

TARZANA TREATMENT CENTERS, INC.

**FINANCIAL STATEMENTS
AND SINGLE AUDIT REPORTS AND SCHEDULES**

FOR THE YEAR ENDED JUNE 30, 2014

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INDEPENDENT AUDITORS' REPORT

Board of Directors of
TARZANA TREATMENT CENTERS, INC.
Tarzana, California

We have audited the accompanying financial statements of Tarzana Treatment Centers, Inc. (the "Organization"), which comprise the statement of financial position as of June 30, 2014, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to 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 ("U.S. GAAP"); 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. ("U.S. GAAS") and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S. 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 auditors' 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 auditors consider 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 Organization's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tarzana Treatment Centers, Inc. as of June 30, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with U.S. GAAP.



INDEPENDENT AUDITORS' REPORT (Continued)

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2014, on our consideration of the Organization'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 the Organization's internal control over financial reporting and compliance.

RBZ, LLP

December 11, 2014

TARZANA TREATMENT CENTERS, INC.

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2014

ASSETS

Current Assets	
Cash and cash equivalents	\$ 5,427,203
Accounts receivable, net	6,786,121
U.S. Treasury Bills	4,529,498
Investments	2,553,580
Prepaid expenses	465,080
Other current assets	<u>96,722</u>
	19,858,204
Property and Equipment, net	5,667,362
Other	<u>617,056</u>
	<u>\$ 26,142,622</u>

LIABILITIES AND UNRESTRICTED NET ASSETS

Current Liabilities	
Accounts payable	\$ 2,102,229
Accrued expenses	3,609,469
Deferred revenue	127,550
Current portion of debt	85,000
Current portion of capital lease obligation	<u>102,529</u>
	<u>6,026,777</u>
Long-Term Liabilities	
Debt, net of current portion	1,015,000
Capital lease obligation, net of current portion	257,440
Deferred compensation liability	<u>38,977</u>
	<u>1,311,417</u>
Total Liabilities	<u>7,338,194</u>
Commitments and Contingencies (Notes 8, 11 and 12)	
Net Assets	
Unrestricted	
General	14,597,035
Property and equipment, net	<u>4,207,393</u>
Total Net Assets	<u>18,804,428</u>
	<u>\$ 26,142,622</u>

See accompanying notes to financial statements.

TARZANA TREATMENT CENTERS, INC.

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2014

Revenue	
Grants and contracts	\$ 24,293,363
Federal funding	12,369,191
Private insurance and private pay	5,521,532
Healthy Way L.A. clinic revenue	3,413,352
Other program income	1,038,561
In-kind goods and services	156,316
Unrealized gains on investments	45,898
Interest and dividends	<u>23,063</u>
	<u>46,861,276</u>
Functional Expenses	
Program services	33,407,350
General and administrative	<u>13,291,964</u>
	<u>46,699,314</u>
Changes in Unrestricted Net Assets	161,962
Unrestricted Net Assets, beginning of year	<u>18,642,466</u>
Unrestricted Net Assets, end of year	<u>\$ 18,804,428</u>

See accompanying notes to financial statements.

TARZANA TREATMENT CENTERS, INC.

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2014

	Inpatient Services	Non-inpatient Services	Total Program Services	General & Administrative	Total Expenses
Personnel Costs					
Administrative	\$ -	\$ -	\$ -	\$ 3,684,516	\$ 3,684,516
Program directors	731,738	2,194,514	2,926,252	506,121	3,432,373
Counselors	2,275,934	5,707,534	7,983,468	16,725	8,000,193
Nurses	1,300,824	561,458	1,862,282	-	1,862,282
Clinical	1,000,578	3,671,098	4,671,676	-	4,671,676
Kitchen	399,443	-	399,443	-	399,443
Maintenance and janitorial	<u>228,846</u>	<u>437,969</u>	<u>666,815</u>	<u>140,317</u>	<u>807,132</u>
	<u>5,937,363</u>	<u>12,572,573</u>	<u>18,509,936</u>	<u>4,347,679</u>	<u>22,857,615</u>
Payroll Taxes and Employee Benefits					
Payroll taxes	461,765	977,802	1,439,567	338,131	1,777,698
Medical insurance	445,135	942,588	1,387,723	325,954	1,713,677
Retirement plan	56,135	118,868	175,003	41,105	216,108
Vacation accrual	1,149	2,434	3,583	842	4,425
Workers' compensation insurance	<u>152,849</u>	<u>323,663</u>	<u>476,512</u>	<u>111,925</u>	<u>588,437</u>
	<u>1,117,033</u>	<u>2,365,355</u>	<u>3,482,388</u>	<u>817,957</u>	<u>4,300,345</u>
Other Costs					
Auto mileage and travel costs	14,746	40,032	54,778	305,607	360,385
Computer supplies and maintenance	2,091	60,868	62,959	483,180	546,139
Consultants and home care nursing	598,333	1,750,708	2,349,041	828,442	3,177,483
Depreciation and amortization	-	-	-	796,825	796,825
Facility maintenance and costs	2,945	12,882	15,827	268,998	284,825
Food costs	1,249,754	-	1,249,754	-	1,249,754
Insurance	-	-	-	506,776	506,776
Interest, bank charges, payroll processing and merchant fees	-	-	-	261,727	261,727
Laboratory, medication, medical supplies and radiology	677,588	1,722,549	2,400,137	-	2,400,137
Marketing costs	-	-	-	203,545	203,545
Office supplies	-	-	-	211,998	211,998
Printing and duplicating	4,983	43,080	48,063	61,121	109,184
Professional fees	-	-	-	553,595	553,595
Program supplies and expenses	9,309	476,046	485,355	17,101	502,456
Property taxes and other taxes	-	-	-	291,101	291,101
Provision for contract allowances	-	-	-	136,616	136,616
Rent	1,695,144	2,156,075	3,851,219	845,046	4,696,265
Subcontract grants & allocations	107,753	473,010	580,763	-	580,763
Supplies	-	-	-	358,677	358,677
Telephone	-	-	-	335,879	335,879
Utilities and waste disposal	30,855	49,744	80,599	887,423	968,022
In-kind volunteer personnel	11,790	19,410	31,200	-	31,200
Other costs	<u>87,871</u>	<u>117,460</u>	<u>205,331</u>	<u>772,671</u>	<u>978,002</u>
	<u>4,493,162</u>	<u>6,921,864</u>	<u>11,415,026</u>	<u>8,126,328</u>	<u>19,541,354</u>
Total Expenses	<u>\$ 11,547,558</u>	<u>\$ 21,859,792</u>	<u>\$ 33,407,350</u>	<u>\$ 13,291,964</u>	<u>\$ 46,699,314</u>

See accompanying notes to financial statements.

TARZANA TREATMENT CENTERS, INC.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2014

Cash Flows from Operating Activities	
Changes in net assets	\$ 161,962
Adjustments to reconcile changes in net assets to net cash provided by operating activities	
Depreciation and amortization	796,825
Unrealized gains on investments	(45,898)
Unrealized gains on U.S. Treasury Bills	(277)
Change in allowance for doubtful accounts	(299,683)
(Increase) decrease in operating assets	
Accounts receivable	613,491
Prepaid expenses	79,518
Other current assets	15,135
Deferred compensation investments (Note 7)	(24,040)
Other	(112,513)
Increase (decrease) in operating liabilities	
Accounts payable	(521,493)
Accrued expenses	(368,428)
Deferred revenue	85,078
Deferred compensation (Note 7)	<u>27,782</u>
Net Cash Provided by Operating Activities	<u>407,459</u>
Cash Flows from Investing Activities	
Purchases of property and equipment	(75,863)
Redemption of U.S. Treasury Bills	7,028,577
Purchase of U.S. Treasury Bill	(4,529,221)
Purchases of investments	<u>(2,507,682)</u>
Net Cash Used in Investing Activities	<u>(84,189)</u>
Cash Flows from Financing Activities	
Principal payments on debt	(80,000)
Principal payments on capital lease obligation	<u>(93,489)</u>
Net Cash Used in Financing Activities	<u>(173,489)</u>
Net Increase in Cash and Cash Equivalents	149,781
Cash and Cash Equivalents, beginning of year	<u>5,277,422</u>
Cash and Cash Equivalents, end of year	<u>\$ 5,427,203</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash Paid during the Year for Interest	<u>\$ 105,139</u>
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See accompanying notes to financial statements.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 1 - NATURE OF OPERATIONS

Nature of Activities

Tarzana Treatment Centers, Inc. (the "Organization") is a full-service behavioral healthcare organization that provides high quality, cost-effective substance abuse and mental health treatment to adults and youth. The Organization is a nonprofit, community-based organization that operates a psychiatric hospital, residential and outpatient alcohol and drug treatment centers, adolescent drug treatment centers and family medical clinics in locations throughout Southern California. The Organization has been accredited by the Joint Commission on Accreditation of Healthcare Organizations and all facilities are licensed and certified by the State of California and the County of Los Angeles. Since 1972, the Organization has been providing a comprehensive continuum of healthcare services including:

- Addiction treatment for alcohol and drugs
- Housing and sober living
- Mental health support
- Home care
- Education
- HIV education and treatment
- Community access and programs
- Youth services
- Family services
- Court-related services

Additionally, the Organization operates three primary medical care facilities that provide family medical care and other community services. A more detailed description of the Organization's services can be found on its website www.tarzanatc.org.

Funding

Primary support and revenue for the Organization are from federal, state and county funding, patient payments and insurance.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Organization is presented to assist in understanding the Organization's financial statements. The financial statements and notes are representations of the Organization's management who are responsible for its integrity and objectivity. These accounting policies conform to U.S. GAAP and have been consistently applied in the preparation of the financial statements.

Basis of Accounting

The accompanying financial statements were prepared on the accrual basis of accounting.

Income Tax Status

The Organization is a nonprofit public benefit corporation organized under the laws of California and, as such, is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and corresponding state provisions.

The Organization's federal income tax and informational returns for tax years ending June 30, 2011 and subsequent remain subject to examination by the Internal Revenue Service. The returns for California, the Organization's only state tax jurisdiction, remain subject to examination by the California Franchise Tax Board for tax years ending June 30, 2010 and subsequent.

Financial Statement Presentation

The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted. Typically, the Organization only has unrestricted sources of revenue.

Unrestricted Net Assets - Include service fees from government, insurance or patients as well as government grants that are not restricted by the donor or grantor as well as expenditures related to the general operations of the Organization.

Temporarily Restricted Net Assets - Include contributions that are temporarily restricted by the donor or grantor. The Organization has no temporarily restricted net assets.

Permanently Restricted Net Assets - Include contributions that have been restricted by the donor in perpetuity. The Organization has no permanently restricted net assets.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from these estimates.

Insurance Coverage

The Organization is exposed to risk of loss related to professional and general liability. Management believes that the levels of coverage carried are adequate so that no potential claim could negatively impact the Organization operations in future periods.

Concentrations of Credit Risk

Frequently, the Organization's bank balances exceed the FDIC-insured limits. The Organization has not experienced and does not anticipate any losses relating to cash held in these balances.

The Organization derived 65% of its total revenues during the year from the County of Los Angeles through a number of contracts and agreements, each of which is negotiated, performed and monitored on an individual basis. Management anticipates this funding will continue at the present levels.

Impairment of Long-Lived Assets

Management reviews each asset or asset group for impairment whenever events or circumstances indicate that the carrying value of an asset or asset group may not be recoverable, but at least annually. No impairment provision was recorded by the Organization during the year.

Cash and Cash Equivalents

The Organization considers all highly liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments are stated at fair value. Income from investments is recorded as unrestricted or temporarily restricted revenue in accordance with donor instructions.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments (Continued)

The Organization must report its investments at fair value among three categories of price inputs available. These categories of inputs are quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3). At year-end, all investments were considered to be Level 1, with the exception of certain alternative assets which were determined to be Level 3 (see Note 3).

Accounts Receivable

Accounts receivable are unsecured and the Organization is at risk to the extent that such amounts become uncollectible. Management has provided an allowance for doubtful accounts in the amount of \$385,840, which it believes is adequate based on known events and historical activity.

Other Assets

Included in other assets are the following:

Deposits	\$ 300,980
Certificate reserve	147,280
Incentive gift cards	65,179
Debt issue costs, net	46,858
Insurance premium reserves	32,719
Investments in security options trust	<u>24,040</u>
	<u>\$ 617,056</u>

Certificate reserve - represents the maximum annual payment of the Organization's long-term debt, which is required to be maintained in a reserve account in accordance with the debt agreement (see Note 6).

Debt issue costs - represents the direct costs of structuring the Organization's long-term debt (see Note 6). The capitalized amount is being amortized over the term of the debt. At June 30, 2014, there was \$77,527 of accumulated amortization of which \$4,975 was amortized in the fiscal year.

Incentive gift cards - represents purchased retail gift cards for use in providing rewards to clients or tokens of appreciation to employees.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Assets (Continued)

Insurance premium reserves - represents a reserve for insurance premiums paid in accordance with the bond payment terms (see Note 6).

Investments in security options trust - the Organization holds investments in a financial institution for the benefit of its participant in the Discounted Employee Security Option Program (see Note 7).

Property and Equipment

Purchases of fixed assets are recorded at cost. Donated items are recorded at fair value when received. Depreciation and amortization on both purchased and donated items are recorded using the straight line method over the shorter of the estimated useful life of the related asset or the term of the lease for leasehold improvements as follows:

Buildings	39 years
Hospital and house equipment	7 years
Leasehold improvements	15 years
Computer and office equipment	5 years
Computer software	3 years
Transportation equipment	5 years

Normal repairs and maintenance are expensed as incurred, whereas significant charges that materially increase values or extend useful lives are capitalized and depreciated over the estimated useful lives of the related assets.

Deferred Compensation

The Organization maintains a deferred compensation plan for the benefit of certain management employees. Assets of the deferred compensation plan are discussed in this note at "Other Assets" and the corresponding liability is discussed at Note 7.

Deferred Revenue

Deferred revenue represents money received from contracts/grants prior to being earned. Grant and contract income is recognized in subsequent years as services are rendered.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Government Grants

The Organization receives a portion of its public support based on reimbursable costs as defined by the respective grants. Reimbursements recorded under these grants are subject to audit by the granting agency.

Cost Allocation

The Organization allocates its expenses on a functional basis among its various programs and support services. Expenses that can be identified with a specific program or support services are allocated directly according to functional expense classifications. Other expenses common to several functions are allocated using reasonable statistical bases.

Contributions

Contributed services are reported at the estimated fair value in the financial statements for voluntary donations of services when those services (1) create or enhance nonfinancial assets, or (2) require specialized skills provided by individuals possessing those skills, and (3) are services which would typically be purchased if not provided by donation. The Organization recorded contributed services revenue and a related expense for donated professional services valued at \$31,200.

Contributed assets are recorded at fair value at the date of the gift, as contributed asset revenue. The Organization received and recorded non-cash contributions of clothing, furniture, food, and appliances valued at \$125,116.

Subsequent Events

The Organization has evaluated events subsequent to June 30, 2014 to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through December 11, 2014, the date the financial statements were available to be issued. No such events were noted, except those described in Note 11.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 3 - INVESTMENTS

The following table sets forth by level, within the fair value hierarchy, the Organization's investments at fair value as of June 30, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity mutual funds	\$ 103,529	\$ 0	\$ 0	\$ 103,529
International equity funds	50,383	-	-	50,383
Alternative assets	1,078,361	-	864,778	1,943,139
Fixed income	<u>456,529</u>	<u>-</u>	<u>-</u>	<u>456,529</u>
	<u>\$ 1,688,802</u>	<u>\$ 0</u>	<u>\$ 864,778</u>	<u>\$ 2,553,580</u>

Alternative assets consist of institutional funds, closed-end funds, long/short equity funds and other investments.

Activity in the investments during the year was as follows:

Balance, beginning of year	\$ 0
Purchases of investments	2,507,682
Unrealized gains	<u>45,898</u>
Balance, end of year	<u>\$ 2,553,580</u>

The value of certain alternative assets has been determined using statements provided by investment brokers. The changes in Level 3 measurements of these alternative assets during the year are as follows:

Balance, beginning of year	\$ 0
Purchases	850,000
Change in value	<u>14,778</u>
Balance, end of year	<u>\$ 864,778</u>

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

Los Angeles County	\$ 4,925,652
Private insurance	772,860
U.S. Government	511,125
Other agencies	489,461
State of California	253,665
City of Los Angeles	<u>219,198</u>
	7,171,961
Allowance for doubtful accounts	<u>(385,840)</u>
	<u>\$ 6,786,121</u>

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Land	\$ 897,305
Buildings	1,120,933
Hospital and house equipment	949,172
Leasehold improvements	11,111,504
Computer and office equipment	2,768,660
Computer software	926,319
Transportation equipment	<u>489,602</u>
	18,263,495
Accumulated depreciation and amortization	<u>(12,596,133)</u>
	<u>\$ 5,667,362</u>

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 6 - DEBT

On December 1, 1998, the ABAG Finance Authority for Nonprofit Organizations ("ABAG"), a California joint powers agency, issued Insured Revenue Certificates of Participation (essentially bonds and hereinafter referred to as the "Bonds") in the amount of \$1,950,000 on behalf of the Organization to finance the purchase of a facility in Long Beach, California. The Bonds are insured by Cal-Mortgage and are publicly-traded. US Bank is the trustee for the Bonds and the Organization will make monthly payments of approximately \$12,300, including bond insurance, through December 2023, with interest at 5.75%, into accounts established for the Bonds' repayment. The Organization has signed a deed of trust to US Bank for the benefit of ABAG granting a first lien on the property. The debt agreements contain several covenants with which noncompliance has no material financial statement implication.

The following is a schedule of future minimum principal payments required under the Bond as of June 30, 2014:

<u>Year Ending June 30.</u>	
2015	\$ 85,000
2016	90,000
2017	95,000
2018	100,000
2019	105,000
Thereafter	<u>625,000</u>
	1,100,000
Current Portion	<u>(85,000)</u>
	<u>\$ 1,015,000</u>

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 7 - DEFERRED COMPENSATION

In 1999, the Organization established a non-qualified deferred compensation plan structured as a Discounted Employee Security Option Program (DESOP) for the benefit of certain management employees. The Organization's board makes annual grants of options in publicly-traded mutual funds which the Organization has purchased to fund the DESOP, and the account balance fluctuates with the investment returns on those funds. The DESOP assets are held in a separate trust, but are subject to the claims of the Organization's creditors in the event that the Organization becomes insolvent. Consequently, the trust qualifies as a grantor trust for income tax purposes. Members of management exercised the majority of options outstanding on December 10, 2012 and only one member of management remains a participant in the plan. Charges to deferred compensation expense are included within salaries in the accompanying statement of functional expenses. The difference of \$14,937 between the asset (see Note 2) and the remaining liability is due to amounts not yet transferred to the remaining DESOP trust account.

401(k) Plan

The Organization has established a defined contribution plan under Section 401(k) of the Internal Revenue Code ("IRC"), covering certain employees aged 18 years and older who have completed six months of service. The terms of the plan provide that employees, once eligible, may participate in the plan by making contributions up to the maximum allowed under the IRC. The Organization makes elective matching contributions of 50% of the elective deferral up to 2.5% of eligible earnings. Contribution expense was \$216,108 for the year.

NOTE 8 - WORKERS' COMPENSATION LIABILITY

The Organization is partially self-insured for workers' compensation. The program is supplemented with commercial excess insurance with third-party insurance carriers for total claims above the Organization's self-insurance retention of \$500,000. The Organization has retained an outside administrator to monitor, process and administer its claims. The administrator also establishes an accrual for future payments on known claims. Historically, the Organization has had a very low frequency of incurred but not reported claims.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 8 - WORKERS' COMPENSATION LIABILITY (Continued)

Changes in the balance of claim liabilities for the year ended June 30, 2014, are as follows:

Balance July 1, 2013	Current Year Claims and Change in Estimates	Claims/ Payments	Balance June 30, 2014
<u>\$ 1,062,715</u>	<u>\$ 448,270</u>	<u>\$ (612,027)</u>	<u>\$ 898,958</u>

The liability has been included in accrued expenses in the accompanying financial statements.

California's private insurance program requires that self-insured employers post collateral to cover estimated future claim liabilities. The Organization participates in California's "Alternative Security Program," part of the Self-Insurer's Security Fund. Membership in this program allows the Organization to fulfill the collateral requirement through its membership and investment in the program and without posting the Organization's assets as collateral.

NOTE 9 - CAPITAL LEASE OBLIGATION

The Organization leases certain equipment under a capital lease arrangement that expires in August 2017. The assets under capital lease have been recorded at fair value and are being amortized over the assets' useful lives. Amortization of property under capital leases is included in depreciation and amortization in the financial statements.

Net book value of assets under capital lease obligation consists of the following:

Clinic equipment	\$ 529,092
Accumulated amortization	<u>(194,000)</u>
	<u>\$ 335,092</u>

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 9 - CAPITAL LEASE OBLIGATION (Continued)

Future maturities of the capital lease obligation are as follows:

<u>Year Ending June 30,</u>		
2015	\$	131,600
2016		131,600
2017		131,600
2018		<u>21,933</u>
Total minimum lease payments		416,733
Imputed interest		<u>(56,764)</u>
Present value of minimum lease payments		359,969
Current portion		<u>(102,529)</u>
		<u>\$ 257,440</u>

NOTE 10 - RELATED PARTY TRANSACTIONS

In the year ended June 30, 2014, the Organization leased six properties from entities in which a director and/or the Organization's CEO have invested. These transactions are summarized as follows:

<u>Property</u>	<u>Lease Termination</u>	<u>Fiscal 2014</u>	
		<u>Rent Paid</u>	<u>Property Taxes Paid</u>
18700 Oxnard St.	June, 2028	\$ 293,428	\$ 22,247
44447 North 10th St.	December, 2017	668,547	47,062
7101 Baird St.	June, 2028	285,791	14,654
8330 Reseda Blvd.	July, 2028	256,756	34,609
907 West Lancaster Blvd.	March, 2018	115,838	12,094
38744 Cortina Way	Month-to-month	<u>36,000</u>	<u>-</u>
		<u>\$ 1,656,360</u>	<u>\$ 130,666</u>

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 10 - RELATED PARTY TRANSACTIONS (Continued)

The Organization has had valuations performed on all of the significant properties by a third-party appraiser. The Organization believes the appraisals support the Organization's position that it is paying fair rental value (or less) for each property.

NOTE 11 - COMMITMENTS

The Organization leases 29 facilities (including the leases discussed in Note 10), all of which are accounted for as operating leases.

The Organization recognized rental expense of \$4,696,265 for the year ended June 30, 2014. The following is a schedule of future minimum rental payments required under the above operating leases as of June 30, 2014:

2015	\$ 4,225,551
2016	4,352,318
2017	4,344,895
2018	4,422,842
2019	4,017,407
Thereafter	<u>18,754,589</u>
	<u>\$ 40,117,602</u>

Subsequent to June 30, 2014, the Organization extended the operating leases related to the 10th Street West Lancaster properties an additional ten years to 2030 with scheduled rent increases of \$15,000 per month occurring on December 1, 2017 and December 1, 2019 with no other scheduled increases.

NOTE 12 - CONTINGENCIES

Litigation

The Organization operates its mission in an environment that is subject to professional and general liability risks. Whereas there are no asserted claims at this time, management contends it is adequately insured so that no potential claim could create a significant adverse financial impact.

TARZANA TREATMENT CENTERS, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 12 - CONTINGENCIES (Continued)

Health Care Reform

As a result of the Patient Protection and Affordable Care Act, as well as the Health Care and Education Reconciliation Act of 2010 and related health care reform legislation and regulations (collectively "Health Care Reform"), significant changes to the current U.S. healthcare system are anticipated. Health Care Reform includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, payments to healthcare providers, and the legal obligations of health insurers, providers and employers. Such provisions include measures designed to promote quality and cost efficiency in healthcare delivery and to generate budgetary savings, including with respect to Medi-Cal, the California Department of Mental Health and other State programs pursuant to which the Organization is reimbursed for the services it provides. The Organization is unable to predict the full impact of Health Care Reform at this time. However, the Organization expects that Health Care Reform may have a material effect on its business.

State Funding

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. During the last few years, as a result of nationwide investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as regulatory action, which could include fines, penalties, exclusion from the Medicare and Medicaid programs, and revocation of federal or state tax-exempt status. Moreover, the Organization expects that the level of review and audit to which it and other health care providers are subject will increase.

Various state and federal agencies routinely initiate audits of healthcare providers, including the Organization. The Organization investigations are continually in various stages of discovery and relate to reimbursement, billing practices and other matters of the Organization. There can be no assurance that regulatory authorities will not challenge the Organization's compliance with these laws and regulations, and it is not possible to determine the impact, if any, such claims or penalties would have on the Organization. As a result, there is a possibility that recorded amounts will change by a material amount in the near term, although management currently has no information that would suggest there will be a material change. To foster compliance with applicable laws and regulations, the Organization maintains a compliance program designed to detect and correct potential violations of laws and regulations related to its programs.

TARZANA TREATMENT CENTERS, INC.
SINGLE AUDIT REPORTS AND SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2014

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors of
TARZANA TREATMENT CENTERS, INC.
Tarzana, California

We have audited, in accordance with U.S. GAAS and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the U.S., the financial statements of Tarzana Treatment Centers, Inc. (the "Organization") (a nonprofit organization), which comprise the statement of financial position as of June 30, 2014, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to financial statements, and have issued our report thereon dated .

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Organization'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 the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization'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 Organization'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 the Organization'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*.



INDEPENDENT AUDITORS' 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*

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 Organization'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 Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

RBZ, LLP

December 11, 2014

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY OMB CIRCULAR A-133

Board of Directors of
TARZANA TREATMENT CENTERS, INC.
Tarzana, California

Report on Compliance for Each Major Federal Program

We have audited Tarzana Treatment Centers, Inc.'s (the "Organization") 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 the Organization's major federal programs for the year ended June 30, 2014. The Organization's major federal programs are identified in the summary of auditors' 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.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Organization'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 U.S. GAAS; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S.; 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 the Organization'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 the Organization's compliance.

Opinion on Each Major Federal Program

In our opinion, the Organization 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, 2014.



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY OMB CIRCULAR A-133

Report on Internal Control Over Compliance

Management of the Organization 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 the Organization'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 the Organization'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 over that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of the Organization as of and for the year ended June 30, 2014, and have issued our report thereon dated December 11, 2014, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. GAAS. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY OMB CIRCULAR A-133

Purpose of this Report

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.

RBZ, LLP

December 11, 2014

TARZANA TREATMENT CENTERS, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2014

Federal Grantor/ Pass-through Grantor/ Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures Non ARRA	Major Program	Funds Provided to Sub recipients	Match
U.S. Department of Housing and Urban Development						
Supportive Housing Programs						
Porchlight	14.235	CA0437B9B001004	\$ 247,376		\$ -	\$ 53,419
End to Homeless & High Risk	14.235	CA0506B9D001104	186,725		-	48,021
U.S. Department of Veteran Affairs						
Veterans Rehabilitation_Alcohol and Drug Dependence	64.019	VA262-P-0404	164,400		-	-
U.S. Department of Health and Human Services						
Substance Abuse and Mental Health Services_Projects of Regional and National Significance:						
Getting off at TTC	93.243	1H79TI024452-01	521,722	*	-	-
Assertive Community Treatment	93.243	5H79SM059714-03	434,702	*	-	-
HCV Screening for OTP	93.243	1H79TI024717-01	39,969	*	-	-
Growing Miracles	93.243	5H79TI023743-02	460,171	*	-	156,696
Tele Treatment	93.243	5H79TI023795-02	264,682	*	-	-
Diamonds & Pearls	93.243	5U79SP016464-03	281,547	*	-	-
Prevention Public Health Fund: Viral Hepatitis Prevention	93.736	1U51PS003847-01	248,390		-	-
Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	93.943	5U65PS002353-03	307,336		-	-
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	1H76 HA00791-10-00	374,148	*	-	-
Passed through from The University Corporation (Northridge)						
Substance Abuse and Mental Health Services_Projects of Regional and National Significance:	93.243	1H79TI020199-01	75,000	*	-	-
Passed through County of Los Angeles:						
Office of AIDS Program and Policy:						
HIV Emergency Relief Project Grants:						
Medical Transportation	93.914	PH001534	145,578	*	-	-
Case Management Medical / Case Management Non-Medical	93.914	PH001536	135,278	*	-	-
Benefits Specialty	93.914	PH001537	74,523	*	-	-
Mental Health Psychiatric / Mental Health Psychotherapy	93.914	PH001538	42,086	*	-	-
Medical Outpatient / Medical Outpatient Med. Specialty	93.914	PH001542	9,872	*	-	-
Medical Outpatient	93.914	PH002345	112,997	*	-	-
Medical Outpatient MOP AOM	93.914	PH002352	94,957	*	-	-
Medical Outpatient	93.914	H209018	42,328	*	-	-
OAPP Mental Health	93.914	H210794	89,359	*	-	-
NOCHAA Benefits Specialty	93.914	H210795	90,969	*	-	-
HIV Care Formula Grants:						
Oral Health Care Services	93.917	PH001535	29,586	*	-	-
Case Management home-based	93.917	H204608	430,904	*	-	-
Prerelease County Prison	93.917	H300127	153,300	*	-	-
Residential	93.917	H700982	319,841	*	-	-
Detox	93.917	H700983	247,487	*	-	-
Transitional Housing	93.917	H701004	90,486	*	-	-
Substance Abuse and Mental Health Services_Projects of Regional and National Significance (Drug Court)	93.243	PH002307	23,080	*	-	-
HIV Prevention Activities_Health Department Based						
Mobile Testing	93.940	PH000827	129,392		-	-
Storefront	93.940	PH000827	105,061		-	-
Block Grants for Prevention and Treatment of Substance Abuse						
Health Education / Risk Reduction: IDU	93.959	PH001047	117,103	*	-	-
Health Education / Risk Reduction: Women	93.959	PH001062	152,968	*	-	-
Substance Abuse & Prevention Control						
Block Grants for Prevention and Treatment of Substance Abuse						
Prevention (ADPS)	93.959	PH002003 A-B	488,625	*	-	-
Substance Use Disorder Services	93.959	PH002307	4,183,742	*	133,550	-
Medical Assistance Program (Drug Medical Court)	93.778	PH001854 A-H	150,203		-	-
Edward Byrne Memorial Justice Assistance Grant Program(Drug Court)	16.738	PH002307	324,000		-	-
Department of Children and Family Services						
Foster Care_Title IV-E (Wraparound)	93.658	04-011-32	347,692		-	-
Passed through from the City of Los Angeles:						
Housing Opportunities for Persons with AIDS	14.241	120401 & 112192	597,245	*	-	-
Emergency Food and Shelter National Board Program	97.024		21,500		-	-
Totals			\$ 12,356,330		\$ 133,550	\$ 258,136

TARZANA TREATMENT CENTERS, INC.

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED JUNE 30, 2014

NOTE 1 - GENERAL

The accompanying schedule of expenditures of federal awards presents the activity of all federal assistance programs of Tarzana Treatment Centers, Inc.

NOTE 2 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards is presented using the accrual basis of accounting, which is described in Note 2 of the notes to financial statements of Tarzana Treatment Centers, Inc. as of and for the year ended June 30, 2014.

TARZANA TREATMENT CENTERS, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2014

- A -

SUMMARY OF AUDITORS' RESULTS

1. An unmodified opinion was issued on the financial statement of Tarzana Treatment Centers, Inc.
2. The audit of the financial statements disclosed no material weaknesses in internal control over financial reporting; no significant deficiencies not considered to be material weaknesses were reported.
3. The audit of the financial statements disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
4. The audit of compliance with requirements applicable to each major program disclosed no material weaknesses in internal control over compliance with requirements applicable to major programs; no significant deficiencies not considered to be material weaknesses were reported.
5. An unmodified opinion was issued on compliance with requirements applicable to major programs.
6. The audit disclosed no findings required to be reported under OMB Circular A-133 §510(a).
7. The major programs are identified as follows:

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures of Federal Awards</u>
U.S. Department of Housing and Urban Development Housing Opportunities for Persons with AIDS	14.241	\$ 597,245
U.S. Department of Health and Human Services Grants to Provide Outpatient Early Intervention Services with Respect to HIV Diseases:	93.918	374,148
Substance Abuse and Mental Health Services Projects	93.243	2,100,873
Block Grants for Prevention and Treatment of Substance Abuse	93.959	4,942,438
HIV Emergency Relief Project Grants	93.914	837,947
HIV Care Formula Grants	93.917	<u>1,271,604</u>
Total Major Programs		<u>\$ 10,124,255</u>

TARZANA TREATMENT CENTERS, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2014

8. The dollar threshold used to distinguish between Type A and Type B programs was \$370,690, as described in OMB Circular A-133 §520(b).
9. The auditee did not qualify as a low-risk auditee under OMB Circular A-133 §530.

- B - FINDINGS AND QUESTIONED COSTS - FINANCIAL STATEMENT AUDIT,
JUNE 30, 2014

None

- C - FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL PROGRAMS AUDIT,
JUNE 30, 2014

None

TARZANA TREATMENT CENTERS, INC.

CORRECTIVE ACTION PLAN

FOR THE YEAR ENDED JUNE 30, 2014

No corrective action required.

TARZANA TREATMENT CENTERS, INC.
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2014

- A - FINDINGS AND QUESTIONED COSTS - FINANCIAL STATEMENT AUDIT,
JUNE 30, 2013

Finding 2013-001 – Estimates

Current Status: Corrective action was taken.

- B - FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL PROGRAMS AUDIT,
JUNE 30, 2013

Finding 2013-002 – Personnel Activity Reports

Current Status: Corrective action was taken.

Finding 2013-003 - Allowable Costs

Current Status: Corrective action was taken.