial Statements.

NEIGHBORHOOD HOUSE ASSOCIATION

STATEMENT OF FUNCTIONAL EXPENSES YEAR ENDED JUNE 30, 2010 (with summarized financial information for 2009)

	Program Services			Supporting Services		Total Expenses	
	Childcare Programs	Health and Nutrition Programs	Youth and Other Services	Fundraising	Management and General	2010	2009
Salaries	\$ 17,608,852	\$ 1,590,371	\$ 314,858	\$ -	\$ 3,636,700	\$ 23,150,781	\$ 27,669,927
Fringe benefits	7,979,386	730,513	94,497	-	1,384,894	10,189,290	8,974,670
Contracted services	790,851	123,164	119,972	-	1,204,814	2,238,801	2,648,841
Supplies	1,122,592	97,526	19,100	-	86,991	1,326,209	1,932,859
Telephone and pagers	317,562	44,014	40,968	-	92,121	494,665	522,378
Postage	6,119	523	30	-	4,258	10,930	22,606
Occupancy and storage	2,430,043	305,541	(308,159)	-	101,190	2,528,615	2,928,773
Utilities	275,546	31,358	61,026	-	50,750	418,680	512,244
Printing, publications and advertising	78,459	826	3,344	-	29,147	111,776	170,016
Travel and meetings	772,006	144,166	7,552	-	254,526	1,178,250	941,218
Subcontracts	39,850,787	33,694	-	-	20,430	39,904,911	31,499,505
Food expense	1,134,964	134,718	8,561	-	38,549	1,316,792	1,600,355
Client assistance	101,867	45,743	34,868	-	14,376	196,854	244,134
Equipment expense	904,101	45,717	4,243	-	141,325	1,095,386	383,134
Minor renovations	57,529	36,058	-	-	-	93,587	-
Depreciation and amortization	751,066	-	-	-	167,169	918,235	1,330,208
Insurance	354,610	28,609	2,063	-	100,501	485,783	647,186
Direct fundraising expenses	-	-	-	695	-	695	21,801
Interest and fees	39,360	6,875	102,777	-	124,253	273,265	458,777
In-kind donation	-	-	-	-	-	-	699,306
Other expenses	170,608	3,300	130,844	-	134,134	438,886	326,487
Indirect cost	6,735,953	378,959	11,202	-	(7,126,114)	-	-
Subtotal	81,482,261	3,781,675	647,746	695	460,014	86,372,391	83,534,425
Less: indirect allocation	(6,735,953)	(378,959)	(11,202)	-	7,126,114	-	-
Total expenses by function	\$ 74,746,308	\$ 3,402,716	\$ 636,544	\$ 695	\$ 7,586,128	\$ 86,372,391	\$ 83,534,425

See Notes to Financial Statements.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and significant accounting policies:

General:

Neighborhood House Association ("NHA") is a California nonprofit corporation organized to provide an extensive network of services to residents of San Diego County.

NHA provides comprehensive health and human services through programs that include child development, family day care, senior nutrition, adult day health care, mental health services, housing and rental assistance and other related services that assist low-income and less fortunate families.

Pursuant to an agreement with the Federal Department of Health and Human Services, NHA agreed to a voluntary relinquishment of 20% of its service area in September of 2008. NHA has also revised its service delivery model. From a risk assessment plan, NHA has moved to reduce its direct service operations by partnering with other child care providers in San Diego County.

Basis of accounting:

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with guidance for financial statements of Not-for-Profit Organizations. Under this guidance, NHA 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. NHA does not have any temporarily or permanently restricted assets.

NHA classifies its net assets and its revenues, gains and other support, based on the existence or absence of donor-imposed restrictions. Temporarily restricted net assets result from contributions whose use is limited by donor stipulations that either expire with the passage of time or can be fulfilled and removed by actions of NHA pursuant to those stipulations. Unrestricted net assets represent resources over which the board of directors has discretionary control.

Revenue and support:

Contributions and support are recognized in the period in which NHA receives a promise to give that is, in substance, unconditional. Support that is restricted by the donor 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 donor-restricted support is reported as an increase in temporarily restricted or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets and reclassified to unrestricted net assets.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and significant accounting policies (continued):

Revenue and support (concluded):

Accounts receivable are stated at unpaid balances, less an allowance for doubtful accounts. NHA provides for losses on accounts receivable by calculating an allowance for uncollectible receivables. The allowance is based on experience, third-party contracts and other circumstances. As of June 30, 2010 and 2009, no allowance was deemed necessary. Receivables are considered impaired if full principal payments are not received in accordance with the contractual terms. It is NHA's policy to charge off uncollectible accounts receivable when management determines the receivable will not be collected.

Support from grants and contracts is recognized in the period in which terms of the grant or contractual agreements have been met, and the revenue earned.

Donated goods and services:

Contributions of services are recognized when they are received if the services (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not donated. During 2010 and 2009, the value of contributed services recognized as revenues in the accompanying financial statements was approximately \$398,000, which included ophthalmology services and related use of supplies and equipment.

In addition, a substantial number of volunteers donated their time to NHA's program services during the year; however, the value of these donated services is not reflected in the financial statements, as the requirements for recognition have not been met.

Cash and cash equivalents:

NHA considers all highly-liquid investments with an original maturity of three months or less to be cash equivalents.

Investments:

NHA invests in certificates of deposit issued by various banks in order to qualify for full insurance coverage provided by the Federal Deposit Insurance Corporation ("FDIC"). Investments in marketable securities are carried at fair value, with realized and unrealized gains and losses included in the statement of activities.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and significant accounting policies (continued):

Derivatives:

NHA makes limited use of derivative instruments for the purpose of managing interest rate risks. Interest rate swap agreements are used to convert NHA's floating rate long-term debt to a fixed rate. NHA recognizes all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. Changes in fair value of those instruments are reported in the statement of activities.

Debt issue costs:

Debt issue costs consist primarily of loan fees which are capitalized and amortized over the term of the loan using the straight-line method.

Property and equipment:

Property and equipment with an acquisition cost of \$5,000 or greater is capitalized at cost and depreciated using the straight-line method over its estimated useful life. Leasehold improvements are amortized over the shorter of the useful life or the lease term. Useful lives are as follows:

<u>Description</u>	<u>Useful Life</u>
Buildings	15-30 years
Building improvements	3-10 years
Leasehold improvements	3-15 years
Vehicles	5 years
Furniture and equipment	3-5 years
Computer equipment	3-5 years

Income taxes:

NHA is a private, nonprofit agency organized under the laws of the State of California and is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code.

Advertising:

NHA expenses advertising costs as incurred. Advertising costs for the years ended June 30, 2010 and 2009 were approximately \$27,000 and \$55,000, respectively.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and significant accounting policies (concluded):

Functional expenses:

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of functional expenses. Accordingly, certain costs have been allocated among the program and supporting services benefited.

Use of 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.

New accounting pronouncements:

In January 2010, the Financial Accounting Standards Board ("FASB") issued ASU No. 2010-06, Improving Disclosures about Fair Value Measurements ("ASU 2010-06"). ASU 2010-06 amends FASB ASC 820, Fair Value Measurements and Disclosures, to require additional disclosures regarding fair value measurements. The new disclosures and clarifications of existing disclosures are effective for the reporting period beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward activity of Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010. Management believes that adopting this guidance will not have a significant impact on NHA's financial position or results of operations.

Reclassifications:

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation

Subsequent events:

Subsequent events have been evaluated through November 3, 2010, which is the date the financial statements were available to be issued.

Note 2 - Investments:

Investments consist of equity and other securities with an approximate fair value of \$39,752 at June 30, 2010 and 2009. Fair values have been determined by reference to the most recent market quotations for the respective investments.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 3 - Grants and contracts receivable:

At June 30, 2010 and 2009, grants and contracts receivable consisted of the following:

	2010	2009
Head Start	\$ 3,848,984	\$ 185,123
State programs	549,479	972,403
County programs	468,775	480,084
Food reimbursements	320,212	238,195
Other programs	33,671	12,848
Totals	\$ 5,221,121	\$ 1,888,653

Note 4 - Property and equipment:

Property and equipment acquired by NHA with funds from award programs is considered to be owned by NHA while used in the program for which it was purchased and in other authorized programs. However, funding sources have reversionary interest in the property and in its disposition (i.e., the asset is returned to the Federal government upon disposal or if no longer in-use), as well as the ownership of any proceeds which are subject to pertinent regulations. The net book value of reversionary assets as of June 30, 2010 and 2009 are \$2,798,544 and \$3,625,135, respectively.

Property and equipment as of June 30, 2010 consists of the following:

	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 1,317,475	\$ -	\$ 1,317,475
Building	5,270,903	2,024,309	3,246,594
Building improvements	654,986	650,989	3,997
Leasehold improvements	8,784,733	6,979,711	1,805,022
Vehicles	3,122,780	3,112,327	10,453
Furniture and equipment	5,218,528	4,474,493	744,035
Computer equipment	407,739	406,011	1,728
Totals	\$ 24,777,144	\$ 17,647,840	\$ 7,129,304

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 4 - Property and equipment (concluded):

Property and equipment as of June 30, 2009 consists of the following:

	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 1,317,476	\$ -	\$ 1,317,476
Building	5,270,903	1,832,516	3,438,387
Building improvements	654,985	650,988	3,997
Leasehold improvements	8,632,300	6,613,455	2,018,845
Vehicles	4,142,563	4,013,538	129,025
Furniture and equipment	4,150,325	3,469,795	680,530
Equipment acquired with capital leases	1,016,752	760,792	255,960
Computer equipment	407,739	400,903	6,836
Totals	<u>\$ 25,593,043</u>	<u>\$ 17,741,987</u>	<u>\$ 7,851,056</u>

A significant portion of NHA's property and equipment is identified as collateral for certain long-term debt as described at Note 6. During fiscal 2009, NHA sold certain land and a building related to a discontinued operation (see Note 15).

Note 5 - Line of credit:

NHA has a \$1,500,000 unsecured line of credit with Union Bank of California which expires on February 1, 2011 and requires monthly interest payments with interest at the bank's reference rate (3.25% at June 30, 2010). At June 30, 2010 and 2009, there was no balance outstanding. The line of credit requires that NHA maintain certain loan covenants for which NHA was in compliance with at June 30, 2010.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 6 - Long-term debt:

Long-term debt consists of the following:

	2010	2009
<p>Note payable to Union Bank of California in monthly installments of principal and interest, with a variable interest rate of LIBOR plus 1.5%. The interest rate as of June 30, 2010 was 1.85%. The loan commenced on May 1, 2005 and matures on April 1, 2020. The note is secured by a Deed of Trust covering real property located at 5660 Copley Drive, San Diego, California. (A)</p>	\$ 2,602,060	\$ 2,779,334
<p>Note payable to Neighborhood National Bank in monthly installments of principal and interest, with a variable interest rate at The Wall Street Journal Prime rate plus 1.5%. The interest rate as of June 30, 2010 was 4.75%. The loan commenced on November 2, 2004 and matures on November 2, 2014. The note is secured by a Deed of Trust covering real property located at 802-804 San Pasqual Street, San Diego, California.</p>	138,330	165,787
<p>Note payable to Union Bank of California in monthly installments of principal and interest at a fixed rate of 8.63%. The loan commenced on September 26, 2000 and matures on November 1, 2015. The note is secured by a Deed of Trust covering real property located at 835 N. Hickory Street, Escondido, California.</p>	242,522	276,206
	2,982,912	3,221,327
Less current portion	(248,168)	(238,890)
Long-term debt	\$ 2,734,744	\$ 2,982,437

(A) On May 1, 2005, NHA entered into an interest rate swap agreement with Union Bank of California to reduce exposure to the floating interest rate of LIBOR plus 1.5% (1.85% at June 30, 2010). The agreement sets the interest rate at a fixed rate of 5.15% starting with a notional amount of \$2,601,534 that declines monthly through the term expiring April 1, 2020. At June 30, 2010, the estimated fair value of the interest rate swap agreement was a liability of \$393,791. The change in the fair value of the interest rate swap agreement for the years ended June 30, 2010 and 2009 totaled \$84,585 and \$169,873, respectively, and is included as a nonoperating loss in the statements of activities.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 6 - Long-term debt (concluded):

Maturities of long-term debt in each of the five years subsequent to June 30, 2010 and thereafter are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 248,168
2012	274,594
2013	295,036
2014	316,993
2015	339,509
Thereafter	<u>1,508,612</u>
Total	<u>\$ 2,982,912</u>

Note 7 - Operating lease commitments:

NHA occupies numerous facilities under operating lease agreements that expire at various dates through September 2019. The future minimum payments under these operating leases for each of the five years subsequent to June 30, 2010 and thereafter are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 1,547,565
2012	1,325,116
2013	930,821
2014	630,700
2015	244,606
Thereafter	<u>859,831</u>
Total	<u>\$ 5,538,639</u>

Total operating lease expense for the years ended June 30, 2010 and 2009 was \$1,692,426 and \$1,644,592, respectively.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 8 - Legal matters:

NHA is involved in various claims arising from the normal course of operating its programs and activities, none of which in the opinion of management or NHA's legal counsel, will have a material adverse effect on the financial position or results of operations of NHA.

Note 9 - Grants and contracts revenues:

In the fiscal years ended June 30, 2010 and 2009, NHA recognized grants and contract revenues from the following sources:

	<u>2010</u>	<u>2009</u>
Head Start program ⁽¹⁾	\$ 74,051,967	\$ 70,196,321
State programs	4,853,062	2,726,067
County programs	2,607,343	2,470,312
Other programs	<u>48,542</u>	<u>44,847</u>
Total grants and contracts	<u>\$ 81,560,914</u>	<u>\$ 75,437,547</u>

⁽¹⁾ Difference in Head Start program revenues to amount included on the schedule of expenditures of Federal awards relates to the American Reinvestment and Recovery Act ("ARRA") and capital expenditures.

Note 10- 401(k) plan:

NHA has a defined contribution 401(k) plan covering regular full-time employees. NHA's contribution to the 401(k) plan is based upon a maximum of 6% of the salaries of those employees participating in the plan. Employees covered by the plan have a mandatory contribution of 3% of their respective gross salaries, and can make additional voluntary contributions not to exceed \$16,500 for the tax year ending December 31, 2010. Also, employees age 50 or over by the end of the plan year are allowed to make up to \$5,500 of additional contributions to the 401(k) plan, in excess of the standard limits. The 401(k) plan is administered by a private pension company. Employer contributions charged to operations for the years ended June 30, 2010 and 2009 were \$1,051,569 and \$1,107,749, respectively.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 11- Indirect costs:

NHA has negotiated and obtained the following indirect cost rates from the U.S. Department of Health and Human Services, the Federal cognizant agency:

	<u>Provisional 2010</u>	<u>Final 2009</u>
All programs	10.8%	10.8%
Delegate agencies	0.2%	0.2%

Indirect costs are charged to the programs in accordance with negotiated rates or specific budgetary limits. The amounts charged for the years ended June 30, 2010 and 2009 were \$7,126,114 and \$6,949,657, respectively.

Note 12- Concentration of credit risk:

Financial instruments which potentially subject NHA to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. NHA maintains its cash and cash equivalents with high-credit quality institutions. At times, such amounts may exceed Federally insured limits. However, to minimize the risk the funds are diversified among various financial institutions.

NHA has approximately eleven government contracts in fiscal year 2010 from Federal, State and local sources. The largest contract was for the Federal Head Start program totaling \$74,051,967. Included in grants and contracts receivable at June 30, 2010 is \$3,848,985 related to this contract.

Note 13- Union contract:

Most non-management personnel (representing 50% of total employees) of NHA are members of the Service Employees International Union, Local #2028. NHA's contract with the union was in effect through June 30, 2010, and continues to be in effect from year to year thereafter, unless either party terminates the contract. NHA's other employees are not represented by a union.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 14- Subcontracts expense:

Subcontracts expense for the fiscal years ended June 30, 2010 and 2009 included the following:

	<u>2010</u>	<u>2009</u>
Head Start delegate agencies	\$ 21,369,548	\$ 19,691,105
Head Start partners	18,299,446	10,455,407
Head Start/child development day care providers	202,223	1,319,506
Health and nutrition programs	<u>33,694</u>	<u>33,487</u>
Totals	<u>\$ 39,904,911</u>	<u>\$ 31,499,505</u>

Note 15- Discontinued operations:

NHA established the San Diego Food Bank Corporation ("SDFB") program in 1977 and continued to operate the program until July 1, 2007, when the program and certain operational assets were transferred to SDFB, an unrelated entity. Not included in this original transfer was the NHA owned building and land at 9850 Distribution Avenue, in San Diego, California utilized by the SDFB.

SDFB was given use of approximately 67,241 square feet of the building (not including common areas) and all improvements in exchange for consideration of \$1 per year for the three year period commencing on July 1, 2007. The fair value for the rent attributable to this space is considered a donation to SDFB from NHA. The value of the in-kind donated rent was \$0 and \$699,306 for the years ended June 30, 2010 and 2009, respectively.

On February 26, 2009, NHA sold the land, building and improvements at 9850 Distribution Avenue to SDFB for total consideration of approximately \$4.1 million, including settlement of the associated note payable for \$3.5 million and approximately \$588,000 in net cash proceeds. The net book value of the land, building, improvements and related furniture and equipment was approximately \$6.9 million, and the net loss related to this disposal was approximately \$2.8 million, which is included in the loss on disposal of discontinued operations.

In the first half of fiscal 2009, NHA completed a voluntary relinquishment of 20% of its Head Start program service area to an unrelated Head Start program operator, including the transfer of leases, child care licenses, staff, supplies and fixed assets. The net book value of the transferred assets was approximately \$118,000, which is included in the loss on disposal of discontinued operations.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 16- Fair value measurements:

NHA values its financial assets and liabilities based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in inactive markets or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, NHA utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value at June 30, 2010 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Equity securities	\$ 29,752	\$ -	\$ -	\$ 29,752
Investment in stock of a local bank	-	-	10,000	10,000
Total assets at fair value	\$ 29,752	\$ -	\$ 10,000	\$ 39,752
Interest rate swap derivative liability		\$ 393,791		\$ 393,791

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 16- Fair value measurements (concluded):

Investments in equity securities are valued using market prices on active markets (Level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

The investment in common stock of a local bank is designated as a Level 3 instrument due to inherent limitations on the availability of market data. Management believes that the investment's cost fairly approximates its fair value as of June 30, 2010 and 2009.

The fair value of the interest rate swap is determined using observable market inputs such as current interest rates, and considers nonperformance risk of the company and that of its counterparties.

SUPPLEMENTARY INFORMATION

NEIGHBORHOOD HOUSE ASSOCIATION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED JUNE 30, 2010

<u>Federal Grantor / Pass-Through Grantor / Program Title</u>	<u>Federal CFDA Number</u>	<u>Award Number</u>	<u>Net Federal Program Expenditures</u>
<u>U.S. Department of Health and Human Services</u>			
Head Start Program	93.600	09CH7015/44	\$ 71,182,519
American Reinvestment and Recovery Act (ARRA)	93.708	09SE701501	2,869,448
Passed through from the County of San Diego			
Senior Nutrition Program - Supportive Services	93.044	513862	19,860
Senior Nutrition Program - Nutrition Services	93.045	513862	139,996
Senior Nutrition Program - Nutrition Services Incentive Program	93.053	513862	22,328
Senior Nutrition Program - ARRA C-1	93.707	513862	6,842
Senior Nutrition Program - ARRA C-2	93.705	513862	5,725
HIV Case Management	93.914	518041	342,939 ⁽¹⁾
HIV/AIDS Transportation Services	93.914	512326	310,776 ⁽¹⁾
Passed through from the State of California			
Department of Education			
Instructional Materials	93.575	CIMS-9524	1,781
Department of Health Services			
Community Challenge Grant Program	93.558	05-45295	<u>204,327</u>
Total Department of Health and Human Services			<u>75,106,541</u>
<u>U.S. Department of Agriculture</u>			
Passed through from the State Department of Education			
Child and Adult Care Food Program			
Child Care Centers	10.558	37-1564-3A	1,089,275 ^{(3) (2)}
Adult Day Care	10.558	37-5030-1N	<u>45,689 ⁽²⁾</u>
Total Department of Agriculture			<u>1,134,964</u>
<u>U.S. Department of Housing and Urban Development</u>			
Housing Counseling Programs	14.169	HC090921003	39,228 ⁽²⁾
Housing Counseling Programs	14.169	HC090923001	<u>9,314 ⁽²⁾</u>
Total Expenditures of Federal Awards			<u>\$ 76,290,047</u>

Notes:

⁽¹⁾ Program year - March 2009-February 2010

⁽²⁾ Program year - October 2009-September 2010

⁽³⁾ Less state portion of \$65,996

Value of non-cash assistance (in - kind)	\$ 32,090,208
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Amount of insurance in effect during the year	355,726
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Loan guarantees outstanding at year - end - Head Start only	380,852
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See Accompanying Notes to Schedule of Expenditures of Federal Awards.
See Report of Independent Public Accountants.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1 - Organization and significant accounting policies:

General:

Neighborhood House Association ("NHA") is a California nonprofit corporation organized to provide an extensive network of services to residents of San Diego County.

NHA provides comprehensive health and human services through programs that include child development, family day care, senior nutrition, adult day health care, mental health services, housing and rental assistance and other related services that assist low-income and less fortunate families.

Basis of presentation:

The accompanying schedule of expenditures of Federal awards includes the Federal grant activity of NHA, and is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

Program revenues:

Revenues from award programs are recognized in the period in which terms of the grant or contractual agreements have been met and the revenue earned.

Noncash awards:

Noncash awards are recorded and reflected in the accompanying schedule of expenditures of Federal awards at their fair values at the time of receipt, or the assessed value provided by NHA.

Net program expenditures:

It is the policy of NHA to record expenditures in the period incurred in accordance with the accrual basis of accounting. Where applicable, Federal expenditures are reflected net of other income sources.

NEIGHBORHOOD HOUSE ASSOCIATION

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 2 - Federal contracts:

Reconciliation of Reported and Audited Expenses:

<u>Program</u>	<u>Program Expenses</u>
Reconciliation of Child Care Food Program Revenue:	
Amount shown on the Schedule of Expenditures of Federal Awards	\$ 1,089,275
Add: State portion not included in SEFA	<u>65,996</u>
Total Child Care Food Program Revenue Reimbursed	<u>\$ 1,155,271</u>
Reconciliation of Head Start Revenue:	
Amount shown on the Schedule of Expenditures of Federal Awards	\$ 74,051,967
Add: obligations liquidated after June 30, 2010	<u>1,313,456</u>
Total Head Start Expensed Reports on the SF-269	<u>\$ 75,365,423</u>

Note 3 - Disclosure of audit fees:

In accordance with the audit disclosure requirements of the State of California, Department of Education, the audit contract for NHA for the fiscal year ended June 30, 2010 included an audit fee of \$130,000.

**Report of Independent Public Accountants 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 Audit Committee
Neighborhood House Association

We have audited the financial statements of Neighborhood House Association ("NHA") as of and for the year ended June 30, 2010, and have issued our report thereon, dated November 3, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A deficiency in internal control exists when the design or operation of control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the Board of Directors, the Audit Committee, 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.

J.H. Cohn LLP

San Diego, California
November 3, 2010

**Report of Independent Public Accountants on Compliance with
Requirements That Could Have a Direct and Material Effect
on Each Major Program and on Internal Control over
Compliance in Accordance with OMB Circular A-133**

To the Audit Committee
Neighborhood House Association

Compliance

We have audited the compliance of Neighborhood House Association ("NHA") with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of NHA's major governmental programs for the year ended June 30, 2010. NHA's major governmental programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major governmental programs is the responsibility of NHA's management. Our responsibility is to express an opinion on NHA'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 NHA'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 on NHA's compliance with those requirements.

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

Internal Control over Compliance

Management of NHA is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to governmental programs. In planning and performing our audit, we considered NHA's internal control over compliance with requirements that could have a direct and material effect on a major governmental program to determine the auditing procedures for the purpose of expressing our opinion on compliance, 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 NHA's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a governmental program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of control deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended for the information and use of the Board of Directors, the Audit Committee, 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.

J.H. Cohn LLP

San Diego, California
November 3, 2010

NEIGHBORHOOD HOUSE ASSOCIATION

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2010**

Part I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: unqualified
 Internal control over financial reporting:
 Material weaknesses identified? _____yes X no
 Significant deficiencies identified not considered
 to be material weaknesses? _____yes X none reported
 Noncompliance material to financial statements noted? _____yes X no

Federal Awards

Internal control over major programs:
 Material weaknesses identified? _____yes X no
 Significant deficiencies identified not considered
 to be material weaknesses? _____yes X none reported

Type of auditor's report issued on compliance
 for major programs: unqualified

Any audit findings disclosed that are required to be
 reported in accordance with Section .510(a) of
 Circular A-133? _____yes X no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>	<u>Amount</u>
93.600	Head Start	\$ 71,182,519
93.708	American Reinvestment and Recovery Act (ARRA)	\$ 2,869,448 ^(a)

(a) These funds were granted for the Head Start Program.

Dollar threshold used to distinguish between
 Type A and Type B programs: \$2,300,000

Auditee qualified as low-risk auditee? X yes _____no

NEIGHBORHOOD HOUSE ASSOCIATION

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED JUNE 30, 2010

Part II - Financial Statement Findings Section

This section identifies the significant deficiencies, material weaknesses and instances of noncompliance related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

No such items.

Part III - Federal Award Findings and Questioned Costs Section

This section identifies the audit findings required to be reported by Circular A-133 Section .510(a) (for example, significant deficiencies, material weaknesses and material instances of noncompliance, including questioned costs), as well as any abuse findings involving Federal awards that are material to a major program.

No such items.