Neighborhood House Association

Financial Statements, and Supplementary Information in Accordance with Office of Management and Budget Circular A-133 and Independent Auditor's Reports

June 30, 2013 and 2012

Neighborhood House Association

<u>**Index**</u>

Independent Auditor's Report

To the Audit Committee
Neighborhood House Association

Report on the Financial Statements

We have audited the accompanying financial statements of Neighborhood House Association ("NHA"), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities, and cash flows for the years then ended and the related statement of functional expenses for the year ended June 30, 2013 (with summarized financial information for 2012), and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NHA as of June 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the financial statements of NHA as a whole. The accompanying schedules of expenditures of Federal and state awards, as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2013 financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2013 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 information is fairly stated, in all material respects, in relation to the 2013 financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 12, 2013 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 on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering NHA's internal control over financial reporting and compliance.

CohnReznick LLP

San Diego, California
November 12, 2013

Neighborhood House Association

Statements of Financial Position
June 30, 2013 and 2012

	2013	2012
Assets		
Current assets:		
Cash and cash equivalents (Note 14)	$ 5,680,962	$ 5,317,554
Investments (Notes 2 and 17)	93,339	73,131
Grants and contracts receivable (Note 4)	3,782,563	4,362,157
Other accounts receivable	377,514	311,907
Operating advances	37,060	10,988
Prepaid expenses	66,799	24,337
Total current assets	10,038,237	10,100,074
Property and equipment (Note 5):		
Property and equipment	23,882,793	23,792,889
Less: accumulated depreciation and amortization	(18,249,258)	(17,446,479)
Total property and equipment, net	5,633,535	6,346,410
Deposits	73,600	69,435
Total assets	$ 15,745,372	$ 16,515,919
Liabilities and Net Assets		
Current liabilities:		
Accrued payroll and related liabilities	$ 1,197,109	$ 1,119,115
Accounts payable and accrued expenses	4,306,048	3,266,820
Accrued annual leave (Note 6)	2,165,214	2,377,361
Current portion of long-term debt (Note 8)	83,244	2,237,870
Interest rate swap agreement (Note 17)	270,184	398,865
Total current liabilities	8,021,799	9,400,031
Deferred rent	131,195	153,018
Long-term debt, net of current portion (Note 8)	1,951,528	47,982
Total liabilities	10,104,522	9,601,031
Commitments and contingencies		
Net assets:		
Unrestricted	5,640,850	6,914,888
Total net assets	5,640,850	6,914,888
Total liabilities and net assets	$ 15,745,372	$ 16,515,919

See Notes to Financial Statements.

Neighborhood House Association

Statements of Activities
Years Ended June 30, 2013 and 2012

	2013	2012
Changes in unrestricted net assets:		
Revenues and support:		
Grants and contracts (Note 11)	$ 77,489,500	$ 77,074,168
Food reimbursements	1,199,036	1,224,781
Reimbursements from partners	489,127	284,396
Contributions and donations	812,528	676,250
Service fees	886,301	862,296
Special events	176,297	187,438
Investment return and interest income	4,405	6,830
Other revenues	1,141,836	1,030,759
Total unrestricted revenues and support	82,199,030	81,346,918
Expenses:		
Program services	77,540,027	76,280,999
Supporting services:		
Fundraising	5,211	11,956
Management and general	6,056,511	7,001,409
Total expenses	83,601,749	83,294,364
Change in unrestricted net assets from continuing operations before gain (loss) on mark-to-market of interest rate swap agreement	(1,402,719)	(1,947,446)
Gain (loss) on mark-to-market of interest rate swap agreement	128,681	(60,030)
Change in unrestricted net assets	(1,274,038)	(2,007,476)
Unrestricted net assets:		
Beginning of year	6,914,888	8,922,364
End of year	$ 5,640,850	$ 6,914,888

See Notes to Financial Statements.

Neighborhood House Association

Statements of Cash Flows
Years Ended June 30, 2013 and 2012

	2013	2012
Operating activities:		
Change in net assets	$ (1,274,038)	$ (2,007,476)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	802,779	895,982
Bad debt expense	21,678	103,086
(Gain) loss on mark-to-market of interest rate swap agreement	(128,681)	60,030
Deferred rent	(21,823)	130,293
Nonoperating grant and contract revenue	(89,904)	(488,284)
Unrealized gain on investments	(20,208)	-
Loss on disposal of equipment	-	62,705
Changes in operating assets and liabilities:		
Grants and contracts receivable	579,594	959,567
Other accounts receivable	(87,285)	(162,706)
Prepaid expenses and deposits	(46,627)	40,850
Operating advances	(26,072)	362,498
Accounts payable and accrued expenses	1,039,228	483,612
Accrued payroll and related liabilities	77,994	92,861
Accrued annual leave	(212,147)	(15,377)
Net cash provided by operating activities	614,488	517,641
Investing activities:		
Purchases of investments	-	(43,380)
Proceeds from sale of property and equipment	-	222,012
Purchases of property and equipment	(89,904)	(488,284)
Net cash used in investing activities	(89,904)	(309,652)
Financing activities:		
Repayments on debt	(251,080)	(264,568)
Receipt of grant and contract revenue for capital projects	89,904	488,284
Net cash provided by (used in) financing activities	(161,176)	223,716
Net increase in cash and cash equivalents	363,408	431,705
Cash and cash equivalents at beginning of year	5,317,554	4,885,849
Cash and cash equivalents at end of year	$ 5,680,962	$ 5,317,554
Cash paid for interest	$ 39,719	$ 128,869
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, 2013
(With Summarized Financial Information for 2012)

	Program Services			Supporting Services		Total Expenses	
	Childcare Programs	Health and Nutrition Programs	Youth and Other Services	Fundraising	Management and General	2013	2012
Salaries	$ 19,615,141	$ 1,851,289	$ 607,255	$ -	$ 3,522,950	$ 25,596,635	$ 25,445,509
Fringe benefits	6,821,753	602,512	93,649	-	837,918	8,355,832	9,023,560
Contracted services	653,584	69,550	515,492	-	886,476	2,125,102	2,209,335
Supplies	1,416,676	118,015	42,006	-	41,588	1,618,285	1,088,025
Telephone and pagers	399,548	38,220	58,966	-	83,624	580,358	495,111
Postage	11,756	2,548	292	-	19,202	33,798	31,298
Occupancy and storage	2,389,425	304,668	(257,900)	-	22,156	2,458,349	2,638,302
Utilities	261,875	25,572	67,012	-	42,492	396,951	414,583
Printing, publications and advertising	80,759	3,776	4,655	-	22,556	111,746	79,379
Travel and meetings	501,532	207,113	34,084	-	156,531	899,260	812,401
Subcontracts (Note 16)	36,823,483	-	2,215	-	24,835	36,850,533	36,868,571
Food expense	1,406,513	152,029	13,377	-	12,920	1,584,839	1,458,876
Client assistance	84,824	103,273	51,722	-	3,106	242,925	221,205
Equipment expense	677,735	75,136	65,823	-	16,091	834,785	668,223
Depreciation and amortization	694,149	-	-	-	108,630	802,779	895,982
Insurance	212,262	42,509	5,905	-	100,995	361,671	291,005
Direct fundraising expenses	-	-	-	5,211	-	5,211	11,956
Interest and fees	86,059	7,510	70,690	-	102,855	267,114	383,338
Other expenses	201,230	22,461	200,299	-	51,586	475,576	257,705
Indirect cost	5,157,518	393,947	5,788	-	(5,557,253)	-	-
Subtotal	77,495,822	4,020,128	1,581,330	5,211	499,258	83,601,749	83,294,364
Less: indirect allocation	(5,157,518)	(393,947)	(5,788)	-	5,557,253	-	-
Total expenses by function	$ 72,338,304	$ 3,626,181	$ 1,575,542	$ 5,211	$ 6,056,511	$ 83,601,749	$ 83,294,364

See 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.

Accounts receivable:

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. There were no allowances for doubtful accounts recorded as of fiscal years ended June 30, 2013 and 2012.

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 2013 and 2012, the value of contributed services recognized as revenues in the accompanying financial statements was approximately $526,000 and $444,000, 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 each 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.

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:

Description	Useful Life
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.

Deferred rent:

Rent expense on operating leases with scheduled or minimum rent increases is expensed on the straight-line basis over the lease terms. Deferred rent represents the excess of rent charged to expense over rent payable under the lease agreements. Deferred rent was approximately $131,000 and $153,000 as of June 30, 2013 and 2012, respectively.

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.

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 believes 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, 2013.

NHA's Federal and state income tax returns prior to fiscal years 2010 and 2009, 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, 2013 and 2012 were approximately $36,000 and $22,000, 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 the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and those differences could be significant.

Reclassifications:

Certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation.

Subsequent events:

Subsequent events have been evaluated through November 12, 2013, 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 $93,000 and $73,000 at June 30, 2013 and 2012, 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, 2013 and 2012 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, 2013 and 2012, grants and contracts receivable consists of the following:

	2013	2012
Head Start	$ 2,646,146	$ 3,074,172
State programs	237,091	554,589
County programs	553,842	503,844
Food reimbursements	323,364	220,035
Other programs	22,120	9,517
Totals	$ 3,782,563	$ 4,362,157

Note 5 - Property and equipment:

Property and equipment as of June 30, 2013 consists of the following:

	Cost	Accumulated Depreciation and Amortization	Net Book Value
Land	$ 1,191,750	$ -	$ 1,191,750
Building	4,768,000	2,172,221	2,595,779
Building improvements	649,316	647,683	1,633
Leasehold improvements	8,429,735	7,306,365	1,123,370
Vehicles	2,837,946	2,706,813	131,133
Furniture and equipment	5,697,138	5,132,638	564,500
Computer equipment	308,908	283,538	25,370
	$ 23,882,793	$ 18,249,258	$ 5,633,535

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

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 value of approximately $461,000 was disposed during the fiscal year ended June 30, 2012. There were no disposals during the fiscal year ended June 30, 2013.

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, 2013 and 2012 are approximately $5,542,100 and $5,908,000, 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, 2013 and 2012 was approximately \$2,165,000 and \$2,377,000, 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 had a \$1,000,000 unsecured line of credit with Union Bank of California which matured on April 30, 2013. The line of credit was not renewed. On June 28, 2013, NHA entered into a \$200,000 secured line of credit with Torrey Pines Bank which matures on June 25, 2014. There were no outstanding balances for the years ended June 30, 2013 and 2012.

Note 8 - Long-term debt:

Long-term debt consists of the following:

	2013	2012
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, 2013 was 1.69%. The loan commenced on May 1, 2005 and matured on July 31, 2013. The note was secured by a Deed of Trust covering real property located at 5660 Copley Drive, San Diego, California. (A)	$ 1,987,051	$ 2,206,943
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, 2013 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.	47,721	78,909
	2,034,772	2,285,852
Less current portion	(83,244)	(2,237,870)
Long-term portion	$ 1,951,528	$ 47,982

(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% (1.69% at June 30, 2013). The agreement sets the interest rate at a fixed rate of 5.15% starting with a notional amount of \$1,987,227 that declines monthly through the term expiring April 1, 2020. At June 30, 2013, the estimated fair value of the interest rate swap agreement was a liability of \$270,184. The change in the fair value of the interest rate swap agreement for the years ended June 30, 2013 and 2012 totaled \$128,681 and (\$60,030), 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 July 31, 2013. Subsequent to year end, NHA refinanced the debt with Torrey Pines Bank for $2,550,000 and the outstanding loan and interest rate swap agreement with Union Bank were paid in full. The new loan commenced on July 25, 2013 and matures on July 28, 2023. The loan is payable in equal monthly installments of principal and interest in the amount of $15,402. The interest rate is 5.25%. The note is secured by real property located at 5660 Copley Drive, San Diego, California.

Maturities of long-term debt in each of the years subsequent to June 30, 2013 are calculated based on the new loan terms with Torrey Pines Bank and the note payable to Neighborhood National Bank as follows:

Year Ending June 30,	Amount
2014	$ 83,244
2015	66,974
2016	57,704
2017	60,808
2018	64,078
Thereafter	2,264,913
Total	$ 2,597,721

Interest expense for the years ended June 30, 2013 and 2012 was approximately $40,000 and $129,000, 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, 2013 and thereafter are as follows:

Year Ending June 30,	Amount
2014	$ 1,314,526
2015	669,033
2016	411,475
2017	234,426
2018	204,934
Thereafter	265,585
Total	$ 3,099,979

Total operating lease expense for the years ended June 30, 2013 and 2012 was approximately $1,596,000 and $1,742,000, 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.

Note 11- Grants and contracts revenues:

In the fiscal years ended June 30, 2013 and 2012, NHA recognized grants and contract revenues from the following sources:

	2013	2012
Head Start program	$ 70,442,667	$ 70,290,494
State programs	3,679,399	3,926,762
County programs	3,273,072	2,728,040
Other programs	94,362	128,872
Total grants and contracts	$ 77,489,500	$ 77,074,168

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 $17,500 for the tax year ending December 31, 2013. 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, 2013 and 2012 were approximately $1,202,000 and 1,197,000, 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 2013	Provisional 2012
All programs	10.5%	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, 2013 and 2012 were approximately $5,557,000 and $6,427,000, respectively.

Note 14- Concentrations 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.

At June 30, 2013, NHA had cash and cash equivalents which exceeded FDIC insured limits at certain financial institutions in excess of $2,831,000.

NHA has approximately eleven government contracts in fiscal year 2013 from Federal, state and local sources. The largest contract was for the Federal Head Start program totaling $70,442,667. Included in grants and contracts receivable at June 30, 2013 is $2,646,146 related to this contract.

Note 15- Union contract:

Most non-management personnel (representing 54% 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, 2013 and 2012 included the following:

	2013	2012
NHA delegate agencies	$ 28,421,297	$ 27,934,873
Other	8,429,236	8,933,698
Totals	$ 36,850,533	$ 36,868,571

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, 2013 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Equity securities	$ 83,339	$ -	$ -	$ 83,339
Investment stock of a local bank	-	-	10,000	10,000
Total assets at fair value	$ 83,339	$ -	$ 10,000	$ 93,339
Interest rate swap derivative liability		$ 270,184		$ 270,184

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:

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

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, 2013 and 2012.

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, 2013 and 2012.

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, 2013

Federal Grantor / Pass-Through Grantor / Program Title	Federal CFDA Number	Award Number	Net Federal Program Expenditures
U.S. Department of Health and Human Services			
Head Start Program	93.600	09CH7015/47	$ 70,115,748
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	12,400
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045	533569	135,421
Nutrition Services Incentive Program	93.053	533569	22,548
Total Aging Cluster			170,369
HIV Emergency Relief Project Grants (Case Management)	93.914	537490	253,253 (1)
HIV Emergency Relief Project Grants (Case Management)	93.914	537490	102,451 (2)
HIV Emergency Relief Project Grants (Transportation Services)	93.914	536702	114,705 (1)
HIV Emergency Relief Project Grants (Transportation Services)	93.914	536702	59,853 (2)
Total for HIV Emergency Relief Project Grants			530,262
Total U.S. Department of Health and Human Services			70,816,379
U.S. Department of Agriculture			
Passed through from the State Department of Education:			
Child and Adult Care Food Program:			
Child Care Centers	10.558	04500-CACFP-37-NP-CS	1,152,971
Adult Day Care Centers	10.558	04500-CACFP-37-NP-CS	46,065
Total U.S. Department of Agriculture			1,199,036
U.S. Department of Education			
CCDF Cluster:			
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	CCTR-2239	148,142
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	CSPP-2467	141,477
Total for Child Care Mandatory and Matching Funds of the Child Care and Development Fund			289,619
Child Care and Development Block Grant	93.575	CCTR-2239	81,471
Child Care and Development Block Grant	93.575	CSPP-2467	77,674
Total for Child Care and Development Block Grant			159,145
Total CCDF Cluster			448,764
Passed through from the Rural Community Assistance Corporation:			
Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets	14.000		83,679
Total Department of Housing and Urban Development			83,679
Total Expenditures of Federal Awards			$ 72,547,858

Notes:

(1) Program year - July 2012 - February 2013

(2) Program year - March 2013 - June 2013

Value of non-cash assistance (in - kind)	$ 20,171,217
Amount of insurance expense during the year	160,788
Loan guarantees outstanding at year - end - Head Start only	47,721

See Notes to Schedules of Expenditures of Federal and State Awards.

Neighborhood House Association

Schedule of Expenditures of State Awards
Year Ended June 30, 2013

State Department / Program Title	Award Number	Award Amount	Net Program Expenditures
California State Department of Education			
Child Development Program	CCTR-2239	$ 453,478	$ 203,601
Child Development Program	CSPP-2467	3,246,187	3,027,034
Total Expenditures of State Awards		$ 3,699,665	$ 3,230,635

See Notes to Schedules of Expenditures 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, Non-Profit Organizations,* and with the CDE Audit Guide issued by the California Department of Education.

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.

Subrecipients:

During the year ended 2013, NHA provided $36,850,533 to sub-grantees under its fund for improvement of Head Start Program (CFDA # 93.600).

Neighborhood House Association

Notes to Schedules of Expenditures of Federal and State Awards

Note 2 - Federal contracts:

Reconciliation of Reported and Audited Expenses:

Program	Program Expenses
Reconciliation of Head Start Revenue:	
Amount shown on the Schedule of Expenditures of Federal Awards	$ 70,115,748
Add: obligations liquidated after June 30, 2013	662,103
Total Head Start Expenses Reported on the SF-425	$ 70,777,851

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, 2013 included an audit fee of approximately $130,000.

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Audit Committee
Neighborhood House Association

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, the financial statements of Neighborhood House Association ("NHA"), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 12, 2013.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

CohnReznick LLP

San Diego, California
November 12, 2013

Independent Auditor's Report on Compliance for Each Major Federal Program and Report on Internal Control over Compliance Required by OMB Circular A-133

To the Audit Committee
Neighborhood House Association

Report on Compliance for Each Major Federal Program

We have audited Neighborhood House Association's ("NHA") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of NHA's major Federal programs for the year ended June 30, 2013. NHA's major Federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its Federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of NHA's major Federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. 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 on compliance for each major Federal program. However, our audit does not provide a legal determination of NHA's compliance.

Opinion on Each Major Federal Program

In our opinion, NHA complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2013.

Report on Internal Control over Compliance

Management of NHA is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered NHA's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with 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 Federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

CohnReznick LLP

San Diego, California
November 12, 2013

Neighborhood House Association

Schedule of Findings and Questioned Costs
Year Ended June 30, 2013

Part I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified
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:	Unmodified
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:

CFDA Number	Name of Federal Program	Amount
93.600	Head Start Program	$ 70,115,748

Dollar threshold used to distinguish between Type A and Type B programs:	$2,176,436
Auditee qualified as low-risk auditee?	______yes __X__no

Schedule of Findings and Questioned Costs
Year Ended June 30, 2013

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.

Findings for fiscal year ended 2013: None.

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.

Findings for fiscal year ended 2013: None.

Neighborhood House Association

Schedule of Prior Audit Findings
Year Ended June 30, 2013

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 10% 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 responded to the regulatory finding through a corrective action plan. A memo was 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 were revised to clarify this process. Management met 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. After completing the corrective action plan, NHA was awarded a five year grant. NHA also secured a waiver on the 10% disability requirement. 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, 2013.