



**Financial Statements
For the Year Ended
September 30, 2008**

LifeWays
paths for personal growth

Your First Pathway to
Behavioral Health Care
in Jackson and Hillsdale

 **Rehmann**
Business wisdom delivered.

LifeWays

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INDEPENDENT AUDITORS' REPORT

August 14, 2009

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the accompanying financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays* as of and for the year ended September 30, 2008, which collectively comprise LifeWays' basic financial statements as listed in the table of contents. These financial statements are the responsibility of LifeWays' management. Our responsibility is to express opinions 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities, the major fund, and the aggregate remaining fund information of LifeWays as of September 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note J to the financial statements, beginning net assets of the Operating Fund were increased by \$95,062 for revenue accruals not recorded in previous years.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 14, 2009, on our consideration of LifeWays' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or 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.

LifeWays has not presented Management's Discussion and Analysis (MD&A) as required supplementary information. The Governmental Accounting Standards Board has determined that such information is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise LifeWays' basic financial statements. The combining fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads "Lehmann Johnson".

BASIC FINANCIAL STATEMENTS

LifeWays
Statement of Net Assets
Proprietary Funds
September 30, 2008

	<u>Enterprise Operating Fund</u>	<u>Internal Service Funds</u>	<u>Total Business-type Activities</u>
Assets			
Cash and cash equivalents	\$ 813,747	\$ 176,324	\$ 990,071
Restricted cash and cash equivalents	148,587	-	148,587
Receivables:			
Fees, net of allowance for doubtful accounts of \$100,556	219,351	-	219,351
Due from State of Michigan	1,959,481	-	1,959,481
Other	135,214	-	135,214
Prepaid items	64,625	-	64,625
Capital assets not being depreciated	2,000,000	-	2,000,000
Capital assets being depreciated, net	10,470,242	-	10,470,242
Unamortized bond issuance costs	81,214	-	81,214
	<hr/>	<hr/>	<hr/>
Total assets	15,892,461	176,324	16,068,785
Liabilities			
Accounts payable	2,341,170	-	2,341,170
Due to Michigan Department of Community Health	74,550	-	74,550
Accrued liabilities	433,973	-	433,973
Claims incurred but not reported	923,926	-	923,926
Long-term debt:			
Due within one year	378,736	-	378,736
Due in more than one year	9,471,232	-	9,471,232
	<hr/>	<hr/>	<hr/>
Total liabilities	13,623,587	-	13,623,587
Net assets			
Invested in capital assets, net of related debt	2,620,274	-	2,620,274
Restricted for contract losses	-	176,324	176,324
Unrestricted (deficit)	(351,400)	-	(351,400)
	<hr/>	<hr/>	<hr/>
Total net assets	\$ 2,268,874	\$ 176,324	\$ 2,445,198

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

LifeWays
Statement of Activities and
Proprietary Funds Revenue, Expenses, and Changes in Fund Net Assets
For the Year Ended September 30, 2008

	<u>Enterprise Operating Fund</u>	<u>Internal Service Funds</u>	<u>Adjustments</u>	<u>Total Business-type Activities</u>
Operating revenue				
Medicaid capitation	\$ 32,247,858	\$ -	\$ -	\$ 32,247,858
State general fund indigent	6,226,703	-	-	6,226,703
Earned revenues, grants and federal programs	6,064,661	-	-	6,064,661
Substance abuse	693,396	-	-	693,396
Local revenue:				
County appropriations	94,136	-	-	94,136
Rental revenue	478,422	-	-	478,422
First party	13,286	-	-	13,286
Third party	396,468	-	-	396,468
Other local revenue	86,903	-	-	86,903
Total operating revenue	<u>46,301,833</u>	<u>-</u>	<u>-</u>	<u>46,301,833</u>
Operating expenses				
Board administration	3,983,474	-	-	3,983,474
Mental health services	41,489,740	-	-	41,489,740
Substance abuse	597,241	-	-	597,241
Depreciation and amortization	328,406	-	-	328,406
Total operating expenses	<u>46,398,861</u>	<u>-</u>	<u>-</u>	<u>46,398,861</u>
Operating loss	<u>(97,028)</u>	<u>-</u>	<u>-</u>	<u>(97,028)</u>
Nonoperating revenue (expense)				
Interest income	14,701	50,232	-	64,933
Interest expense	(571,955)	-	-	(571,955)
Total nonoperating revenue (expense)	<u>(557,254)</u>	<u>50,232</u>	<u>-</u>	<u>(507,022)</u>
Net income (loss) before transfers	<u>(654,282)</u>	<u>50,232</u>	<u>-</u>	<u>(604,050)</u>
Transfers in	530,799	-	(530,799)	-
Transfers out	<u>-</u>	<u>(530,799)</u>	<u>530,799</u>	<u>-</u>
Change in net assets	<u>(123,483)</u>	<u>(480,567)</u>	<u>-</u>	<u>(604,050)</u>
Net assets, beginning of year, as restated	<u>2,392,357</u>	<u>656,891</u>	<u>-</u>	<u>3,049,248</u>
Net assets, end of year	<u>\$ 2,268,874</u>	<u>\$ 176,324</u>	<u>\$ -</u>	<u>\$ 2,445,198</u>

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

LifeWays
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2008

	Enterprise Operating Fund	Internal Service Funds
Cash flows from operating activities		
Cash received from contracts, grants, customers and others	\$ 45,700,077	\$ -
Cash payments to employees	(3,376,961)	-
Cash payments to suppliers for goods and services	(42,532,274)	-
	(209,158)	-
Net cash used in operating activities	(209,158)	-
Cash flows from capital and related financing activities		
Principal paid on bonds	(380,880)	-
Interest paid on bonds	(569,811)	-
Purchase of capital assets	(51,484)	-
	(1,002,175)	-
Net cash used in capital and related financing activities	(1,002,175)	-
Cash flows from noncapital financing activities		
Transfers in	530,799	-
Transfers out	-	(530,799)
	530,799	(530,799)
Net cash provided by (used in) noncapital financing activities	530,799	(530,799)
Cash flows from investing activities		
Interest received	14,701	50,232
	14,701	50,232
Net change in cash and cash equivalents	(665,833)	(480,567)
Cash and cash equivalents, beginning of year	1,628,167	656,891
	1,628,167	656,891
Cash and cash equivalents, end of year	\$ 962,334	\$ 176,324
Classification on the Statement of Net Assets		
Cash and cash equivalents	\$ 813,747	\$ 176,324
Restricted cash and cash equivalents	148,587	-
	\$ 962,334	\$ 176,324
	\$ 962,334	\$ 176,324

continued...

LifeWays
Statement of Cash Flows
Proprietary Funds (Concluded)
For the Year Ended September 30, 2008

	Enterprise Operating Fund	Internal Service Funds
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	\$ (97,028)	\$ -
Adjustments to reconcile operating income to net cash used in operating activities:		
Depreciation and amortization	328,406	-
Changes in assets and liabilities:		
Fees receivable	(139,439)	-
Due from State of Michigan	(535,597)	-
Other receivables	73,280	-
Prepaid items	(267)	-
Accounts payable	24,247	-
Due to Michigan Department of Community Health	(90,084)	-
Accrued liabilities	225,900	-
Claims incurred but not reported	1,424	-
	<u>\$ (209,158)</u>	<u>\$ -</u>
Net cash used in operating activities	<u>\$ (209,158)</u>	<u>\$ -</u>

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

NOTES TO FINANCIAL STATEMENTS

LifeWays

Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of LifeWays, a Community Mental Health Authority established under Section 205 of the Michigan Mental Health Code, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Government Accounting Standards Board (GASB) is the accepted standards-setting body for establishing governmental accounting and financial reporting principles. The more significant of LifeWays accounting policies are described below.

A. Reporting Entity

As indicated above, LifeWays is a Community Mental Health Authority serving the mental health needs of Jackson and Hillsdale County residents. Its Board of Directors is appointed by the County Commissions of Jackson and Hillsdale Counties.

B. Government-wide and Fund Financial Statements

As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets – Proprietary Funds and the Statement of Activities and Proprietary Funds Revenue, Expenses and Changes in Fund Net Assets. LifeWays' only major fund is reported in a separate column in the aforementioned financial statements.

The operations of LifeWays are accounted for as an Enterprise Fund (a proprietary fund type) which is designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Risk Reserve Funds (all of which are internal service funds, a proprietary fund type) are used to account for assets held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH). Pursuant to these contractual provisions, LifeWays' risk management plan has been reviewed and approved by MDCH. Separate risk reserves are maintained for mental health and substance abuse services.

LifeWays

Notes to Financial Statements

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The enterprise fund is LifeWays' primary operating fund, and only major fund. It accounts for all financial resources of the government, except those required to be accounted for in another fund.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The government has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of LifeWays' operating fund are contract revenues from MDCH, county appropriations, and first and third party billings. Operating revenues of the internal service funds are primarily comprised of charges to other funds and governmental entities for risk financing. Operating expenses include the cost of providing mental health and substance abuse services. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is LifeWays' policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, liabilities and equity

1. Deposits

Cash and cash equivalents are considered to be cash on hand, amounts in demand deposit accounts, and amounts on deposit with the Jackson County Treasurer.

LifeWays

Notes to Financial Statements

State statutes authorize units of local government to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

2. *Receivables and Payables*

Fee accounts receivable are shown net of an allowance for uncollectibles, which is based on management's estimate using collection history trends.

3. *Prepaid Items*

Payments made to vendors for services that will benefit periods beyond year end are recorded as "prepaid items" in the accompanying statement of net assets.

4. *Capital Assets*

Capital assets are capitalized and reported in the operating fund, net of accumulated depreciation. The Authority defines capital assets as assets with an initial individual cost of at least \$5,000 and an estimated useful life of at least three years. Capital assets are depreciated on the straight-line basis over the estimated useful lives of those assets, which range from five to forty years. All purchased capital assets are recorded at cost where historical records are available and at estimated historical costs where no historical records exist. Donated capital assets, if any, are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized.

5. *Compensated Absences*

Vacation, sick leave and personal days cannot be carried over, and are not accrued in the accompanying financial statements.

6. *Unearned Revenue*

Unearned revenue, if any, represents that portion of the current-year MDCH contract amount that may be carried-over to and expended in subsequent fiscal years. Such carryover is generally limited to five percent of the MDCH contract amount.

LifeWays

Notes to Financial Statements

Medicaid savings are considered local funds under the contract with MDCH, and may be spent over a period of several years in accordance with a Medicaid Reinvestment Strategy. State General Funds carried over must generally be spent in the following year.

7. Risk Management

LifeWays is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. During the year ended September 30, 2008, the entity carried commercial insurance to cover all risks of losses, except for any potential operating shortfalls under the terms of its contract with MDCH, which are covered by the Risk Reserve Internal Service Funds. LifeWays had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

2. DETAILED NOTES ON ALL FUNDS

A. Deposits

At year end, LifeWays' cash and cash equivalents consisted of the following:

Bank deposits - checking accounts	\$ 289,126
Deposits with Jackson County Treasurer	849,132
Cash on hand	<u>400</u>
	<u>\$ 1,138,658</u>

LifeWays' demand accounts are comprised of checking accounts with local banks with combined bank balances of \$463,415, of which \$263,415 was uninsured and uncollateralized.

As an Authority, LifeWays is authorized to deposit or invest in any accounts or institutions as permitted by State statutes. However, because of favorable terms, LifeWays has chosen to participate in Jackson County's investment pool, which is managed by the Jackson County Treasurer. These funds are deposited in the Treasurer's pooled accounts, and are in the name of the Jackson County Treasurer. Other County funds are also deposited in those accounts and, as such, because of the complexities of FDIC Regulation #330.8, it is not possible to readily determine the amount of insurance that would be allocated to LifeWays' deposits.

LifeWays

Notes to Financial Statements

B. Due From State of Michigan/Due To Michigan Department of Community Health

For the year ended September 30, 2008, the operations of LifeWays were conducted under the terms and conditions of its contract with the MDCH.

The \$1,959,481 due from the State of Michigan represents amounts due for the prisoner reentry initiative and other services provided by LifeWays. The receivable balance is comprised wholly of federal and state grants.

The \$74,550 due to the MDCH represents LifeWays' estimate of amounts payable to the State of Michigan for institutional care services provided by State institutions.

C. Capital Assets

Following is a summary of capital assets activity for the year ended September 30, 2008:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets not being depreciated				
Land	<u>\$ 2,000,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,000,000</u>
Capital assets being depreciated				
Buildings	9,560,171	16,599	-	9,576,770
Computer equipment	807,347	-	-	807,347
Furnishings and other equipment	181,158	-	-	181,158
Leashold improvements	842,947	34,885	-	877,832
Group homes	915,015	-	-	915,015
Total capital assets being depreciated	<u>12,306,638</u>	<u>51,484</u>	<u>-</u>	<u>12,358,122</u>
Less accumulated depreciation for				
Buildings	205,614	239,627	-	445,241
Computer equipment	782,851	12,944	-	795,795
Furnishings and other equipment	36,093	13,004	-	49,097
Leashold improvements	343,779	31,751	-	375,530
Group homes	196,074	26,143	-	222,217
Total accumulated depreciation	<u>1,564,411</u>	<u>323,469</u>	<u>-</u>	<u>1,887,880</u>
Total capital assets being depreciated - net	<u>10,742,227</u>	<u>(271,985)</u>	<u>-</u>	<u>10,470,242</u>
Capital assets - net	<u>\$ 12,742,227</u>	<u>\$ (271,985)</u>	<u>\$ -</u>	<u>\$ 12,470,242</u>

LifeWays

Notes to Financial Statements

D. Long-term Debt

Leases Payable. The Jackson County Building Authority leases payable are equal to the aggregate outstanding principal payments due on bonds issued by the Jackson County Building Authority, that pledge the full faith and credit of the government. Those bonds were issued to finance the acquisition of five group homes for providing residential services (Series 1999 A) and to purchase and renovate the administrative building (Series 2006 A).

Mortgage Payable. During the year ended September 30, 2006, LifeWays borrowed \$2,800,000 under a mortgage agreement to finance the purchase and renovation of the portion of the administrative building leased to other entities. During the year, LifeWays defaulted on the bond covenant that required the Authority to maintain \$2,000,000 in unrestricted net assets. As a result, the mortgage agreement has been amended to require a checking account balance with a minimum balance of \$265,000 (effective December 15, 2008).

Long-term debt currently outstanding is as follows:

	<u>Interest Rate</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Series 1999 A Jackson County Building Authority Bonds (lease payable)	4.0 - 6.0%	\$ 725,000	\$ -	\$ 50,000	\$ 675,000	\$ 50,000
Series 2006 A Jackson County Building Authority Bonds (lease payable)	4.75 - 5.0%	6,845,000	-	250,000	6,595,000	250,000
Mortgage payable	7.23%	<u>2,698,900</u>	<u>-</u>	<u>80,880</u>	<u>2,618,020</u>	<u>80,880</u>
Subtotal		10,268,900	-	380,880	9,888,020	380,880
Series 2006 A Jackson County Building Authority Bonds (debt discount)		<u>(40,196)</u>	<u>-</u>	<u>(2,144)</u>	<u>(38,052)</u>	<u>(2,144)</u>
Total		<u>\$ 10,228,704</u>	<u>\$ -</u>	<u>\$ 378,736</u>	<u>\$ 9,849,968</u>	<u>\$ 378,736</u>

LifeWays

Notes to Financial Statements

The requirements to amortize all debt outstanding at September 30, 2008, are as follows:

Year Ending September 30,	Principal	Interest	Total
2009	\$ 380,880	\$ 548,690	\$ 929,570
2010	405,880	528,318	934,198
2011	405,880	506,707	912,587
2012	405,880	485,047	890,927
2013	2,644,500	421,553	3,066,053
2014-2018	2,025,000	1,226,038	3,251,038
2019-2023	2,125,000	694,500	2,819,500
2024-2027	1,495,000	151,750	1,646,750
Total	<u>\$ 9,888,020</u>	<u>\$ 4,562,603</u>	<u>\$ 14,450,623</u>

Interest Rate Swap. During the year ended September 30, 2006, the Authority entered into an interest rate swap agreement (the "Swap") to modify interest rates in connection with its mortgage payable, which had an original issuance amount that matched the notional amount of \$2,800,000. The notional amount of the swap declines according to the amortization schedule of the mortgage payable. The swap was entered into at the same time the mortgage was issued (June 30, 2006). The stated termination date of the Swap is June 30, 2013. Under the terms of the Swap, the Authority effectively pays interest calculated at a fixed rate of 7.23% to the lender, Citizens Bank.

E. Risk Reserve Fund Net Assets

At September 30, 2008, the net assets of the Risk Reserve Internal Service Funds were comprised of the following:

	<u>Mental Health</u>	<u>Substance Abuse</u>	<u>Total</u>
Beginning balance	\$ 648,615	\$ 8,276	\$ 656,891
Additions	49,599	633	50,232
Deductions	<u>(530,799)</u>	<u>-</u>	<u>(530,799)</u>
Ending balance	<u>\$ 167,415</u>	<u>\$ 8,909</u>	<u>\$ 176,324</u>

LifeWays

Notes to Financial Statements

Mental Health Risk Reserve

Under the terms of its managed specialty supports and services contract with MDCH, LifeWays is at risk for its operating expenses in excess of contract revenues within a specified risk corridor. In accordance with the contract, LifeWays is authorized and required to retain these funds until needed to offset actual operating losses within the risk corridor. LifeWays maximum risk exposure under the Medicaid contract with MDCH is \$2,463,726 based on current funding levels.

Substance Abuse Risk Reserve

Net assets in the substance abuse risk reserve are held on behalf of the Mid-South Substance Abuse Coordinating Agency. Contributions are made to the reserve by Mid-South as funding permits, and LifeWays distributes funds to Mid-South upon request. During the year ended September 30, 2008, no contributions or distributions were made.

F. Retirement Plan

LifeWays has a single-employer defined benefit pension plan (the "LifeWays Pension Plan") for employees of LifeWays, which provides retirement, death and disability benefits covering substantially all of LifeWays' full-time employees. Membership of the Plan consisted of the following at October 1, 2007, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	11
Terminated plan members entitled to but not yet receiving benefits	65
Active plan members	<u>50</u>
	<u>126</u>

The Plan is non-contributory for employees; by Board Resolution, LifeWays is required to contribute at an actuarially determined rate all amounts necessary to provide assets sufficient to pay for member benefits. LifeWays' contribution to the Plan for the year ended September 30, 2008, represents 13.5% of the annual covered payroll.

The Plan is administered by a third-party insurance company. Administrative costs of the Plan are financed through investment earnings.

Plan provisions are established and amended under the authority of LifeWays' Board. Contribution requirements are established and amended subject to Board approval.

LifeWays

Notes to Financial Statements

The Plan's annual retirement benefits cost and net retirement benefits obligation for the current year were as follows:

Annual required contribution / retirement benefit cost	\$360,641
Contribution made	<u>(360,641)</u>
Increase (decrease) in net retirement benefit obligation	-
Net retirement benefit obligation, beginning of year	<u>-</u>
Net retirement benefit obligation, end of year	<u><u>\$ -</u></u>

The annual required contribution for the current year was determined as part of an actuarial valuation of the Plan as of September 30, 2007, using the aggregate actuarial cost method. The actuarial assumptions included: (a) a rate of return on investments of 7%; (b) projected salary increases of 2.5% attributable to inflation; and (c) the assumption that the excess of the present value of benefits over valuation assets is spread over the average working lifetime of plan participants.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis over 30 years from April 15, 1992.

Three-Year Trend Information

<u>Year</u> <u>Ending</u>	<u>Annual</u> <u>Retirement</u> <u>Benefit</u> <u>Cost</u> <u>(ARBC)</u>	<u>Percentage</u> <u>of ARBC</u> <u>Contributed</u>	<u>Net</u> <u>Retirement</u> <u>Benefit</u> <u>Obligation</u>
9/30/2006	\$353,321	100.0%	\$ -
9/30/2007	352,283	100.0%	-
9/30/2008	360,641	100.0%	-

GASB Statement 25 required supplementary information is presented after the Notes to Financial Statements section of this report.

LifeWays

Notes to Financial Statements

G. Claims Incurred But Not Reported

LifeWays estimates the liability for contractual services provided by its contract providers that have been incurred through the end of the fiscal year, including both those claims that have been reported as well as those that have not yet been reported. Changes in the estimated liability are as follows:

Estimated liability, beginning of year	\$ 922,502
Estimated claims incurred	20,631,781
Claim payments	<u>(20,630,357)</u>
Estimated liability, end of year	<u>\$ 923,926</u>

H. Contribution to the King Trust Charitable Gift Fund

In 2002, LifeWays made contributions to the King Trust Charitable Gift Fund (the "Fund") to establish the "LifeWays Foundation" account. While LifeWays may make recommendations regarding the use of the Fund, any contributions made are irrevocable and become assets of the Fund. Since LifeWays is not the trustee of the LifeWays Foundation account, and does not exercise any control over the Fund's assets, no amounts were recorded in these financial statements at year end. The balance in the LifeWays Foundation account at September 30, 2008 was \$6,636.

I. Contingencies

Under the terms of various federal and state grants and regulatory requirements, LifeWays is subject to periodic audits of its agreements. Such audits could lead to questioned costs and/or requests for reimbursement to grantor or regulatory agencies. Management does not consider such amounts to be significant.

As is the case with other entities, LifeWays faces exposure from potential claims and legal proceedings involving environmental and other matters. No such claims or proceedings have been asserted as of September 30, 2008.

J. Restatements

Beginning net assets of the Operating Fund were increased by \$95,062 for revenue accruals not recorded in previous years.

REQUIRED SUPPLEMENTARY INFORMATION

LifeWays
GASB Statement 25 Required Supplementary Information
Employee Retirement System

Schedule of Funding Progress

Actuarial Valuation Date Oct. 1	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL) Entry Age	(3) Unfunded AAL (UAAL) (2-1)	(4) Funded Ratio (1/2)	(5) Covered Payroll	(6) UAAL as a % of Covered Payroll (3/5)
1998	\$ 1,445,894	\$ 2,222,694	\$ 776,800	65.1 %	\$ 2,464,317	31.5 %
1999	1,809,122	2,380,312	571,190	76.0	2,576,654	22.2
2000	2,236,469	2,793,508	557,039	80.1	2,271,312	24.5
2001	2,157,775	2,349,783	192,008	91.8	2,337,520	8.2
2002	2,214,182	2,708,063	493,881	81.8	1,948,381	25.3
2003	2,775,533	3,617,533	842,000	76.7	1,940,994	43.4
2004	3,401,945	3,975,950	574,005	85.6	2,197,653	26.1
2005	3,844,328	4,417,267	572,939	87.0	2,294,787	25.0
2006	4,292,667	4,858,767	566,100	88.3	2,253,345	25.1
2007	4,951,087	5,346,176	395,089	92.6	2,666,898	14.8

Schedule of Employer Contributions

Fiscal Year Ended Sept. 30	Annual Required Contribution	Actual Contribution	Percentage Contributed
2003	\$ 336,528	\$ 336,528	100.0 %
2004	319,537	319,537	100.0
2005	319,818	319,818	100.0
2006	353,321	353,321	100.0
2007	352,283	352,283	100.0
2008	360,641	360,641	100.0

SUPPLEMENTARY INFORMATION

LifeWays
Combining Statement of Net Assets - Internal Service Funds
September 30, 2008

	<u>Mental Health Risk Reserve</u>		<u>Substance</u>	<u>Totals</u>
	<u>Medicaid</u>	<u>General Fund</u>	<u>Abuse Risk Reserve</u>	
Assets				
Cash and cash equivalents	\$ 147,434	\$ 19,981	\$ 8,909	\$ 176,324
Liabilities				
Unearned revenue	-	-	-	-
Net assets				
Restricted for contract losses	<u>\$ 147,434</u>	<u>\$ 19,981</u>	<u>\$ 8,909</u>	<u>\$ 176,324</u>

LifeWays
Combining Statement of Revenue, Expenses and Changes
in Net Assets - Internal Service Funds
For the Year Ended September 30, 2008

	<u>Mental Health Risk Reserve</u>		<u>Substance</u>	<u>Totals</u>
	<u>Medicaid</u>	<u>General Fund</u>	<u>Abuse Risk Reserve</u>	
Nonoperating revenue				
Interest income	\$ 48,180	\$ 1,419	\$ 633	\$ 50,232
Transfers out	<u>(530,799)</u>	<u>-</u>	<u>-</u>	<u>(530,799)</u>
Change in net assets	(482,619)	1,419	633	(480,567)
Net assets, beginning of year	<u>630,053</u>	<u>18,562</u>	<u>8,276</u>	<u>656,891</u>
Net assets, end of year	<u><u>\$ 147,434</u></u>	<u><u>\$ 19,981</u></u>	<u><u>\$ 8,909</u></u>	<u><u>\$ 176,324</u></u>

LifeWays
Combining Statement of Cash Flows
Internal Service Funds
For the Year Ended September 30, 2008

	<u>Mental Health Risk Reserve</u>		<u>Substance</u>	<u>Totals</u>
	<u>Medicaid</u>	<u>General Fund</u>	<u>Abuse Risk Reserve</u>	
Cash flows from noncapital financing activities				
Transfers out	\$ (530,799)	\$ -	\$ -	\$ (530,799)
Cash flows from investing activities				
Interest received	48,180	1,419	633	50,232
Net change in cash and cash equivalents	(482,619)	1,419	633	(480,567)
Cash and cash equivalents, beginning of year	630,053	18,562	8,276	656,891
Cash and cash equivalents, end of year	<u>\$ 147,434</u>	<u>\$ 19,981</u>	<u>\$ 8,909</u>	<u>\$ 176,324</u>

INTERNAL CONTROL AND COMPLIANCE

**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***

August 14, 2009

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays*, as of and for the year ended September 30, 2008, which collectively comprise LifeWays' basic financial statements as listed in the table of contents, and have issued our report thereon dated August 14, 2009. 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 LifeWays' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of LifeWays' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of LifeWays' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

Item 2008-1 - Preparation of Financial Statements in Accordance with GAAP

- Criteria:** All Michigan governments are required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). This is a responsibility of the government's management. The preparation of financial statements in accordance with GAAP requires internal controls over both (1) recording, processing, and summarizing accounting data (i.e., maintaining internal books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting.)
- Condition/Finding:** As is the case with many smaller and medium-sized entities, the government has historically relied on its independent external auditors to assist in the preparation of the financial statements and footnotes as part of its external financial reporting process. Accordingly, the government's ability to prepare financial statements in accordance with GAAP is based, in part, on its reliance on its external auditors, who cannot by definition be considered a part of the government's internal controls.
- Cause:** This condition was caused by the government's decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the time and expense of obtaining the necessary training and expertise required for the government to perform this task internally.
- Effect:** As a result of this condition, the government lacks internal controls over the preparation of financial statements in accordance with GAAP, and instead relies, in part, on its external auditors for assistance with this task.
- View of Responsible Officials:** The government has evaluated the cost vs. benefit of establishing internal controls over the preparation of financial statements in accordance with GAAP, and determined that it is in the best interests of the government to outsource this task to its external auditors, and to carefully review the draft financial statements and notes prior to approving them and accepting responsibility for their content and presentation.

Item 2008-2 – Financial Reporting

Criteria:	A key element of effective internal controls is the ability to collect, analyze, and report on financial data in a timely and accurate manner.
Condition/Finding:	In connection with our audit, we examined the Financial Status Report (FSR) and Contract Reconciliation and Cost Settlement (CRCS) schedules. We noted that a significant number of consumers were eligible for Medicaid services, but due to errors in LifeWays' claims system were being flagged as ineligible for Medicaid, which caused the associated expenditures to be charged to the General Fund program. In addition, LifeWays was using budgeted percentages to allocate administrative costs between the various cost objectives, which is not acceptable in accordance with the contract with the Michigan Department of Community Health.
Cause:	The condition appears to be the result of inappropriate internal controls over the input of consumer data into the claims system that caused the automatic comparison to the Medicaid website to return false negatives for Medicaid eligibility. Further, management lacked a complete understanding of the acceptable methods for allocating administrative costs.
Effect:	As a result of this condition, an adjustment of \$530,799 was necessary to move funds from the Medicaid internal service fund to the Operating Fund.
Recommendation:	We recommend that LifeWays implement controls over their claims data to ensure that information about consumers is accurate and complete. Further, we recommend that LifeWays evaluate the allowable methods of allocating administrative costs per the contract with the Michigan Department of Community Health, and select an appropriate method to utilize.
View of Responsible Officials:	Under the direction of a new IT Director, LifeWays is currently defining processes regarding claims data and will be implementing internal control measures to ensure the accuracy of the data. Errors that were identified during this audit process have been corrected. Administrative costs will no longer be allocated using budgeted percentages since this is not acceptable in accordance with OMC Circular A-87, but will be allocated based on the percent of service dollars spent.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 2008-2 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether LifeWays' 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*.

We noted certain matters that we reported to management of LifeWays, in a separate letter dated August 14, 2009.

LifeWays' responses to the findings identified in our audit are described above. We did not audit LifeWays' responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the audit committee, the governing board, management, others within the organization, 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.

A handwritten signature in black ink that reads "Lehmann Johnson". The signature is written in a cursive, flowing style.

August 14, 2009

To the Board of Directors of
LifeWays

We have audited the financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of the LifeWays (the "Organization") for the year ended September 30, 2008, and have issued our report thereon dated August 14, 2009. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

As stated in our engagement letter dated December 12, 2008, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the Organization. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Organization's compliance with certain provisions of laws, regulations, contracts and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on December 12, 2008.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Organization are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. Other than the prior period adjustment disclosed in Note 2J to the financial statements, there are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future.
- Management's estimate of the uncollectible portion of accounts receivable is based on historical collection rates and subsequent payment activity.
- Management's estimate of the insurance claims incurred but not reported is based on information provided by the entity's third party administrators and subsequent claims activity.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level

of management. Management has corrected all such misstatements. The finding contained in the GAGAS report, accompanying the financial statements, as item 2008-1 describes the only material misstatement detected as a result of audit procedures and was corrected by management.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated August 14, 2009.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Authority's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the governing body and management of the LifeWays and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Lehmann Johnson". The signature is written in a cursive, flowing style.

LifeWays

Comments and Recommendations

For the Year Ended September 30, 2008 Audit

In planning and performing our audit of the financial statements of the LifeWays (the "Organization") as of and for the year ended September 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the Organization's internal control over financial reporting (internal control) 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 Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. The deficiencies we noted that we consider to be significant deficiencies are described in which are described in our 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*.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. The deficiencies we noted that we consider to be material weaknesses are described in our 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*.

Other Matters

Review and Approval of Bank Reconciliations

Effective internal control procedures should provide documentation that clearly indicates when a procedure was performed and by whom. LifeWays has been diligent in completing bank reconciliations in a timely manner; however, the preparer does not initial and date the reconciliation

LifeWays

Comments and Recommendations

For the Year Ended September 30, 2008 Audit

as evidence of the procedure being completed. In addition, not all bank reconciliations show evidence of being independently reviewed. We recommend that bank reconciliations be reviewed by a responsible official and both the preparer and reviewer initial and date the document as evidence of preparation and review.

Internal Controls – Segregation of Duties

Management is responsible for establishing and maintaining effective internal control over financial reporting and the safeguarding of LifeWays' assets. In establishing appropriate internal controls, careful consideration must be given to the cost of a particular control and the related benefits to be received. Accordingly, management must make the difficult decision of what degree of risk it is willing to accept, given the government's unique circumstances.

As is the case with many organizations of similar size, LifeWays lacks a sufficient number of accounting personnel in order to ensure a complete segregation of duties within its accounting function. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and being able to conceal it.

Events of recent years have given rise to a heightened awareness of the risks of fraud and abuse, especially in the governmental environment, where public accountability is at its highest. The purpose of internal controls is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are properly authorized and recorded. Any limitations on the effectiveness of a government's internal controls carries with it a greater risk of fraud and abuse.

As stated previously, the establishing and maintaining of internal controls is the responsibility of management. As LifeWays' independent external auditors, we are specifically banned by professional standards from performing any management functions. In other words, the annual audit is not a part of LifeWays' internal control structure, and cannot not be relied upon as part of *management's* systems to deter or detect fraud and abuse.

LifeWays

Comments and Recommendations

For the Year Ended September 30, 2008 Audit

While there are, of course, no easy answers to the challenge of balancing the costs and benefits of internal controls and the segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal control structure by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management as possible. During our audit, we noted several internal control processes that could be enhanced as follows:

- One individual has the ability to write-off and otherwise make adjustments to consumer accounts, and these adjustments are not being reviewed and approved by an appropriate official. We recommend that adjustments to consumer accounts are periodically reviewed and approved by an appropriate official.
- During 2008, one employee had the responsibility for processing payroll and also was responsible for maintaining the payroll master file and had access to the general ledger. We are pleased to report that during our work on-site a new policy was drafted for payroll processing to ensure that the individual with access to the payroll master file is not the employee who will be processing payroll in the future.

Capital Asset Addition and Deletion Review

During our fieldwork, we noted that capital asset records are not reviewed on a periodic basis by various departments in order to verify the existence of the assets listed. In order to ensure that all capital asset additions and deletions are properly recorded, the detailed capital asset records should be reviewed annually (or another appropriate a schedule) by the various departments involved.

Calculation of Allowance for Uncollectible Receivables

During our fieldwork, it was discovered that the percentages used for estimating the allowance for uncollectible receivables were based on calculations that were performed a number of years ago. Since the factors affecting the allowance for uncollectible receivables have likely changed in the past several years, we recommend that LifeWays revisit the allowance calculation to ensure that an appropriate uncollectible allowance is recorded.

* * * * *