MATSON & ISOM

REDWOOD COAST DEVELOPMENTAL SERVICES CORPORATION

Ukiah, California

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION WITH INDEPENDENT AUDITORS' REPORTS

June 30, 2012

TABLE OF CONTENTS

June 30, 2012

Redwood Coast Developmental Services Corporation

INDEPENDENT AUDITORS' REPORT

Matson & Isom

To the Board of Directors
Redwood Coast Developmental
Services Corporation
Ukiah, California

We have audited the accompanying statement of financial position of Redwood Coast Developmental Services Corporation (the Center), a California nonprofit corporation, as of June 30, 2012, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Center's management. 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 United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Redwood Coast Developmental Services Corporation as of June 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 10, 2013, on our consideration of the Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Matson and Isom

May 10, 2013
Redding, California

FINANCIAL SECTION

	Unrestricted		
June 30, 2012	**General**	**State Contracts**	**Total**
ASSETS			
Cash and cash equivalents	$ -	$ 6,402,776	$ 6,402,776
Investments	49,969	-	49,969
Contracts receivable - State Regional Center Contract	-	19,520,460	19,520,460
Prepaid expenses	-	24,058	24,058
Due from State - accrued vacation and other leave benefits	-	409,571	409,571
Total Assets	$ 49,969	$ 26,356,865	$ 26,406,834
LIABILITIES AND NET ASSETS			
LIABILITIES			
Accounts payable	$ -	$ 5,763,948	$ 5,763,948
Short-term borrowings	-	6,500,000	6,500,000
Advance - State Regional Center Contract	-	13,274,297	13,274,297
Accrued vacation and other leave benefits	-	409,571	409,571
Due to State	-	308,702	308,702
Reserve for unemployment insurance	-	100,347	100,347
Total Liabilities	-	26,356,865	26,356,865
NET ASSETS			
Unrestricted	49,969	-	49,969
Total Liabilities and Net Assets	$ 49,969	$ 26,356,865	$ 26,406,834

The accompanying notes are an integral part of these financial statements.

Year Ended June 30, 2012	
CHANGE IN UNRESTRICTED NET ASSETS	
REVENUE	
State Regional Center Contracts	$ 75,888,317
Interest income	27,628
Other income	25,679
Unrealized and realized gain (loss) on investments	(1,093)
Total Revenue	75,940,531
EXPENSES	
PROGRAM SERVICES	
Intake	216,852
Case management	4,793,747
Program development	502,161
Other direct services	932,615
Living out of home	9,008,591
Day program	3,561,954
Other purchased services	55,589,362
Total Program Services	74,605,282
SUPPORTING SERVICES	
General and administrative	1,335,713
Total Supporting Services	1,335,713
Total Expenses	75,940,995
Change in Net Assets	(464)
Net Assets - Beginning of Year	50,433
Net Assets - End of Year	$ 49,969

The accompanying notes are an integral part of these financial statements.

STATEMENT OF FUNCTIONAL EXPENSES

Redwood Coast Developmental Services Corporation

Year Ended June 30, 2012	Program Services								Supporting Services	
	Intake	Case Management	Program Development	Other Direct Services	Living Out of Home	Day Program	Other Purchased Services	Total Program Services	General and Administrative	Total
Salaries	$ 123,029	$ 2,594,738	$ 294,705	$ 637,487	$ -	$ -	$ -	$ 3,649,959	$ 674,924	$ 4,324,883
Employee health and retirement benefits	35,769	990,477	83,127	212,822	-	-	-	1,322,195	245,813	1,568,008
Payroll taxes	1,739	38,896	5,845	8,597	-	-	-	55,077	10,653	65,730
Purchase of services	-	-	-	-	9,008,591	3,561,954	55,589,362	68,159,907	-	68,159,907
Equipment rental and maintenance	3,103	70,054	7,416	-	-	-	-	80,573	18,003	98,576
Facility rent	21,823	492,656	52,157	1,736	-	-	-	568,372	126,612	694,984
Facility maintenance	1,602	36,166	3,829	-	-	-	-	41,597	9,295	50,892
Communication	7,417	167,442	17,727	591	-	-	-	193,177	43,032	236,209
General office expenses	1,687	38,082	4,032	39	-	-	-	43,840	9,787	53,627
Printing	751	16,958	1,795	-	-	-	-	19,504	4,358	23,862
Insurance	1,894	42,746	4,525	37	-	-	-	49,202	10,986	60,188
Data processing	738	16,665	1,764	-	-	-	-	19,167	4,283	23,450
Legal fees	761	17,184	1,819	-	-	-	-	19,764	4,416	24,180
Board expenses	635	14,334	1,517	-	-	-	-	16,486	3,684	20,170
Equipment purchases	262	5,920	627	-	-	-	-	6,809	1,521	8,330
Consultant services	1,685	38,035	4,027	25,674	-	-	-	69,421	9,775	79,196
Staff travel	9,277	107,723	6,061	38,353	-	-	-	161,414	14,481	175,895
ARCA dues	-	-	-	-	-	-	-	-	34,504	34,504
General expenses	1,238	27,948	2,959	4,121	-	-	-	36,266	7,183	43,449
Accounting fees	-	-	-	-	-	-	-	-	52,500	52,500
Interest	-	-	-	-	-	-	-	-	29,927	29,927
Bank service charges	1,012	22,847	2,419	158	-	-	-	26,436	5,872	32,308
Utilities	2,302	51,975	5,503	-	-	-	-	59,780	13,358	73,138
Special assessment - Prevention	-	-	-	3,000	-	-	-	3,000	-	3,000
Advertising	128	2,901	307	-	-	-	-	3,336	746	4,082
Total Expenses	$ 216,852	$ 4,793,747	$ 502,161	$ 932,615	$ 9,008,591	$ 3,561,954	$ 55,589,362	$ 74,605,282	$ 1,335,713	$ 75,940,995

The accompanying notes are an integral part of these financial statements.

Year Ended June 30, 2012	
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from grants, contracts, and clients	$ 69,954,803
Cash paid to suppliers and employees	(76,329,161)
Interest received	27,628
Net Cash Used by Operating Activities	(6,346,730)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of investments	(629)
Net Cash Used by Investing Activities	(629)
CASH FLOWS FROM FINANCING ACTIVITIES	
Net change in short-term borrowings	6,500,000
Net Cash Provided by Financing Activities	6,500,000
Change in Cash and Cash Equivalents	152,641
Cash and Cash Equivalents - Beginning of Year	6,250,135
Cash and Cash Equivalents - End of Year	$ 6,402,776
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH USED BY OPERATING ACTIVITIES	
Change in net assets	$ (464)
Adjustments to reconcile change in net assets to net cash used by operating activities:	
Unrealized (gain) loss on investments	1,093
Changes in:	
Contracts receivable - State Regional Center Contract	(5,807,718)
Due from State - accrued vacation and other leave benefits	(10,195)
Prepaid expenses	53,922
Accounts payable	(443,185)
Advance - State Regional Center Contract	286,384
Accrued vacation and other leave benefits	10,195
Due to State	(437,859)
Reserve for unemployment insurance	1,097
Net Cash Used by Operating Activities	$ (6,346,730)
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION	
Interest paid	$ 29,927

The accompanying notes are an integral part of these financial statements.

1. NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities Redwood Coast Developmental Services Corporation (the Center) was incorporated on June 7, 1983, as a California nonprofit corporation. The Center was organized in accordance with the provisions of the Lanterman Developmental Disabilities Services Act (the Act) of the Welfare and Institutions Code of the State of California. In accordance with the Act, the Center, doing business as the Redwood Coast Regional Center, provides diagnostic evaluations, client program management, and lifelong planning services for persons with developmental disabilities, and their families. The geographical areas served include Del Norte, Humboldt, Mendocino, and Lake Counties.

Basis of Accounting The accompanying financial statements have been prepared on the accrual basis of accounting.

Financial Statement Presentation The Center's financial statements are presented in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958, *Not-for-Profit Entities*. Under FASB ASC Topic 958, the Center is required to report information regarding its financial position and activities according to three classes of net assets based upon the existence or absence of donor-imposed restrictions, as follows:

> *Unrestricted net assets* represent resources over which the Board of Directors has discretionary control and that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations.
>
> *Temporarily restricted net assets* represent resources whose use by the Center is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Center pursuant to those stipulations. When a donor restriction expires, that is, when a stipulated purpose is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets. The Center has no temporarily restricted net assets.
>
> *Permanently restricted net assets* represent resources whose use by the Center is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Center. The Center has no permanently restricted net assets.

Fund Accounting The accounts of the Center are maintained in accordance with the principles of fund accounting. Under fund accounting, resources are classified for accounting and reporting considerations into funds established according to their nature and purpose.

Cash and Cash Equivalents For purposes of the statement of cash flows, the Center considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. In accordance with the State Regional Center Contract, bank accounts are in the name of both the State of California Department of Developmental Services (DDS) and the Center.

Significant Concentrations of Credit Risk At June 30, 2012, and throughout the year, the Center had maintained a cash balance with a bank in excess of federally insured limits. Accounts at the institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At June 30, 2012, cash exceeded federally insured limits by $6,725,288. The Center has not experienced any loss and management believes it is not exposed to any significant credit risk on such accounts.

Investments Investments are recorded at fair value and consist of funds managed by the Community Foundation of Mendocino County and the Humboldt Area Foundation in pooled accounts consisting of mutual funds and equity securities. Unrealized gains and losses are included in the change in net assets.

State Regional Center Contract Receivables and Advances Contracts receivable represent amount due from the State for reimbursement of expenditures made by the Center under the annual Regional Center contracts. Advances represent cash advances received by the Center under annual Regional Center contracts. Amounts receivable from the State are offset against advances payable when the State notifies the Center that a right of offset exists. The Center considers all amounts receivable under grant contracts to be collectible; accordingly, no allowance for doubtful accounts exists.

Due to State The Center reports an amount on the Statement of Financial Position as "Due to State." This is the amount of self-determination funds that were unused for clients by the end of their initial 12-month period. These amounts cannot be used for future budget years and must be repaid to the State.

Prepaid Expenses Payments made to vendors for services that will benefit the Center for periods beyond the current fiscal year are recorded as prepaid expenses.

Receivable, ICF Providers and Payable, DDS During the year ended June 30, 2011, various legislative changes were made to the California Welfare and Institutions Code retroactively to July 1, 2007, making Intermediate Care Facility (ICF) providers responsible for providing consumer day treatment and transportation services; and ultimately, making such services eligible for reimbursement under California's Home and Community Based Services (HCBS) Program, which is funded by the Medicaid Waiver grant (Medicaid).

Previously, such services were not reimbursable by Medicaid because the funds were not directly billed and received by the ICF's. The legislative changes allow for DDS to bill these services to Medicaid and capture federal dollars. The Center prepares the billings to the DDS on behalf of the ICF provider for the cost of these services. The billings included a 5.5% Quality Assurance fee for the State Department of Health Care Services (DHCS), a 1.5% administrative fee for the ICF's, and a 1.5% administration fee for the Center. The ICF's are directed to remit to the Center the amounts billed on their behalf less their administrative fee and the quality assurance fee, which they must remit to DHCS. The Center then remits to DDS the amounts for the day program and transportation services and retains the Center's administrative fee.

During the year ended June 30, 2012, DDS directed the Center to prepare billings for these services on behalf of the ICF's from July 1, 2007, to June 30, 2009. Total amounts billed to the ICF's for this period were $924,790. Of this amount, $911,123 was remitted to the State and $13,667 was retained by the Center as its administrative fee.

Equipment Purchase In accordance with the State Regional Center contracts, all equipment purchased with contract funds is the property of the State. The Center is required to maintain memorandum records of equipment purchases and dispositions. Equipment purchases are recorded as supporting or program service expenses when they are incurred.

Accrued Vacation and Other Leave Benefits The Center has accrued a liability for leave benefits. However, such benefits are reimbursed under the DDS contract only when actually paid. The Center has also recorded a receivable from the DDS for the accrued leave benefits to reflect the future reimbursement of such benefits.

Revenue Concentration State Regional Center contract revenue is revenue received from the State of California in accordance with the Lanterman Act. Ninety-nine percent of revenue is derived from this source.

Contributions Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions.

Allocation of Expenses The statement of functional expenses allocates expenses to the program and supporting service categories based on a direct-cost basis for purchase of services and salaries and related expenses. In addition, expenses are allocated based on a percentage of salaries and related expenses per category to total salaries and related expenses for operating expenses, except for travel and certain administrative costs, which are allocated on a direct-cost basis.

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

Income Taxes The Center has received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, and Section 23701(d) of the State of California Revenue and Taxation Code, and has been classified as an organization that is not a private foundation under Section 509(a) of the Internal Revenue Code. Accordingly, no provision for income taxes is included in the financial statements.

The Center files exempt organization returns in the U.S. federal and California jurisdictions. The federal returns for tax years 2008 and beyond, and the California returns for tax years 2007 and beyond, remain subject to examination by the taxing authorities.

The Center accounts for income taxes in accordance with FASB ASC 740, *Income Taxes*, which clarifies the accounting for uncertainty in income taxes and how an uncertain tax position is recognized in financial statements. The Center analyzes tax positions taken in previously filed returns and tax positions expected to be taken in future returns. Based on this analysis, a liability is recorded if uncertain tax benefits have been received. The Center's practice is to recognize interest and penalties, if any, related to uncertain tax positions in the tax expense. There were no uncertain tax positions identified or related interest and penalties recorded as of June 30, 2012, and the Center does not expect this to change significantly over the next 12 months.

Subsequent Events Management has evaluated subsequent events through May 10, 2013, the date on which the financial statements were available to be issued.

2. LINE OF CREDIT

The Center has an $11,500,000 revolving line of credit with Union Bank, secured by substantially all assets of the Center. Interest on the outstanding balance is payable monthly at an interest rate of 3.25% at June 30, 2012, and amounted to $29,927 for the year ended June 30, 2012. The line of credit expired on September 28, 2012. The outstanding balance at June 30, 2012, was $6,500,000.

3. RETIREMENT PLAN

Defined Benefit Plan

Plan Descriptions The Center contributes to the California Public Employees Retirement System (PERS), an agent multi-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating entities within the State of California. Benefit provisions and all other requirements are established by state statute and Center resolutions. Copies of PERS' annual financial report may be obtained from their Executive Office, 400 Q Street, Sacramento, California 95811.

Funding Policy Participants are required to contribute 7% of their annual covered salary. The Center is required to contribute at an actuarially determined rate for its participants; the rate for the 2011-12 fiscal year was 12.594% of annual covered payroll. The contribution requirements of plan members and the Center are established and may be amended by PERS.

Annual Pension Cost For 2012, the Center's annual pension cost for PERS was equal to the Center's required and actual contributions. The required contribution was determined as part of the June 30, 2009, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percentage of pay.

A summary of principal actuarial assumptions used is as follows:

Investment Rate of Return: 7.75% (net of administrative expense)

Projected Salary Increases: 3.55% to 14.45% depending on age, service, and type of employment

Inflation: 3.00%

Payroll Growth: 3.25%

Individual Salary Growth: A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smoothed market value). PERS unfunded actuarial accrued liability of $4,911,590 as of June 30, 2011, is being amortized as a level percentage of projected payrolls on a closed basis. The remaining amortization period at June 30, 2012, was 30 years.

The three-year trend information for PERS is as follows:

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2010	$ 601,720	100%	$ -
June 30, 2011	$ 537,832	100%	$ -
June 30, 2012	$ 519,337	100%	$ -

The schedule of funding progress is as follows:

Actuarial Valuation Date	Entry Age Actuarial Accrued Liability	Actuarial Asset Value	Unfunded Actuarial Accrued Liability	Funded Ratio	Annual Covered Payroll	Unfunded Actuarial Liability as Percentage of Covered Payroll
June 30, 2009	$ 15,966,144	$ 11,321,226	$ 4,644,918	71%	$ 5,090,068	91%
June 30, 2010	$ 17,184,586	$ 12,588,725	$ 4,595,861	73%	$ 5,117,768	90%
June 30, 2011	$ 18,804,564	$ 13,892,974	$ 4,911,590	74%	$ 4,691,957	105%

4. FUNDING LIMITS

The Center's contract is funded by the State's General Fund and Federal reimbursements. The contracts specify the level and nature of the services to be provided to developmentally disabled persons. Allocated amounts are based primarily on projected client caseloads, and are subject to amendment based upon actual services provided.

Contracts are open for the current and two prior fiscal years as follows:

Fiscal Year Ended	Contract Amount	Cumulative Expenses	Unexpended Balance
June 30, 2012	$ 76,693,182	$ 70,097,771	$ 6,595,411
June 30, 2011	$ 75,935,425	$ 75,352,222	$ 583,203
June 30, 2010	$ 76,154,560	$ 75,899,696	$ 254,864

Management monitors the unexpended balance to avoid overspending the contract limits. Management believes that total expenditures for each open year will not exceed the approved State contract amount.

5. LEASE COMMITMENTS

The Center is obligated under lease agreements for office facilities and equipment. The lease terms range from three to 15 years and expire in various years through 2020. The terms of the leases provide for payment of minimum annual rentals and liability insurance.

Future minimum payments under these leases are as follows:

Year Ended June 30	
2013	$ 689,732
2014	724,219
2015	760,448
2016	816,506
2017	863,332
Thereafter	3,193,570
Total	$ 7,047,807

Total facility rental expense for the year ended June 30, 2012, was $694,984. Equipment rental expense for the year ended June 30, 2012, was $49,645.

6. LITIGATION CLAIMS AND CONTINGENCIES

In accordance with the terms of the State of California contract, an audit may be performed by an authorized state representative. Should such audit disclose any unallowable costs, the Center may be liable to the State for reimbursement of such costs. In the opinion of the Center's management, the effect of any disallowed costs, if any, would be immaterial to the financial statements as of June 30, 2012.

The Center is dependent on continued funding provided by the DDS to operate and provide services for its clients. The Center's contract with DDS provides funding for services under the Lanterman Act. In the event that the operations of the Center result in a deficit position at the end of any contract year, DDS may reallocate surplus funds within the State of California system to supplement the Center's funding. Should a system-wide deficit occur, DDS is required to report to the Governor of California and the appropriate fiscal committee of the State Legislature and recommend actions to secure additional funds or reduce expenditures. DDS's recommendations are subsequently reviewed by the Governor and the Legislature and a decision is made with regard to specific actions, including the possible suspension of the entitlement.

The State of California is experiencing an unprecedented budget shortfall due to the severe national and state economic crisis. The DDS has undertaken numerous efforts to control costs throughout the system and is committed to preserving the entitlement services and supports. Reductions in Regional Center operations and purchase of services are expected for the 2012/2013 fiscal year as a result of cost control efforts and legislation enacted.

The Center has elected to finance its unemployment insurance using the prorated cost-of-benefits method. Under this method, the Center is required to reimburse the State of California for benefits paid to its former employees. At June 30, 2012, the Center had $100,347 in a reserve trust account to pay for any potential unemployment claims.

The Center is involved in various claims and lawsuits arising in the normal conduct of its business. The Center believes it has adequate defenses and insurance coverage for these actions and, thus, has made no provision in the financial statements for any costs relating to the settlement of such claims.

7. CONTRACT COMMITMENTS

The Center contracts with various vendors for administrative functions and client services. Significant unpaid commitments under these contracts at June 30, 2012, consisted of the following:

Administrative services	$ 24,800
Client services	141,019
Total	$ 165,819

8. RELATED-PARTY TRANSACTIONS

California Welfare and Institutions Code 4622 requires that a minimum of 50% of the Center’s governing board be comprised of persons with developmental disabilities or their parents or legal guardians. Program service payments were made on behalf of persons with developmental disabilities that were governing board members or were related to governing board members. Payments of $912,310 were made for the fiscal year ended June 30, 2012.

9. SUBSEQUENT EVENT

Subsequent to June 30, 2012, the Center received a refund from a vendor who had over-charged the Center for services provided over a multiple-year period. The amount of the overpayment was $221,557. The Center is in the process of contacting the State to determine if these funds can be reallocated for future expenditures or if they will need to be offset against current year claim requests.

OTHER REPORTS SECTION

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*

MATSON & ISOM

To the Board of Directors
Redwood Coast Developmental
Services Corporation
Ukiah, California

We have audited the basic financial statements of Redwood Coast Developmental Services Corporation (the Center), a California nonprofit corporation, as of and for the year ended June 30, 2012, and have issued our report thereon dated May 10, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses as item 2012-1 that we consider to be a significant deficiency in internal control over financial reporting. 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.

Compliance and Other Matters

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

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*
Continued

We noted certain matters that we have reported to management of the Center in a separate letter dated May 10, 2013.

The Center's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Center's response; and, accordingly, we express no opinion on it.

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

Matson and Isom

May 10, 2013
Redding, California

FINDINGS AND RESPONSES SECTION

Management Review (Finding 2012-1)

Condition

During our testing of internal controls, we observed that the control environment lacked a high level (management) detailed review of transactions specifically related to disbursements, payroll, and general ledger detail.

Criteria

Control environments can be strengthened when a member of management (controller) is given the responsibility of performing a detail review of transactions and general ledger detail to ensure accuracy and completeness. Implementation of such a position provides a final layer of control and strengthens segregation of duties at the management level.

Effect

Without a high level review performed by management, the potential risk for error, incompleteness, or fraud is increased.

Recommendation

We recommend that the Regional Center implement a controller-type position to oversee and detail review the daily transaction processes that occur within the entity on a daily basis.

Response

The Director of Administration agrees with the assessment of internal controls and the lack of a controller-type position to oversee and detail review transactions and general ledger detail. The Director acknowledges that he has recommended to the Board that such a position would greatly benefit the Center by strengthening the internal control environment of the entity as a whole. It is the intention of management to work toward this goal.