

**Neighborhood House Association**

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

**Years Ended June 30, 2012 and 2011**

# NEIGHBORHOOD HOUSE ASSOCIATION

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## **Report of Independent Public Accountants**

To the Audit Committee  
Neighborhood House Association

We have audited the accompanying statements of financial position of Neighborhood House Association ("NHA") as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. We have also audited the statement of functional expenses for the year ended June 30, 2012 (with summarized financial information for 2011). These financial statements are the responsibility of NHA'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 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 NHA as of June 30, 2012 and 2011, and the changes in its net assets and 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 5, 2012, on our consideration of NHA'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 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 as a whole. The accompanying schedules of expenditures of Federal and state awards are 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 are not a required part of the basic 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 2012 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2012 basic 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 schedules of expenditures of Federal and state awards are fairly presented in all material respects in relation to the 2012 basic financial statements as a whole.

*CohnReznick LLP*

San Diego, California  
November 5, 2012

## NEIGHBORHOOD HOUSE ASSOCIATION

### STATEMENTS OF FINANCIAL POSITION JUNE 30, 2012 AND 2011

	2012	2011
Current assets:		
Cash and cash equivalents (Note 14)	\$ 5,317,554	\$ 4,885,849
Investments (Notes 2 and 17)	73,131	29,751
Grants and contracts receivable (Note 4)	4,362,157	5,321,724
Other accounts receivable, less allowance for doubtful accounts of \$0 and \$71,347	311,907	252,287
Operating advances	10,988	373,486
Prepaid expenses	24,337	65,187
Total current assets	10,100,074	10,928,284
Property and equipment (Note 5):		
Property and equipment	23,792,889	25,225,086
Less: accumulated depreciation and amortization	(17,446,479)	(18,010,125)
Total property and equipment, net	6,346,410	7,214,961
Deposits	69,435	69,435
Total assets	\$ 16,515,919	\$ 18,212,680
<b><u>LIABILITIES AND NET ASSETS</u></b>		
Current liabilities:		
Accrued payroll and related liabilities	\$ 1,127,169	\$ 1,034,308
Accounts payable and accrued expenses	3,411,784	2,797,879
Accrued annual leave (Note 6)	2,377,361	2,392,738
Current portion of long-term debt (Note 8)	2,237,870	264,873
Interest rate swap agreement (Note 17)	398,865	338,835
Total current liabilities	9,553,049	6,828,633
Long-term debt, net of current portion (Note 8)	47,982	2,461,683
Total liabilities	9,601,031	9,290,316
Commitments and contingencies		
Net assets:		
Unrestricted	6,914,888	8,922,364
Total net assets	6,914,888	8,922,364
Total liabilities and net assets	\$ 16,515,919	\$ 18,212,680

See Notes to Financial Statements.

**NEIGHBORHOOD HOUSE ASSOCIATION**

**STATEMENTS OF ACTIVITIES  
YEARS ENDED JUNE 30, 2012 AND 2011**

	2012	2011
Changes in unrestricted net assets:		
Revenues and support:		
Grants and contracts (Note 11)	\$ 77,074,168	\$ 79,425,782
Food reimbursements	1,224,781	1,178,420
Reimbursements from partners	284,396	816,923
Contributions and donations	676,250	501,300
Service fees	862,296	917,852
Special events	187,438	108,634
Investment return and interest income	6,830	7,037
Other revenues	1,030,759	1,663,325
Total unrestricted revenues and support	81,346,918	84,619,273
Expenses:		
Program services	76,280,999	76,976,956
Supporting services:		
Fundraising	11,956	3,417
Management and general	7,001,409	7,295,489
Total expenses	83,294,364	84,275,862
Change in unrestricted net assets from continuing operations before gain (loss) on interest rate swap	(1,947,446)	343,411
Gain (loss) on mark-to-market of interest rate swap	(60,030)	54,956
Change in unrestricted net assets	(2,007,476)	398,367
Unrestricted net assets:		
Beginning of year	8,922,364	8,523,997
End of year	\$ 6,914,888	\$ 8,922,364

See Notes to Financial Statements.

## NEIGHBORHOOD HOUSE ASSOCIATION

### STATEMENTS OF CASH FLOWS YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
Operating activities:		
Change in net assets	\$ (2,007,476)	\$ 398,367
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	895,982	904,550
Bad debt expense	103,086	71,347
(Gain) loss on mark-to-market of interest rate swap agreement	60,030	(54,956)
Nonoperating grant and contract revenue	(488,284)	(992,347)
Unrealized loss on investments	-	10,001
Loss on disposal of equipment	62,705	2,140
Change in operating assets and liabilities:		
Grants and contracts receivable	959,567	(100,603)
Other accounts receivable	(162,706)	(113,160)
Prepaid expenses	40,850	338,417
Operating advances	362,498	183,829
Accounts payable and accrued expenses	622,093	(2,015,545)
Accrued payroll and related liabilities	92,861	291,004
Accrued annual leave	(15,377)	(14,491)
Deferred revenue	(8,188)	13,890
Net cash provided by (used in) operating activities	517,641	(1,077,557)
Investing activities:		
Purchase of investments	(43,380)	-
Proceeds from sale of property and equipment	222,012	-
Purchases of property and equipment	(488,284)	(992,347)
Net cash used in investing activities	(309,652)	(992,347)
Financing activities:		
Repayments on debt	(264,568)	(256,356)
Receipt of grant and contract revenue for capital projects	488,284	992,347
Net cash provided by financing activities	223,716	735,991
Net increase (decrease) in cash and cash equivalents	431,705	(1,333,913)
Cash and cash equivalents at beginning of year	4,885,849	6,219,762
Cash and cash equivalents at end of year	\$ 5,317,554	\$ 4,885,849
Cash paid for interest	\$ 128,869	\$ 70,622
Noncash financing activities:		
Transfer of debt and property related to sale of building	\$ 176,136	\$ -

See Notes to Financial Statements.

**NEIGHBORHOOD HOUSE ASSOCIATION**

**STATEMENT OF FUNCTIONAL EXPENSES  
YEAR ENDED JUNE 30, 2012  
(With Summarized Financial Information for 2011)**

	Program Services		Supporting Services		Total Expenses		
	Childcare Programs	Health and Nutrition Programs	Youth and Other Services	Fundraising	Management and General	2012	2011
Salaries	\$ 19,370,213	\$ 1,726,902	\$ 408,910	\$ -	\$ 3,939,484	\$ 25,445,509	\$ 25,117,885
Fringe benefits	7,273,743	609,465	69,042	-	1,071,310	9,023,560	9,021,407
Contracted services	747,751	963	542,826	-	917,795	2,209,335	2,276,035
Supplies	881,194	116,311	43,352	-	47,168	1,088,025	1,483,244
Telephone and pagers	342,480	29,770	39,417	-	83,444	495,111	473,946
Postage	11,601	2,359	916	-	16,422	31,298	23,799
Occupancy and storage	2,316,669	314,936	(191,443)	-	198,140	2,638,302	2,622,047
Utilities	281,858	26,896	64,137	-	41,692	414,583	416,554
Printing, publications and advertising	45,398	9,026	6,865	-	18,090	79,379	86,066
Travel and meetings	495,845	76,564	26,508	-	213,484	812,401	958,823
Subcontracts (Note 16)	36,810,487	-	20,694	-	37,390	36,868,571	37,743,013
Food expense	1,262,279	159,890	16,186	-	20,521	1,458,876	1,505,847
Client assistance	79,968	56,315	72,521	-	12,401	221,205	224,868
Equipment expense	476,684	70,165	1,048	-	120,326	668,223	425,695
Depreciation and amortization	828,782	-	-	-	67,200	895,982	904,550
Insurance	180,349	31,795	3,549	-	75,312	291,005	338,863
Direct fundraising expenses	-	-	-	11,956	-	11,956	3,417
Interest and fees	133,762	9,655	151,981	-	87,940	383,338	211,036
Other expenses	169,083	56,637	(1,305)	-	33,290	257,705	438,767
Indirect cost	6,029,360	384,417	13,162	-	(6,426,939)	-	-
Subtotal	77,737,506	3,682,066	1,288,366	11,956	574,470	83,294,364	84,275,862
Less: indirect allocation	(6,029,360)	(384,417)	(13,162)	-	6,426,939	-	-
Total expenses by function	\$ 71,708,146	\$ 3,297,649	\$ 1,275,204	\$ 11,956	\$ 7,001,409	\$ 83,294,364	\$ 84,275,862

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.

##### **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 revenues, gains and other support based on the existence or absence of donor-imposed restrictions. Permanently restricted net assets result from contributions whose use is limited by donor stipulations that do not expire. 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:**

Revenue from government grants and contracts designated for use in specific activities is recognized in the period when expenditures have been incurred in compliance with the grantor's restrictions. Grants and contracts awarded for the acquisition of long-lived assets are reported as unrestricted operating revenue, in the absence of donor stipulations to the contrary, during the fiscal year in which the assets are acquired. Cash received in excess of revenue recognized is recorded as refundable advances.

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 are 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. 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.

##### **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 2012 and 2011, the value of contributed services recognized as revenues in the accompanying financial statements was approximately \$444,000 and \$380,000, respectively, 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 when acquired to be cash equivalents.

##### **Investments:**

NHA invests in marketable securities which are carried at fair value, with realized and unrealized gains and losses included in the statements of activities.

##### **Operating advances:**

Operating advances represent advances to delegate agencies that relate to the next program year. Advances are made to ensure that operations continue over the summer. They are repaid through a reduction of funding at the end of the contract.

# 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 statements of financial position and measures those instruments at fair value. Changes in fair value of those instruments are reported in the statements of activities.

#### 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

#### Impairment of long-lived assets:

NHA reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing a review for impairment, NHA compares the carrying value of the assets with their estimated future undiscounted cash flows. If it is determined that impairment has occurred, the loss would be recognized during that period. The impairment loss is calculated as the difference between the asset carrying values and the present value of estimated net cash flows or comparable market values, giving consideration to recent operating performance and pricing trends. NHA does not believe that any material impairment currently exists related to its long-lived assets.

#### 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.

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

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

#### **Income taxes (concluded):**

In accordance with Financial Accounting Standards Boards ("FASB") Accounting Standards Codification ("ASC") 740-10-15-2, income tax benefits and/or liabilities are recognized for income tax positions taken or expected to be taken in a tax return, only when it is determined that the income tax positions will more-likely-than-not be sustained upon examination by taxing authorities. NHA has analyzed the tax positions taken in its filings with the Internal Revenue Service and the California Franchise Tax Board. NHA believe that its income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on NHA's financial condition, results of operations or cash flows. Accordingly, NHA has not recorded any reserves, or related accruals for interest and penalties for uncertain income tax positions at June 30, 2012.

NHA's Federal and state income tax returns prior to fiscal years 2009 and 2008, respectively, are closed. Management continually evaluate expiring statutes of limitations, audits, proposed settlements, changes in tax laws and new authoritative rulings. Management is not aware of any pending reviews or examinations.

#### **Advertising:**

NHA expenses advertising costs as incurred. Advertising costs for the years ended June 30, 2012 and 2011 were approximately \$22,000 and \$9,000, respectively.

#### **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.

#### **Reclassifications:**

Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 presentation.

#### **Subsequent events:**

Subsequent events have been evaluated through November 5, 2012, which is the date the financial statements were available to be issued.

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

**Note 2 - Investments:**

Investments consist of equity and other securities with an approximate fair value of \$73,000 and \$30,000 at June 30, 2012 and 2011, respectively. Fair values have been determined by reference to the most recent market quotations for the respective investments.

**Note 3 - Fair value of financial instruments:**

NHA's material financial instruments at December 31, 2012 and 2011 for which disclosure of estimated fair value is required by certain accounting standards consisted of cash and cash equivalents, accounts receivable, marketable securities, accounts payable and notes payable to unrelated parties. The fair values of cash and cash equivalents, accounts receivable and accounts payable are equal to their carrying value because of their liquidity and short-term maturity. Marketable securities are stated at fair value based on quoted market values, observable inputs such as quoted prices for similar assets, or unobservable inputs. Management believes that the fair values of notes payable to unrelated parties do not differ materially from their aggregate carrying values in that substantially all the obligations bear variable interest rates that are based on market rates or interest rates that are periodically adjustable to rates that are based on market rates.

**Note 4 - Grants and contracts receivable:**

At June 30, 2012 and 2011, grants and contracts receivable consisted of the following:

	2012	2011
Head Start	\$ 3,074,172	\$ 3,495,300
State programs	554,589	995,856
County programs	503,844	588,052
Food reimbursements	220,035	208,363
Other programs	9,517	34,153
Totals	\$ 4,362,157	\$ 5,321,724

**Note 5 - Property and equipment:**

Property and equipment as of June 30, 2012 consists of the following:

	Cost	Accumulated Depreciation and Amortization	Net Book Value
Land	\$ 1,191,750	\$ -	\$ 1,191,750
Building	4,768,000	2,013,954	2,754,046
Building improvements	649,316	647,683	1,633
Leasehold improvements	8,407,798	6,960,170	1,447,628
Vehicles	2,789,141	2,671,613	117,528
Furniture and equipment	5,677,976	4,886,163	791,813
Computer equipment	308,908	266,896	42,012
	\$ 23,792,889	\$ 17,446,479	\$ 6,346,410

## NEIGHBORHOOD HOUSE ASSOCIATION

### NOTES TO FINANCIAL STATEMENTS

**Note 5 - Property and equipment (concluded):**

Property and equipment as of June 30, 2011 consists of the following:

	Cost	Accumulated Depreciation and Amortization	Net Book Value
Land	\$ 1,387,475	\$ -	\$ 1,387,475
Building	5,357,733	2,216,102	3,141,631
Building improvements	654,986	653,353	1,633
Leasehold improvements	9,047,609	7,400,465	1,647,144
Vehicles	2,751,909	2,748,487	3,422
Furniture and equipment	5,716,466	4,741,464	975,002
Computer equipment	308,908	250,254	58,654
	\$ 25,225,086	\$ 18,010,125	\$ 7,214,961

A significant portion of NHA's property and equipment is identified as collateral for certain long-term debt as described at Note 8. Property and equipment with net book values of approximately \$461,000 and \$2,000 were disposed during the fiscal years ended June 30, 2012 and 2011, respectively.

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, 2012 and 2011 are approximately \$5,908,000 and \$3,516,000, respectively, and are included in property and equipment.

**Note 6 - Accrued annual leave:**

Accrued annual leave is presented as a funded liability in the statement of financial position. NHA records the accrued leave as it is earned by the employees. Accrued annual leave for the years ended June 30, 2012 and 2011 was approximately \$2,377,000 and \$2,393,000, respectively. These amounts have been funded with fully FDIC insured deposits with Torrey Pines Bank. These amounts are included in cash and cash equivalents.

**Note 7 - Line of credit:**

NHA has a \$1,000,000 unsecured line of credit with Union Bank of California which expires on March 15, 2013 and requires monthly interest payments with interest at the bank's reference rate (3.25% at June 30, 2012). At June 30, 2012 and 2011, there was no balance outstanding. The line of credit requires that NHA maintain certain loan covenants for which NHA was not in compliance with at June 30, 2012. As of November 1, 2012, Union Bank of California agreed to waive the noncompliance by NHA for the period ending June 30, 2012.

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

### Note 8 - Long-term debt:

Long-term debt consists of the following:

	2012	2011
<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, 2012 was 1.74%. The loan commenced on May 1, 2005 and matures on February 28, 2013. The note is secured by a Deed of Trust covering real property located at 5660 Copley Drive, San Diego, California. <sup>(A)</sup></p>	\$ 2,206,943	\$ 2,411,380
<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, 2012 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>	78,909	109,362
<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. <sup>(B)</sup></p>	-	205,814
<p>Less current portion</p>	2,285,852	2,726,556
<p>Long-term portion</p>	(2,237,870)	(264,873)
	\$ 47,982	\$ 2,461,683

<sup>(A)</sup> 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% (1.74% at June 30, 2012). 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, 2012, the estimated fair value of the interest rate swap agreement was a liability of \$398,865. The change in the fair value of the interest rate swap agreement for the years ended June 30, 2012 and 2011 totaled (\$60,030) and \$54,956, respectively, and is included as a nonoperating gain (loss) in the statements of activities.

NHA was not in compliance with certain nonfinancial covenants and as a result the maturity date on the Union Bank note was modified to February 28, 2013 and the balance has been classified as current. NHA is in the process of refinancing this debt with another financial institution.

<sup>(B)</sup> The property located at 835 N Hickory Street, Escondido, California was transferred to another private agency.

## NEIGHBORHOOD HOUSE ASSOCIATION

### NOTES TO FINANCIAL STATEMENTS

**Note 8 - Long-term debt (concluded):**

Maturities of long-term debt in each of the years subsequent to June 30, 2012 are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2013	\$ 2,237,870
2014	32,139
2015	15,843
Total	<u>\$ 2,285,852</u>

Interest expense for the years ended June 30, 2012 and 2011 was approximately \$129,000 and \$71,000, respectively.

**Note 9 - 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, 2012 and thereafter are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2013	\$ 1,321,175
2014	792,251
2015	250,832
2016	191,308
2017	198,004
Thereafter	470,519
Total	<u>\$ 3,224,089</u>

Total operating lease expense for the years ended June 30, 2012 and 2011 was approximately \$1,742,000 and \$1,727,000, respectively.

**Note 10- Contingencies:**

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.

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

**Note 11- Grants and contracts revenues:**

In the fiscal years ended June 30, 2012 and 2011, NHA recognized grants and contract revenues from the following sources:

	2012	2011
Head Start program	\$ 70,290,494	\$ 72,369,091
State programs	3,926,762	4,230,176
County programs	2,728,040	2,782,490
Other programs	128,872	44,025
Total grants and contracts	\$ 77,074,168	\$ 79,425,782

**Note 12- 401(k) plan:**

NHA maintains 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 \$17,000 for the tax year ending December 31, 2012. 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, 2012 and 2011 were approximately \$1,197,000 and \$1,250,000, respectively.

**Note 13- 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:

	Provisional 2012	Final 2011
All programs	10.6%	10.6%
Delegate agencies	2.0%	2.0%

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, 2012 and 2011 were approximately \$6,427,000 and \$6,927,000, respectively.

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

### Note 14- 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 2012 from Federal, state and local sources. The largest contract was for the Federal Head Start program totaling \$70,290,494. Included in grants and contracts receivable at June 30, 2012 is \$3,074,172 related to this contract.

### Note 15- Union contract:

Most non-management personnel (representing 53% of total employees) of NHA are members of the Service Employees International Union, Local #2028. NHA's contract with the union is in effect through June 30, 2013, 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.

### Note 16- Subcontracts expense:

Subcontracts expense for the fiscal years ended June 30, 2012 and 2011 included the following:

	<u>2012</u>	<u>2011</u>
NHA delegate agencies	\$ 27,934,873	\$ 21,142,354
Other	8,933,698	16,568,139
Health and nutrition programs	<u>-</u>	<u>32,520</u>
Totals	<u>\$ 36,868,571</u>	<u>\$ 37,743,013</u>

# NEIGHBORHOOD HOUSE ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

### Note 17- 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 is 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, 2012 are classified in the table below in one of the three categories described above:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity securities	\$ 63,131	\$ -	\$ -	\$ 63,131
Investment stock of a local bank	-	-	10,000	10,000
Total assets at fair value	<u>\$ 63,131</u>	<u>\$ -</u>	<u>\$ 10,000</u>	<u>\$ 73,131</u>
Interest rate swap derivative liability		<u>\$ 398,865</u>		<u>\$ 398,865</u>

## NEIGHBORHOOD HOUSE ASSOCIATION

### NOTES TO FINANCIAL STATEMENTS

**Note 17- Fair value measurements (concluded):**

Financial assets and liabilities carried at fair value at June 30, 2011 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Equity securities	\$ 19,751	\$ -	\$ -	\$ 19,751
Investment stock of a local bank	-	-	10,000	10,000
Total assets at fair value	\$ 19,751	\$ -	\$ 10,000	\$ 29,751
Interest rate swap derivative liability		\$ 338,835		\$ 338,835

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2012 and 2011.

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, 2012 and 2011.

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.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

**SUPPLEMENTARY INFORMATION**

# NEIGHBORHOOD HOUSE ASSOCIATION

## SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED JUNE 30, 2012

Federal Grantor / Pass-Through Grantor / Program Title	Federal CFDA Number	Award Number	Net Federal Program Expenditures
<u>U.S. Department of Health and Human Services</u>			
Head Start Cluster:			
Head Start Program	93.600	09CH7015/46	\$ 69,970,608
ARRA - Head Start	93.708	09SE7015/01	<u>319,886</u>
Total Head Start Cluster			<u>70,290,494</u>
Passed through from the County of San Diego:			
Aging Cluster:			
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	93.044	533569	9,100
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045	533569	160,257
Nutrition Services Incentive Program	93.053	533569	<u>28,679</u>
Total Aging Cluster			<u>198,036</u>
HIV Emergency Relief Project Grants (Case Management)	93.914	537490	270,763 <sup>(1)</sup>
HIV Emergency Relief Project Grants (Case Management)	93.914	537490	101,354 <sup>(2)</sup>
HIV Emergency Relief Project Grants (Transportation Services)	93.914	536702	85,473 <sup>(1)</sup>
HIV Emergency Relief Project Grants (Transportation Services)	93.914	536702	<u>54,361 <sup>(2)</sup></u>
Total for HIV Emergency Relief Project Grants			<u>511,951</u>
Total Department of Health and Human Services			<u>71,000,481</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	04500-CACFP-37-NP-CS	1,110,972 <sup>(4)</sup>
Adult Day Care Centers	10.558	04500-CACFP-37-NP-CS	<u>48,045</u>
Total Department of Agriculture			<u>1,159,017</u>
<u>U.S. Department of Education</u>			
CCDF Cluster:			
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	CCTR-1257	105,900
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	CSPP-1481	<u>602,051</u>
Total for Child Care Mandatory and Matching Funds of the Child Care and Development Fund			<u>707,951</u>
Child Care and Development Block Grant	93.575	CCTR-1257	58,297
Child Care and Development Block Grant	93.575	CSPP-1481	<u>331,423</u>
Total for Child Care and Development Block Grant			<u>389,720</u>
Total CCDF Cluster			<u>1,097,671</u>
<u>U.S. Department of Housing and Urban Development</u>			
Housing Counseling Assistance Program (Loan Modification)	14.169	HC10-0926-014	46,895 <sup>(3)</sup>
Housing Counseling Assistance Program (Comprehensive)	14.169	HC11-0927-010	16,277 <sup>(3)</sup>
Housing Counseling Assistance Program (Loan Modification)	14.169	HC-10-0921-044	16,555 <sup>(3)</sup>
Housing Counseling Assistance Program (Comprehensive)	14.169	HC-12-0921-041	<u>8,745 <sup>(3)</sup></u>
Total for House Counseling Assistance Program			<u>88,472</u>
Passed through from the Rural Community Assistance Corporation			
Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets	14.000		<u>40,400</u>
Total Department of Housing and Urban Development			<u>128,872</u>
Total Expenditures of Federal Awards			<u>\$ 73,386,041</u>

Notes:

<sup>(1)</sup> Program year - July 2011 - February 2012

<sup>(2)</sup> Program year - March 2012 - June 2012

<sup>(3)</sup> Program year - October 2011 - September 2012

<sup>(4)</sup> Less state portion of \$65,765

Value of non-cash assistance (in - kind)

Amount of insurance expense during the year

Loan guarantees outstanding at year - end - Head Start only

\$ 19,591,847

216,859

79,387

See Accompanying Notes to Schedules of Federal and State Awards.

**NEIGHBORHOOD HOUSE ASSOCIATION**

**SCHEDULE OF EXPENDITURES OF STATE AWARDS  
YEAR ENDED JUNE 30, 2012**

<u>State Department / Program Title</u>	<u>Award Number</u>	<u>Award Amount</u>	<u>Net Program Expenditures</u>
<u>California State Department of Education</u>			
Child Development Program	CCTR-1257	\$ 478,324	\$ 314,127
Child Development Program	CSPP-1481	3,484,831	2,514,964
Child and Adult Care Food Program - State Portion	37-1564-3A	<u>65,764</u>	<u>65,764</u>
Total Expenditures of State Awards		<u>\$ 4,028,919</u>	<u>\$ 2,894,855</u>

See Accompanying Notes to Schedules of Federal and State Awards.

## NEIGHBORHOOD HOUSE ASSOCIATION

### NOTES TO SCHEDULES OF EXPENDITURES OF FEDERAL AND STATE 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 schedules of expenditures of Federal and state awards include the Federal and state grant activity of NHA, and are presented on the accrual basis of accounting. The information in these schedules 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 schedules of expenditures of Federal and state 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 and state expenditures are reflected net of other income sources.

**NEIGHBORHOOD HOUSE ASSOCIATION**

**NOTES TO SCHEDULES OF EXPENDITURES OF FEDERAL AND STATE AWARDS**

**Note 2 - Federal contracts:**

**Reconciliation of Reported and Audited Expenses:**

<u>Program</u>	<u>Program Expenses</u>
<b>Reconciliation of Child Care Food Program Revenue:</b>	
Amount shown on the Schedule of Expenditures of Federal Awards	\$ 1,110,972
Add: State portion not included in SEFA	<u>65,765</u>
Total Child Care Food Program Revenue Reimbursed	<u>\$ 1,176,737</u>
<b>Reconciliation of Head Start Revenue:</b>	
Amount shown on the Schedule of Expenditures of Federal Awards	\$ 69,970,608
Add: obligations liquidated after June 30, 2012	<u>316,573</u>
Total Head Start Expenses Reported on the SF-425	<u>\$ 70,287,181</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, 2012 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, 2012, and have issued our report thereon, dated November 5, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

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

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

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 2012-1.

This report is intended solely for the information and use of the Board of Directors, the Audit Committee, management and Federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*CohnReznick LLP*

San Diego, California  
November 5, 2012

**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**

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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, 2012. 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 governmental 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, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2012-1.

## 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 and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of 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 timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be 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 and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*CohnReznick LLP*

San Diego, California  
November 5, 2012

**NEIGHBORHOOD HOUSE ASSOCIATION**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED JUNE 30, 2012**

**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? \_\_\_\_\_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? \_\_\_\_\_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?   X  yes \_\_\_\_\_no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>	<u>Amount</u>
Head Start Cluster:		
93.600	Head Start Program	\$ 69,970,608
93.708	ARRA – Head Start	\$ 319,886 <sup>(a)</sup>

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

Dollar threshold used to distinguish between  
Type A and Type B programs: \$2,201,581

Auditee qualified as low-risk auditee?   X  yes \_\_\_\_\_no

**NEIGHBORHOOD HOUSE ASSOCIATION**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED JUNE 30, 2012**

**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.

See Part III finding 2012-1.

**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.

Finding 2012-1

Condition:

It was determined as a result of a regulatory review that management's calculation of children with disabilities determined to be eligible for special education and related services, or early intervention services, as appropriate, as determined under the Individuals with Disabilities Education act has erroneously included children being served through Response to Intervention (RTI) program. Management has recalculated the number of children with disabilities being served, excluding those children served through the RTI program, and has concluded that they did not meet the ten percent requirement.

Recommendation:

We recommend that management change its calculation of children with disabilities to comply with the regulatory review process for calculating the number of children with disabilities enrolled in the program to ensure compliance with the regulation.

Management's Response:

Management has responded to the regulatory finding through a corrective action plan. A memo will be issued to all partners and delegates by the Vice President of Children, Youth and Family Services indicating that inclusion of children served through the RTI program in the disability requirement calculation is no longer acceptable. Current policies and procedures will be revised to clarify this process. Management will also meet with the San Diego Unified School District to present and clarify the usage and implementation of the RTI program, conduct trainings for Head Start staff on the usage of the RTI program and educate parents on the rights and accessibility to services. Subsequently, NHA did meet the 10% disability requirement as reported on the Program Information Report to the Federal government for the year ended June 30, 2012.

**NEIGHBORHOOD HOUSE ASSOCIATION**

**SCHEDULE OF PRIOR AUDIT FINDINGS  
YEAR ENDED JUNE 30, 2012**

None.