Pathways
Financial Statements
September 30, 2004

Michigan Dept. of Treasury, Local Audit & Finance Division
496 (3-98), Formerly L-3147

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type	Local Government Name	County
☐ City ☐ Township ☐ Village ☒ Other	Pathways	Marquette
Audit Date: 9/30/04	Opinion Date: 5/19/05	Date Accountant Report Submitted to State: 5/31/05

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.

☒ yes ☐ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).

☒ yes ☐ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).

☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.

☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).

☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.

☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).

☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).

☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).	✓		

Certified Public Accountant (Firm Name)	Anderson Tackman & Co PLC		
Street Address: 102 W. Washington, Suite 109	City: Marquette	State: MI	ZIP: 49855
Accountant Signature	Rebecca Hill CPA		

TABLE OF CONTENTS

ANDERSON, TACKMAN & COMPANY, P.L.C.
CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS
JOHN W. BLEMBERG, CPA **ROBERT J. DOWNS, CPA, CVA** **DANIEL E. BIANCHI, CPA**

MICHIGAN
ESCANABA
IRON MOUNTAIN
KINROSS
MARQUETTE

WISCONSIN
GREEN BAY
MILWAUKEE

INDEPENDENT AUDITOR'S REPORT

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2004, which collectively comprise the Pathways' basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the Pathways' 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways as of September 30, 2004, and the respective changes in financial position and the cash flows, where applicable, thereof 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 19, 2005, on our consideration of Pathways 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 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 read in conjunction with this report in considering the results of our audit. This report can be found on page 45.

The Management's Discussion and Analysis and budgetary comparison information on pages 5 through 9 and 36 through 37, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

102 W. WASHINGTON STREET, SUITE 109 **MARQUETTE, MICHIGAN 49855** **(906)225-1166** **FAX: (906) 225-1714**
E-MAIL: atcomqt@aol.com

Members of the Board
Pathways
Marquette, Michigan 49855

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Pathways basic financial statements. The other supplementary information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements of Pathways. 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.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 19, 2005

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED)

Our discussion and analysis of Pathways financial performance provides an overview of Pathways financial activities for the year ended September 30, 2004. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- Net assets for Pathways as a whole were reported at $2,060,158. Nets assets are comprised of 100% governmental activities.
- During the year, Pathways expenses were $72,805,443, while revenues from all sources totaled $70,830,109, resulting in a decrease in net assets of $(1,975,334).
- The general fund reported a decrease in fund balance of $(2,061,541). Revenues were $1,237,182 below the budgeted amount of $72,082,289 and expenditures and transfers out were $90,409 below the budgeted amount of $72,997,057.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10 and 11) provide information about the activities of Pathways as whole and present a longer-term view of Pathways finances. Fund financial statements start on page 12. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for the future spending. Fund financial statements also report Pathways operations in more detail than the government-wide statements by providing information about Pathways most significant funds.

Reporting Pathways as a Whole
Our analysis of Pathways as a whole begins on page 6. One of the most important questions asked about Pathways' finances is " Is Pathways as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about Pathways as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. These two statements report Pathways' *net assets* and changes in them. You can think of Pathways net assets - the difference between assets and liabilities - as one way to measure Pathways' financial health, or *financial position*. Over time, *increases or decreases* in Pathways' net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in Pathways' client base and the condition of Pathways' capital assets, to assess the *overall financial health* of Pathways.

In the Statement of Net Assets and the Statement of Activities, we divide Pathways into two kinds of activities:

- Government activities – All of Pathways basic services are reported here including client services and general administration. Medicaid and Department of Community Health revenues and other state and federal grants fund most of these activities.

- Business-type activities- Pathways currently does not engage in any business-type activities defined as activities financed by fees charged to external parties who use certain goods or services.

Reporting Pathways' Most Significant Funds

Our analysis of Pathways' major funds begins on page 8. The fund financial statements begin on page 12 and provide detailed information on the most significant funds – not Pathways as a whole. Some funds are required to be established by State law, and by bond covenants. However, the Pathways Board has established other funds to help it control and manage money for particular purposes. Pathways' two kinds of funds - *governmental* and *proprietary* – use different accounting methods.

- *Governmental funds* – Most of Pathways' services are reported in governmental funds which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other financial assets that can be readily converted into cash. The governmental fund statements provide a detailed *short-term view* of Pathways' general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Pathways' programs. We describe the relationship (or differences) between governmental *activities* (reported in the Statement of Net Assets and Statement of Activities) and governmental *funds* in a reconciliation which follows the fund financial statements.

- *Proprietary funds* – When Pathways charges customers for the services it provides – whether to outside customers or to other units of Pathways – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. We use internal service funds (the only component of Pathways proprietary funds) to report activities that provide supplies and services for Pathways other programs and activities – such as Pathways' Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund.

Pathways as a Whole

Table 1 provides a summary of Pathways' net assets at September 30, 2004 and 2003:

Table 1
Net Assets

		Governmental Activities - 2004	Governmental Activities - 2003
Current assets		$ 6,708,666	$ 7,311,129
Capital assets, net		3,565,623	3,593,017
	Total Assets	10,274,289	10,904,146
Current liabilities		5,213,823	4,538,392
Noncurrent liabilities		3,000,308	2,541,600
	Total Liabilities	8,214,131	7,079,992
Net Assets:			
Invested in capital assets, net of related debt		2,130,570	1,810,316
Restricted		770,096	3,025,762
Unrestricted (deficit)		(840,508)	(1,011,924)
	Total Net Assets	$ 2,060,158	$ 3,824,154

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Net assets of Pathways' governmental activities stood at $2,060,158. Unrestricted net assets—the part of net assets that could be used to finance day-to-day activities without constraints established by debt covenants, enabling legislation, or other legal requirements stood at a $(840,508) deficit.

The results of this year's operations for the Board as a whole are reported in the Statement of Activities (see Table 2), which shows the changes in net assets for fiscal years 2004 and 2003.

Table 2
Changes in Net Assets

	Governmental Activities - 2004	Governmental Activities - 2003
Revenues:		
Program revenues:		
Charges for services	$ 1,014,561	$ 1,048,880
Operating grants and contributions	65,739,886	66,213,088
General revenues:		
State sources not restricted to specific program	3,654,036	3,685,219
Investment earnings	14,363	7,555
Gain (loss) on sale of capital assets	(34,248)	(12,046)
Miscellaneous	441,511	517,948
Total Revenues	70,830,109	71,460,644
Expenses:		
General government	72,780,407	70,208,858
Interest on long-term debt	25,036	45,346
Total Expenses	72,805,443	70,254,204
Change in net assets	(1,975,334)	1,206,440
Net assets, beginning	3,824,154	2,617,714
Prior period adjustments	211,338	-
Net Assets, Ending	$2,060,158	$ 3,824,154

Pathways' total revenues were $70,830,109. The total cost of all programs and services was $72,805,443, resulting in a decrease in net assets of $(1,975,334).

For operational purposes, management used as planned $2.2 million from FY 03 year Medicaid savings which had been classified the previous year as fund balance but is really deferred revenue. FY 04 is restating the fund balance to reflect FY 03 Medicaid savings. Also, Medicaid Savings of $983,000 as well as general fund carry forward of $120,000 in FY 04 are classified as deferred revenue and actually represent excess revenue over expenses.

Table 3 presents the cost of Pathways' major activity – General Government – as well as the program's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that this function placed on the Pathways operation.

Table 3
Governmental Activities

	2004		2003	
	Total Cost of Services	Net Cost of Services	Total Cost of Services	Net Cost of Services
General Government	$72,870,407	$6,025,960	$70,208,858	$2,946,890

PATHWAYS' FUNDS

As Pathways completed the year, its governmental funds (as presented in the balance sheet on page 12) reported a combined fund balance of $476,199, a decrease of $(1,763,682) from the beginning of the year including prior period adjustments of $219,951.

The deficit is related to Medicaid revenue being recognized in FY 03 (Medicaid Savings) which was used for Medicaid expenses in FY 04. This was part of our FY 04 budget plan.

General Fund Budgetary Highlights

Over the course of the year, the Pathways Board revised the budget a few times. The purpose of these revisions is to recognize major changes in revenue or expenses. Expense and revenue budgets are corrected throughout the year based actual year to date expenses and revenue as well as updated projections.

With these adjustments, actual charges to expenditures and transfers out were $90,409 lower than the final amended budget. Conversely, revenues were $1,237,182 lower than the final budget projection resulting in a ($1,146,773) decrease in fund balance compared to a planned decrease in fund balance of ($914,768).

Personnel expenditures came in under the revised plan which includes salary and wages as well as self insured medical claims. Medicaid capitation revenue is tied directly to Medicaid expenditures which came in $983,223 under plan. In the public CMH system, excess Medicaid revenue is tied directly to Medicaid expenditures and any excess revenue is classified as deferred revenue (liability) to be used the following year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal 2004, Pathways had $3,565,623 invested in a variety of capital assets including buildings, vehicles and other equipment. (See table 4 below)

Table 4
Capital Assets at Year-End

	Governmental Activities - 2004	Governmental Activities - 2003
Land	$ 363,000	$ 347,000
Land improvements	-	20,700
Buildings	3,166,761	3,050,161
Building improvements	89,670	66,334
Equipment and furnishings	2,348,512	2,537,382
Vehicles	1,441,356	1,316,124
Accumulated depreciation	(3,843,676)	(3,744,684)
Totals	$ 3,565,623	$3,593,017

Debt

At year-end, Pathways had $2,127,354 in notes outstanding as depicted in Table 5 below.

Table 5
Outstanding Debt at Year-End

	Governmental Activities - 2004	Governmental Activities - 2003
Installment contracts payable	$ 692,301	$ 928,002
Equipment notes payable	1,358,660	548,919
Line of credit	76,393	305,780
Totals	$2,127,354	$1,782,701

New additions to debt for this year include $238,239 for equipment purchases and $450,000 for building purchases. See Note J for further details on long-term debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

Pathways appointed officials consider many factors when setting the fiscal year 2005 budget. The major factor that impacts the Pathways budgeting process is the Medicaid and General Fund allocation from the state of Michigan. Governor Granholm and the Michigan legislature in FY 05 strongly supported CMH funding for Michigan's most needy citizens which includes the mentally ill and developmentally disabled. On the expenditure side, Pathways continues to address inpatient hospital expense by directly providing psychiatric service at Marquette General Hospital which will reduce inpatient expenses. FY 05 will be the first year that all staff will be on a market defined, lower salary system. Pathways has also been successful in moving away from providing services for mild and moderate disorders and focusing on the severely mentally ill which we are mandated and funded to serve.

CONTACTING PATHWAYS FINANCIAL MANAGEMENT

This financial report is designed to provide our clients, customers, and investors and creditors with a general overview of Pathways' finances and to show Pathways' accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Pathways Executive Director at Pathways, 200 West Spring Street, Marquette, Michigan, 49855.

Pathways

Statement of Net Assets

September 30, 2004

	Governmental Activities
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 1,492,092
Restricted assets	749,505
Receivables, net:	
Client fees	1,154,175
Other	1,486,193
Grants	580,238
Due from State of Michigan	-
Due from local units	736,840
Inventory	87,831
Prepaid expenses	421,792
Total Current Assets	6,708,666
Noncurrent Assets:	
Capital assets:	
Land	363,000
Other capital assets	7,046,299
Accumulated depreciation	(3,843,676)
Total Noncurrent Assets	3,565,623
TOTAL ASSETS	10,274,289
LIABILITIES	
Current Liabilities:	
Accounts payable	2,083,399
Due to State of Michigan	278,596
Due to counties - liquor tax	408,998
Accrued payroll and related	952,531
Accrued retirement contribution	8,409
Other current liabilities	14,515
Deferred revenue	960,663
Notes payable	506,712
Total Current Liabilities	5,213,823
Noncurrent Liabilities:	
Compensated absences	1,379,666
Notes payable	1,620,642
Total Noncurrent Liabilities	3,000,308
TOTAL LIABILITIES	8,214,131
NET ASSETS	
Invested in capital assets, net of related debt	2,130,570
Restricted for:	
Medicaid savings carryforward	-
Medicaid risk reserve	760,036
Debt service	10,060
Unrestricted	(840,508)
TOTAL NET ASSETS	$ 2,060,158

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Statement of Activities

For the Fiscal Year Ended September 30, 2004

Function/Program	Expenses	Program Revenue: Charges for Services	Program Revenue: Operating Grants and Contributions	Program Revenue: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets
Governmental Activities:					
General government	$ 72,780,407	$ 1,014,561	$ 65,739,886	$ -	$ (6,025,960)
Interest on long-term debt	25,036	-	-	-	(25,036)
Total Governmental Activities	$ 72,805,443	$ 1,014,561	$ 65,739,886	$ -	(6,050,996)

General revenues:	
State sources not restricted to specific program	3,654,036
Investment earnings	14,363
Gain (loss) on disposal of assets	(34,248)
Miscellaneous	441,511
Total general revenues	4,075,662
Changes in net assets	(1,975,334)
Net assets, beginning of year	3,824,154
Prior period adjustment for Medicaid risk carryforward	(8,613)
Prior period adjustment for accounting errors	176,409
Prior period adjustment for Medicaid settlements	43,542
Net assets, beginning of year, as restated	4,035,492
NET ASSETS, END OF YEAR	$ 2,060,158

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Governmental Funds
Balance Sheet

September 30, 2004

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	$ 427,459	$ 75,723	$ 503,182
Accounts receivable:			
Client fees	1,154,175	-	1,154,175
Other	1,476,133	10,060	1,486,193
Grants receivable	580,238	-	580,238
Due from State of Michigan	-	-	-
Due from local units - Medicaid	-	-	-
Due from other funds	49,623	2,185	51,808
Inventory	87,831	-	87,831
Restricted assets	749,505	-	749,505
Prepaid expenditures	421,792	-	421,792
Installment contract receivable	-	-	-
TOTAL ASSETS	$ 4,946,756	$ 87,968	$ 5,034,724
LIABILITIES AND FUND BALANCE			
LIABILITIES:			
Accounts payable	$ 2,083,399	$ -	$ 2,083,399
Due to State of Michigan	278,596	-	278,596
Due to counties - liquor tax	408,998	-	408,998
Due to other funds	2,185	-	2,185
Accrued payroll and related	801,760	-	801,760
Accrued retirement contribution	8,409	-	8,409
Other current liabilities	14,515	-	14,515
Deferred revenue	960,663	-	960,663
TOTAL LIABILITIES	4,558,525	-	4,558,525
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved, reported in:			
General Fund	388,231	-	388,231
Special Revenue Funds	-	77,908	77,908
TOTAL FUND BALANCE	388,231	87,968	476,199
TOTAL LIABILITIES AND FUND BALANCE	$ 4,946,756	$ 87,968	$ 5,034,724

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

September 30, 2004

Total Fund Balances for Governmental Funds	$	476,199
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds		3,565,623
Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets, net of capital assets.		(1,289,363)
Long-term liabilities, including notes payable, are not due and payable in the current period and therefore are not reported in the funds		(692,301)
Net Assets of Governmental Activities	$	2,060,158

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2004

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:			
State sources	$ 65,833,339	-	$ 65,833,339
Contracts and grants	2,850,882	-	2,850,882
Charges for services	3,907,207	-	3,907,207
Local sources	1,206,658	17,672	1,224,330
Interest income	12,785	1,578	14,363
Other	1,234,964	-	1,234,964
Less deductions from revenue:			-
Donated services discounts	(2,892,646)	-	(2,892,646)
Medicaid general funding carryforward	-	-	-
Local match - Medicaid draw down	(1,303,991)	-	(1,303,991)
Public Act 423 of 1980	(4,091)	-	(4,091)
TOTAL REVENUES	70,845,107	19,250	70,864,357
EXPENDITURES:			
Current operations	72,501,419	-	72,501,419
Debt service:			
Principal	-	235,700	235,700
Interest and fiscal charges	-	25,036	25,036
Capital outlay	85,835	-	85,835
TOTAL EXPENDITURES	72,587,254	260,736	72,847,990
EXCESS REVENUES OVER (UNDER) EXPENDITURES	(1,742,147)	(241,486)	(1,983,633)
OTHER FINANCING SOURCES (USES):			
Loan proceeds	-	-	-
Transfers in	-	319,394	319,394
Transfers (out)	(319,394)	-	(319,394)
TOTAL OTHER FINANCING SOURCES (USES)	(319,394)	319,394	-
NET CHANGE IN FUND BALANCE	(2,061,541)	77,908	(1,983,633)
Fund balance, beginning of year	2,229,821	10,060	2,239,881
Prior period adjustment for accounting errors	176,409	-	176,409
Prior period adjustment for Medicaid settlements	43,542	-	43,542
Fund balance, beginning of year, as restated	2,449,772	10,060	2,459,832
FUND BALANCE, END OF YEAR	$ 388,231	$ 87,968	$ 476,199

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities

For the Fiscal Year Ended September 30, 2004

Net Change in Fund Balances - Total Governmental Funds	$ (1,983,633)
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of depreciation expense recorded in the current period.	(228,654)
Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The net revenue (expense) of the internal service funds is reported with governmental activities, net of depreciation expense of $279,540	35,501
Loss on disposal of capital assets is not reported in the governmental funds, but is reported in the statement of activities.	(34,248)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	235,700
Change in Net Assets of Governmental Activities	$ (1,975,334)

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds
Statement of Net Assets

September 30, 2004

	Internal Service Funds
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 988,910
Due from local units	736,840
Due from other funds	-
Total Current Assets	1,725,750
Capital Assets:	
Capital assets	2,041,733
Accumulated depreciation	(557,057)
Total Noncurrent Assets	1,484,676
TOTAL ASSETS	3,210,426
LIABILITIES	
Current Liabilities:	
Accounts payable	-
Due to other funds	49,623
Accrued payroll and related	150,771
Current maturities of long-term debt	296,226
Total Current Liabilities	496,620
Long-term Liabilities:	
Compensated absences	1,379,666
Notes payable	1,138,827
Total Long-term Liabilities	2,518,493
TOTAL LIABILITIES	3,015,113
NET ASSETS	
Invested in capital assets, net of related debt	-
Restricted	760,036
Unrestricted	(564,723)
TOTAL NET ASSETS	$ 195,313

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds
Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2004

		Internal Service Funds
OPERATING REVENUES:		
Charges for services	$	2,745,274
Other		2,491
TOTAL OPERATING REVENUES		2,747,765
OPERATING EXPENSES:		
Personnel services		2,340,157
Other services and charges		89,329
Depreciation		279,540
TOTAL OPERATING EXPENSES		2,709,026
OPERATING INCOME (LOSS)		38,739
NON-OPERATING REVENUES (EXPENSES):		
Interest income		37,655
Interest expense		(40,893)
Transfers from local units		-
TOTAL NON-OPERATING REVENUES (EXPENSES)		(3,238)
CHANGE IN NET ASSETS		35,501
Net assets, beginning of year		168,425
Prior period adjustment for Medicaid risk carryforward		(8,613)
Net assets, beginning of year, as restated		159,812
NET ASSETS, END OF YEAR	$	195,313

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds
Statement of Cash Flows

For the Fiscal Year Ended September 30, 2004

	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from charges for services	$ 2,732,409
Other operating revenues	15,356
Cash paid for operating expenses	(2,422,155)
NET CASH PROVIDED BY OPERATING ACTIVITIES	325,610
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Decrease in due from other funds	22,726
Increase in due to other funds	(344,845)
(Increase) in due from local units	(5,439)
Transfers from local units	-
NET CASH PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	(327,558)
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	(515,049)
Proceeds on issuance of long-term debt	1,199,263
Interest payments on long-term debt	(40,893)
Principal payments on long-term debt	(618,909)
NET CASH PROVIDED BY CAPITAL FINANCING ACTIVITIES	24,412
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest income	40,764
(Increase) in fair market value of investments	(3,109)
NET CASH PROVIDED BY INVESTING ACTIVITIES	37,655
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	60,119
Cash and cash equivalents, beginning of year	928,791
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 988,910
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net operating (loss)	$ 38,739
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:	
Depreciation expense	279,540
Changes in assets and liabilities:	
(Decrease) in accounts payable	-
Increase in accrued sick and vacation	987
Increase in accrued payroll and related	6,344
TOTAL ADJUSTMENTS	286,871
NET CASH PROVIDED FROM OPERATING ACTIVITIES	$ 325,610

The accompanying notes to financial statements are an integral part of this statement.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Pathways is an autonomous entity, separate from the county governments which it services and accordingly consists of a separate set of self-balancing funds and accounts. Pathways is, for financial reporting purposes, and Authority under the Michigan Mental Health Code (P.A. 290 of 1995). The accounting policies of Pathways conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies:

BASIS OF PRESENTATION

During the year Pathways adopted Governmental Accounting Standards Board (GASB) Statement No. 34, which substantially revised the financial statement presentation as described below.

Government-Wide Financial Statements:

The Statement of Net Assets and Statement of Activities display information about Pathways as a whole. They include all funds of Pathways. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through State sources, intergovernmental revenues, and other non-exchange revenues. Pathways currently does not engage in any business-type activities defined as activities financed in whole or in part by fees charged to external parties for goods or services. Equity is classified as net assets and displayed in three components – invested in capital assets, net of related debt, restricted, and unrestricted.

Fund Financial Statements:

The accounts of Pathways are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped in the financial statements in this report into two major categories: governmental and proprietary categories. An emphasis is placed on major funds within the governmental category. The General Fund is always considered a major fund and the remaining funds of Pathways are considered major if the total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding total for all governmental funds in accordance with the criteria.

Pathways' reports the General Fund as its only major governmental fund in accordance with the above criteria. The funds of Pathways are described below:

<u>Governmental Funds</u>

General Fund – The General Fund is the main operating fund and accordingly, it is used to account for all financial resources except those required to be accounted for in another fund.

Debt Service Fund – The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs.

Special Revenue Fund – The Special Revenue Fund is used to account for proceeds of specific revenue sources that are restricted to expenditures for specific purposes. The Ray of Sunshine Fund is a special revenue fund type.

Proprietary Funds

Internal Service Fund – The Internal Service Fund is used to account for the financing of goods or services provided by one department or agency to other departments or agencies of Pathways or to other governments, on a cost-reimbursement basis. The Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund are internal service funds.

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement focus applied.

Measurement Focus

On the government-wide Statement of Net Assets and the Statement of Activities, the governmental activities are presented using the economic resource measurement focus as defined in item (b) below. In the fund financial statements, the "current financial resources" measurement focus or the "economic resources" measurement focus is used as appropriate:

a. All governmental funds utilize a "current financial resources" measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable resources at the end of the period.

b. The proprietary funds utilize an "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets, financial position and cash flows. All assets and liabilities, whether current or noncurrent, associated with their activities are reported. Proprietary fund equity is classified as net assets.

Basis of Accounting

In the government-wide Statement of Net Assets and Statement of Activities, governmental activities are presented using the accrual basis of accounting. Also, the proprietary fund financial statements are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when "measurable and available." Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or within sixty days after year-end. Expenditures, including capital outlay, are generally recognized when the related fund liability is incurred.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

OTHER SIGNIFICANT ACCOUNTING POLICIES

Cash and Equivalents

Pathways cash and cash equivalents as reported in the Statement of Cash Flows and the Statement of Net Assets are considered to be cash on hand, demand deposits and short-term investments with maturities of three months or less.

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible.

Interfund Activity

During the course of its operations, Pathways has numerous transactions between funds to finance operations, to provide services and to service debt. To the extent that certain transactions between funds had not been paid or received as of September 30, 2004, balances of interfund accounts receivable or payable have been recorded in the fund financial statements. Interfund activity is eliminated in the government-wide financial statements.

Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market. Inventory in the General Fund consists of expendable supplies.

Capital Assets

The accounting and reporting treatment applied to capital assets associated with a fund are determined by its measurement focus. In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for the same as in the government-wide financial statements.

In the government-wide financial statements, all capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Pathways defines capital assets as assets with an initial, individual cost of more than $5,000.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net Assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	25-40 years
Vehicles and equipment	3-15 years

The cost of normal maintenance and repairs is charged to operations as incurred. Renewals and betterments are capitalized and depreciated over the remaining useful lives of the related properties.

Long-Term Debt

The accounting treatment of long-term debt depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements. All long-term debt to be repaid from

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

governmental or business-type resources are reported as liabilities in the government-wide statements. Pathways long-term debt consists primarily of notes payable.

Long-term debt for governmental funds is not reported as liabilities in the fund financial statements. The debt proceeds are reported as other financing sources and payments of principal and interest are reported as expenditures. The accounting for proprietary funds is the same in the fund statements as it is in the government-wide statements.

Compensated Absences

Pathways' policies regarding compensated absences permits employees to accumulate earned but unused paid time off, compensation and sick time. The liability for these compensated absences is recorded as long-term debt in the government-wide statements. In the fund financial statements, governmental funds report only the compensated absence liability payable from expendable available financial resources, while proprietary funds report the liability as it is incurred.

Deferred Revenues

In the government-wide statements and proprietary fund financial statements, deferred revenue is recognized when cash, receivables or other assets are received prior to their being earned. In the governmental fund statements, deferred revenue is recognized when revenue is unearned or unavailable. Pathways has reported deferred revenue of $960,663 in the General Fund for Department of Community Health Medicaid and General Funding that has been received but is unearned.

Revenues

In the government-wide Statement of Activities, revenues are segregated by activity and are classified as either a program revenue or a general revenue. Program revenues include charges to customers or applicants for goods or services, operating grants and contributions and capital grants and contributions. General revenues include all revenues, which do not meet the criteria of program revenues and include revenues such as State funding and interest earnings.

In the governmental fund statements, revenues are reported by source, such as federal sources, state sources and charges for services. Revenues consist of general purpose revenues and restricted revenues. General purpose revenues are available to fund any activity reported in that fund, while restricted revenues are available for a specific purpose or activity and the restrictions are typically required by law or a grantor agency. When both general purpose and restricted revenues are available for use, it is the Pathways policy to use the restricted resources first.

Expenses/Expenditures

In the government-wide Statement of Activities, expenses are segregated by activity and are classified by function. In the governmental fund statements, expenditures are classified by character such as current operations, debt service and capital outlay. In the proprietary fund statements, expenses are classified by operating and non-operating and are sub-classified by function such as personnel services and other services and charges.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Budgets and Budgetary Accounting

Pathways follows these procedures in establishing the budgetary data reflected in the financial statements:

a. Prior to October 1, the Executive Director submits to the Board a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and the means of financing them.

b. Prior to October 1, the budget is legally enacted through passage of a Board resolution.

c. The Executive Director is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the Board.

d. Budgets are adopted on a basis consistent with generally accepted accounting principles. Budgeted amounts are as originally adopted, or as amended by the Board. Individual amendments were not material in relation to the original appropriations which were amended.

e. Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is not employed by Pathways because it is at present considered not necessary to assure effective budgetary control or to facilitate effective cash planning and control. Any unexpendable appropriations lapse at the end of the fiscal year.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B – DEPOSITS AND INVESTMENTS:

The composition of cash and equivalents as reported in the government-wide Statement of Net Assets is presented below:

Unrestricted	$1,492,092
Restricted assets	749,505
	$2,241,597

Cash and cash equivalents can also be summarized into the following categories:

Deposits:	
Cash in demand accounts	$ 95,319
Cash in savings accounts	2,146,278
	$2,241,597

NOTE B – DEPOSITS AND INVESTMENTS (Continued):

Deposits

At year end, the carrying amount of the segregated Pathways deposits was $2,241,597 and the bank balance was $2,342,267. Of the bank balance, approximately $100,000 was covered by the FDIC under regulation 330.8. The remaining balance of $2,242,267 was uninsured and uncollateralized. This regulation in summary provides that deposits of a governmental unit are insured for the lesser of the amount of the combined deposit or $100,000 in every financial institution that is not a branch location that is a member of the FDIC in the following deposit accounts.

1. All demand non-interest bearing accounts in the name of the authorized or statutory custodian of public funds.

2. All savings deposits which include regular passbook, daily interest savings and time certificates of deposit in the name of the governmental unit's custodian.

3. Each bookholder is insured pro-rata for the lesser of the amount on deposit in the debt retirement account or $100,000. Each separate debt issue or debt series is similarly insured.

4. The demand accounts and savings accounts as defined in items 1 and 2 above for those bank accounts in the name of a specific fund when all of the following criteria is applicable.

    a. The fund is created by a specific State statute.
    b. The functions of the fund are specified by State statute.
    c. Money is allocated by State statute for the exclusive use of that fund and statutory function.

Investments

Statutory Authority

Act 196, PA 1997, authorized Pathways to deposit and invest in:

1. Bonds, securities and other direct obligations of the United States or its agencies.

2. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of federally insured banks, insured savings and loan associations or credit unions insured by the National Credit Union Administration that are eligible to be depository of surplus money belonging to the State under Section 5 or 6 of Act 105, PA 1855, as amended.

3. Commercial paper rated at time of purchase within the two highest classifications established by not less than two standard rating services.

4. United States government or Federal agency obligation repurchase agreements.

5. Banker's acceptance of United States banks.

6. Mutual funds composed of investments which are legal for direct investments by local units of government in Michigan.

7. Obligations of the State of Michigan or its political subdivisions which are rated investment grade.

NOTE B – DEPOSITS AND INVESTMENTS (Continued):

8. Financial institutions eligible for deposit of public funds must maintain an office in Michigan.

The Pathway's investments are in accordance with statutory authority.

Michigan law prohibits security in the form of collateral, surety bond, or another form for the deposit of public money.

NOTE C – ESTIMATED AMOUNT DUE FROM (TO) MICHIGAN DEPARTMENT OF COMMUNITY HEALTH:

The estimated amount due from (to) the Michigan Department of Community Health represents the Board's cost settlement report of services and expenditures for the year ending September 30, 2004 in accordance with the terms of the master contract. The reported costs related to such services are subject to review by the Department.

NOTE D – CAPITAL ASSETS:

All capital assets are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Capital asset activity for the year ended September 30, 2004 is as follows:

	Balance at 10/01/03	Additions	Disposals	Adjustments	Balance at 9/30/04
Capital assets not being depreciated:					
Land	$ 347,000	$ 15,000	$ 7,000	$ 8,000	$ 363,000
Capital assets being depreciated:					
Land improvements	20,700	-	-	(20,700)	-
Buildings	3,050,161	156,129	50,000	10,471	3,166,761
Building improvements	66,334	5,832	3,196	20,700	89,670
Equipment and furnishings	2,537,382	104,049	292,919	-	2,348,512
Vehicles	1,316,124	234,039	206,957	98,150	1,441,356
Total Capital Assets	7,337,701	515,049	560,072	116,621	7,409,299
Less accumulated depreciation:					
Land improvements	817	-	-	(817)	-
Buildings	1,085,405	126,187	27,500	1,646	1,185,738
Building improvements	40,172	5,383	3,196	818	43,177
Equipment and furnishings	1,536,705	264,853	271,412	-	1,530,146
Vehicles	1,081,585	111,771	206,896	98,155	1,084,615
Total Accumulated Depreciation	3,744,684	508,194	509,004	99,802	3,843,676
Capital Assets, net	$3,593,017	$ 6,855	$ 51,068	$ 16,819	$3,565,623

Depreciation expense was charged to governmental activities as follows:

Governmental Activities:	
General government	$228,654
Internal service funds charged to above activities	279,540
Total	$508,194

NOTE E – UNPAID CLAIMS:

The Board estimates its liability for unpaid health insurance claims on the basis of the date the claim was incurred and historical experience. As of September 30, 2004, the amount of unpaid claims in the accompanying financial statements is $150,771.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES:

Prior to March 10, 1997 regular employees annually earned hours of sick leave. For those employees hired before October 1, 1981 the sick leave was paid out upon termination or retirement at a rate of 50% of the sick leave balance to a maximum of 600 hours (1,200 hours x 50%). For those employees hired after October 1, 1981 the payment was paid out only upon retirement, vesting under both situations occurred after 10 years of service.

The new policy, which became effective March 10, 1997, accrues all employees' sick annual, bonus and personal leave in one leave bank, referred to as Paid Time Off (PTO). In addition to PTO, each full time employee will be given 32 hours of paid, extended/restricted sick leave per year to be used only for major medical events. Extended/Restricted sick leave cannot accrue; therefore, there will be no pay out of this sick leave at retirement or termination. An employee may earn one extra bonus day of PTO per year.

Separation from service entitles the employee to payment of the available balance of PTO leave, up to 40 hours compensation time, plus any unused sick leave according to policies in place prior to March 10, 1997.

The amount of vested leave as of September 30, 2004 is as follows:

Paid time off		$1,204,194
Sick Leave		139,421
Compensation Time		36,051
	TOTAL	$1,379,666

NOTE G – LINE OF CREDIT:

As of September 30, 2004, Pathways had a secured credit agreement with maximum borrowings of $1,100,000. At September 30, 2004 the outstanding balance was $14,515 as reported in the General Fund. The interest rate is 6.53% per annum.

NOTE H – DEFERRED COMPENSATION PLANS:

Pathways offers its employees deferred compensation plans created in accordance with Section 457 of the Internal Revenue Code. The plans, available to all employees, permit them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or unforeseeable emergency.

The amounts deferred under the plan are held in a custodial account for the exclusive benefit of plan participants and their beneficiaries. The plans' participants have the right to designate how the funds will be invested. Therefore, Pathways has no liability for losses under the plans.

Due to changes in the Internal Revenue Code, the plans' assets are considered to be property of the plans' participants and are no longer subject to Pathways general creditors. Therefore, in accordance with GASB Statement No. 32, plan balances and activities are not reflected in these financial statements.

NOTE I – DEFINED CONTRIBUTION PENSION PLAN:

Pathways provides pension benefits to employees through four defined contribution pension plans, as listed below. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Pathways established the plans in the form of the ICMA Retirement Corporation Governmental Money Purchase

NOTE I – DEFINED CONTRIBUTION PENSION PLAN (Continued):

Plan and Trust, as amended by and as authorized by Section 19A of the Municipal Employee's Retirement System of Michigan Plan Document. The ICMA Retirement Corporation is the Plan Administrator and Pathways has agreed to the commingled investment of assets of the Plan within the ICMA Retirement Trust.

	FICA Alternative	Retirement Non-Bargaining	Retirement - Delta Technical/Support Unit	Retirement-Delta Professional Unit
Employees Covered	All regular status full and part-time Employees	All regular status non-bargaining full and part time employees hired after 1/1/98	All 3/4 time, full time, and job-share status bargaining technical and support staff employees hired after 4/7/99	All 3/4 time, full time, and Job -share status bargaining Professional staff Employees hired after 4/9/99
Number of Plan Members	310	124	15	16
Mandatory Employee Contributions	None	None	None	None
Mandatory Employer Contributions	6.20%	5.00%	5.00%	5.00%
Vesting Requirements	Immediate	4 years (25% per year)	4 years (25% per year)	4 years (25% per year)
Actual Employee Contributions	$ 32,777	$ 6,085	-	-
Actual Employer Contributions	$704,799	$175,849	$18,862	$33,380
Total Contributions	$737,576	$181,934	$18,862	$33,380

NOTE J – LONG-TERM DEBT:

Changes in long-term debt principal during the year ended September 30, 2004 are summarized as follows:

	Balance 10-1-03	Additions	Deductions	Balance 9-30-04
Installments contracts	$ 928,002	$ -	$235,701	$ 692,301
Equipment Fund – Line of Credit	305,780	284,913	514,300	76,393
Equipment Fund – Notes payable	548,919	914,350	104,609	1,358,660
Total Long-Term Debt	$1,782,701	$1,199,263	$854,610	$2,127,354

Schedule of Installment Contracts - Maple Ridge
September 30, 2004

Year	Interest	Principal	Total
2005	$ 4,451	$ 13,637	$ 18,088
2006	3,516	14,572	18,088
2007	2,517	15,571	18,088
2008	1,467	16,621	18,088
TOTALS	$11,951	$60,401	$72,352

NOTE J – LONG-TERM DEBT (Continued):

Installment Contract - Bank originally issued for $170,346 and dated April 6, 1995 mature annually as scheduled above with monthly payment of $1,507.63 bearing an interest rate per annum equal to 70% of the National City's Base Lending Rate.

Schedule of Installment Contracts - Wood Ridge
September 30, 2004

Year	Interest	Principal	Total
2005	$ 3,885	$10,732	$ 14,617
2006	3,177	11,440	14,617
2007	2,423	12,194	14,617
2008	1,620	12,997	14,617
2009	819	7,591	8,410
TOTALS	$11,924	$54,954	$66,878

Installment Contract - Bank originally issued for $140,765 and dated May 1, 1995 matures annually as scheduled above with monthly payment of $1,218.12 bearing an interest rate per annum equal to 70% of National City's Base Lending Rate.

Schedule of Installment Contracts - Baraga Street
September 30, 2004

Year	Interest	Principal	Total
2005	$1,095	$ 3,945	$ 5,040
2006	878	4,162	5,040
2007	650	4,390	5,040
2008	409	4,631	5,040
2009	155	3,160	3,315
TOTALS	$3,187	$20,288	$23,475

Installment Contract - Bank originally issued for $48,500 and dated March 1, 1996 matures annually as scheduled above with monthly payment of $420 bearing an interest rate per annum of 6.4%.

Schedule of Installment Contracts - Spring Street
September 30, 2004

Year	Interest	Principal	Total
2005	$ 2,263	$ 7,037	$ 9,300
2006	1,876	7,424	9,300
2007	1,468	7,832	9,300
2008	1,037	8,263	9,300
2009	547	8,753	9,300
2010	125	2,228	2,353
TOTALS	$7,316	$41,537	$48,853

Installment Contract - Bank originally issued for $93,000 and dated January 1, 1996 matures annually as scheduled above with monthly payment of $775 bearing an interest rate per annum of 5.8%.

NOTE J – LONG-TERM DEBT (Continued):

Schedule of Installment Contracts – UPSC M35, Lincoln House and Lake Bluff Refinance # 1

September 30, 2004

Year	Interest	Principal	Total
2005	$523	$23,613	$24,136
TOTALS	$523	$23,613	$24,136

Installment Contract - Bank originally issued for $249,027 and dated June 30, 1998, refinanced for $135,060 dated January 29, 2002 matures annually as scheduled above with monthly payment of $3,650 bearing an interest rate per annum of 4.75%.

Schedule of Installment Contracts - UPSC M35, Lincoln House and Lake Bluff Refinance # 2

September 30, 2004

Year	Interest	Principal	Total
2005	$4,100	$20,304	$24,404
2006	2,931	21,473	24,404
2007	1,694	22,710	24,404
2008	417	17,828	18,245
TOTALS	$9,142	$82,315	$91,457

Installment Contract - Bank originally issued for $186,410 and dated June 23, 1998 matures annually as scheduled above with monthly payment of $2,034 bearing an interest rate per annum of 5.61%.

Schedule of Installment Contracts – Mortgage Payable

September 30, 2004

Year	Interest	Principal	Total
2005	$13,669	$131,218	$144,887
2006	8,446	136,441	144,887
2007	3,014	141,834	144,848
TOTALS	$25,129	$409,493	$434,622

Installment contract bank originally issued for $657,050 and dated August 29, 2002 matures annually as scheduled above with monthly payment of $12,074 bearing an interest rate per annum of 3.91%.

Schedule of Line of Credit – Equipment Purchases

September 30, 2004

Year	Interest	Principal	Total
2005	$5,289	$76,393	$81,682
TOTALS	$5,289	$76,393	$81,682

Line of Credit – Pathways has secured a credit agreement with maximum borrowings of $196,725 to be utilized for equipment purchases by March 31, 2005. At September 30, 2004, the outstanding balance was $76,393 and is currently payable until a loan agreement is secured. The interest rate is 3.45% per annum.

NOTE J – LONG-TERM DEBT (Continued):

Schedule of Notes Payable – Phone System
September 30, 2004

Year	Interest	Principal	Total
2005	$19,073	$ 89,830	$108,903
2006	14,572	94,331	108,903
2007	9,844	99,059	108,903
2008	4,880	104,023	108,903
2009	513	43,542	44,055
TOTALS	$48,882	$430,785	$479,667

Note Payable – Phone System originally issued for $643,000 and dated February 22, 2002, mature annually as scheduled above with monthly payments of $9,075.28 bearing an interest rate of 4.90% per annum.

Schedule of Installment Contracts – Vehicle
September 30, 2004

Year	Interest	Principal	Total
2005	$ -	$ 4,268	$ 4,268
2006	-	4,268	4,268
2007	-	3,912	3,912
TOTALS	$ -	$12,448	$12,448

Notes payable bank originally issued for $21,340 and dated October 1, 2002 matures annually as scheduled above with monthly payment of $357 bearing an interest rate per annum of 0.00%.

Schedule of Installment Contracts – Vehicle
September 30, 2004

Year	Interest	Principal	Total
2005	$ -	$ 4,202	$ 4,202
2006	-	4,202	4,202
2007	-	3,851	3,851
TOTALS	$ -	$12,255	$12,255

Notes payable bank originally issued for $21,009 and dated October 1, 2002 matures annually as scheduled above with monthly payment of $350 bearing an interest rate per annum of 0.00%.

Schedule of Installment Contracts – Equipment
September 30, 2004

Year	Interest	Principal	Total
2005	$13,955	$110,485	$124,440
2006	10,082	114,358	124,440
2007	6,074	118,366	124,440
2008	1,926	111,730	113,656
TOTALS	$32,037	$454,939	$486,976

Notes payable bank originally issued for $464,350 and Dated August 26, 2004 mature annually as schedule above with monthly payment of $10,370 bearing an interest rate per annum of 3.45%.

NOTE J – LONG-TERM DEBT (Continued):

Schedule of Installment Contracts - Building
September 30, 2004

Year	Interest	Principal	Total
2005	$ 18,943	$ 12,023	$ 30,966
2006	17,023	11,561	28,584
2007	16,556	12,028	28,584
2008	16,074	12,510	28,584
2009	15,570	13,014	28,584
2010-2014	69,564	73,356	142,920
2015-2019	53,575	89,345	142,920
2020-2024	34,102	108,818	142,920
2025-2029	10,668	115,578	126,246
TOTALS	$252,075	$448,233	$700,308

Notes payable bank originally issued for $450,000 and dated June 22, 2004 matures annually as scheduled above with monthly payments of $2,382 bearing an interest rate per annum of 3.95%.

NOTE K – DEFICIT NET ASSETS:

The Employee Benefit Fund had a deficit in total net assets at September 30, 2004 of $(564,723). Pathways' position is that a deficit exists and at present they are unable to remedy the issue. However, Pathways periodically calculates the value of this liability charging or crediting the Fund as appropriate. Pathways plans to reduce the unfunded liability each year to the extent that state and local funding is available.

NOTE L – MEDICAID REIMBURSEMENTS:

Effective October 1, 1998, Pathways entered into a Specialty Community Mental Health Services and Supports Managed Care Contract with the Michigan Department of Community Health (MDCH). Under the Managed Care Contract, the MDCH provides Pathways' state and federal share of Medicaid funds as a capitated payment based on a Per Eligible Per Month methodology for contractually identified and described covered services. Each month of the contract, Pathways receives a prepayment based upon the number of eligibles for that month. This payment methodology replaced the Medicaid reimbursement system in effect through September 30, 1998. In accordance with the contract, Pathways may retain up to 5% of the prepayment as Medicaid savings which are allowed to be treated as local funds and must be expended in the following year. The Medicaid savings must be included in a formal reinvestment strategy which must be directed to the Medicaid population and must be approved by the MDCH.

NOTE M – TRANSFERS IN (OUT):

	In		Out
Debt Service Fund	$260,736	General Fund	$319,394
Special Revenue Fund	58,658		
TOTALS	$319,394	TOTALS	$319,394

NOTE N – DEFINED BENEFIT RETIREMENT PLAN:

The following information is based upon the latest available actuarial valuation (as of December 31, 2003).

Plan Description

Pathways contributes to the Municipal Employees Retirement System of Michigan (System), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for all Michigan municipal employees. The System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MERS at 1134 Municipal Way, Lansing, MI 48917-9755.

All regularly scheduled full and part-time employees of Pathways are eligible to participate in the System. Benefits vest after ten years of service. Pathways employees who retire at or after the age of 60 with 10 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to the sum of 2.25 percent of a member's final average compensation times years of service, with a maximum benefit of 80% of final average compensation. The System also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute and Pathways' Board.

Funding Policy

Employees of Pathways at present are required to contribute two percent of their annual salary to the System. Pathways is currently contributing the remaining amounts necessary to fund the System, using the actuarial basis specified by statute.

Annual Pension Cost

For the year ended September 30, 2004, Pathways' annual pension cost of $1,100,604 for the plan was equal to Pathways' required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2001, using the entry age normal cost method. Significant actuarial assumptions used in the valuation include (a) a rate of return on the investment of present and future assets of 8%, (b) projected salary increases of 4.5% a year compounded annually, attributable to inflation, and (c) additional projected salary increases of 0.0% to 4.16% per year, depending on age, attributable to seniority/merit. 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 five year period. The unfunded actuarial accrued liability is being amortized as a level percent of projected payroll on an open basis over a period of 30 years.

Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due.

Three-Year Trend Information
Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Accrued Liability (AAL) – Entry Age (a)	Actuarial Value Of Assets (b)	Unfunded AAL (UAAL) (a) – (b)	Funded Ratio (b/a)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((a-b)/c)
12/31/01	$34,188,685	$24,299,290	$9,889,395	71%	$7,318,897	135%
12/31/02	36,587,574	24,933,962	11,653,612	68	7,124,649	164
12/31/03	38,995,925	26,404,421	12,591,504	68	6,753,347	186

NOTE N – DEFINED BENEFIT RETIREMENT PLAN (Continued):

Schedule of Employer Contributions

Fiscal Year Ending September 30	Valuation Date December 31	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2002	1999	$1,238,542	100%	-
2003	2000	1,152,979	100	-
2004	2001	1,100,604	100	-

NOTE O – RISK MANAGEMENT:

Pathways is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Pathways was unable to obtain general liability, auto, and property insurance at a cost it considered to be economically justifiable. Pathways joined together with other units to participate in a public entity risk pool currently operating as a common risk management and insurance program. Pathways pay an annual contribution to the pool for its general insurance coverage. The agreement provides that the pool will be self-sustaining through member contributions and will reinsure through commercial companies for claims in excess of $75,000 for each insured event.

Pathways continues to carry commercial insurance for Physician Malpractice and all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE P – OWNERSHIP:

Pathways membership is currently divided in proportion to each county's population, based on the 1980 U.S. Census, and is approximately 7.14%, 56.35%, 31.75%, and 4.76% for Alger, Marquette, Delta and Luce Counties respectively. The 2004 financial statements include 100% of the recorded assets of Pathways.

NOTE Q – OTHER POST EMPLOYMENT BENEFITS:

Pathways offers group medical insurance under various collective bargaining agreements covering substantially all employees and former employees of Pathways. The amount paid for former Pathways employees for the fiscal year ended September 30, 2004 was $23,850 with 52 participants receiving benefits. This benefit is accounted for on the "pay-as-you-go" method, whereby Pathways is reporting the amounts paid as expenditures in the year the amount is paid for the benefit provided. For employees hired after January 1, 1998, Pathways no longer provides group medical insurance after separation from employment with Pathways.

NOTE R – BUDGETARY NONCOMPLIANCE:

Excesses of expenditures over appropriations in individual governmental funds are as follows:

GENERAL FUND:	
Equipment Rental	$369,398
Insurance	218,805
Miscellaneous	87,303

NOTE S – FUND BALANCE/NET ASSET RESTATEMENT:

The following fund balance/net asset restatements were made as a result of discovering prior period accounting errors and prior period adjustments to Medicaid amounts resulting from Department of Community Health's review of prior period information.

	Governmental Activities	General Fund	Medicaid Risk Reserve Fund
Net assets/fund balance, beginning of year	$3,824,154	$2,229,821	$762,740
Prior period adjustment for Medicaid Risk Carry forward	(8,613)	-	(8,613)
Prior period adjustment for Medicaid Settlements	43,542	43,542	-
Prior period adjustment for accounting errors	176,409	176,409	-
NET ASSETS/FUND BALANCE, BEGINNING OF YEAR, AS RESTATED	$4,035,492	$2,449,772	$754,127

NOTE T – SUBSEQUENT EVENT:

On October 4, 2004, Pathways entered into an agreement with the County of Marquette to purchase the Defant Building for a total sum of $1,998,952. Pathways financed the purchase with $371,282 in cash and issuing $1,627,670 in bonds.

REQUIRED SUPPLEMENTARY INFORMATION

Pathways

General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Fiscal Year Ended September 30, 2004

	Budgeted Amounts Original	Budgeted Amounts Final	Actual GAAP Basis	Variance with Final Budget Positive (Negative)
REVENUES:				
State sources:				
Medicaid - Mental health	$ 62,500,000	$ 62,000,000	$ 61,016,777	$ (983,223)
Medicaid - Substance abuse	730,000	730,000	699,699	(30,301)
Medicaid - Child waiver	300,000	300,000	462,827	162,827
General funding	3,738,965	3,738,965	3,654,036	(84,929)
Contracts and grants:				
Mental health	525,000	513,008	477,892	(35,116)
Substance abuse	2,588,824	2,588,824	2,372,990	(215,834)
Charges for services:				
Client fees except Medicaid	775,000	797,000	3,612,997	2,815,997
Client revenues - work centers	310,000	305,600	294,210	(11,390)
Local sources:				
County appropriations	600,972	600,972	600,972	-
County liquor tax	610,000	610,000	600,385	(9,615)
Contributions	-	40,800	5,301	(35,499)
Interest income	25,000	25,000	12,785	(12,215)
Other revenues	1,240,634	1,235,974	1,234,964	(1,010)
Less deductions from revenues:				
Donated services discount	-	-	(2,892,646)	(2,892,646)
Medicaid general funding carryforward	(99,863)	(99,863)	-	99,863
Local match - Medicaid draw down	(1,303,991)	(1,303,991)	(1,303,991)	-
Public Act 423 of 1980	-	-	(4,091)	(4,091)
TOTAL REVENUES	72,540,541	72,082,289	70,845,107	(1,237,182)
EXPENDITURES:				
Current operations:				
Personnel services	18,525,440	18,680,153	18,351,157	328,996
Contract services	50,597,289	50,645,009	50,588,752	56,257
Building rental	1,071,691	1,071,691	843,953	227,738
Supplies	701,913	697,826	576,004	121,822
Equipment rental	15,495	15,495	384,893	(369,398)
Utilities	340,136	340,136	283,932	56,204
Insurance	524,083	219,694	438,499	(218,805)
Repairs/maintenance	377,585	366,543	365,801	742
Staff development	161,795	152,795	134,279	18,516
Travel	388,904	354,153	346,846	7,307
Miscellaneous	125,000	100,000	187,303	(87,303)
Capital outlay	102,850	92,850	85,835	7,015
TOTAL EXPENDITURES	72,932,181	72,736,345	72,587,254	149,091
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	(391,640)	(654,056)	(1,742,147)	(1,088,091)

Pathways

General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
For the Fiscal Year Ended September 30, 2004

	Budgeted Amounts		Actual GAAP Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
OTHER FINANCING SOURCES (USES):				
Transfers (out)	$ (260,712)	$ (260,712)	$ (319,394)	$ (58,682)
TOTAL OTHER FINANCING SOURCES (USES)	(260,712)	(260,712)	(319,394)	(58,682)
NET CHANGE IN FUND BALANCE	(652,352)	(914,768)	(2,061,541)	(1,146,773)
Fund balance, beginning of year	2,229,821	2,229,821	2,229,821	-
Prior period adjustment for accounting errors	-	-	176,409	176,409
Prior period adjustment for Medicaid settlements	-	-	43,542	43,542
Fund balance, beginning of year, as restated	2,229,821	2,229,821	2,449,772	219,951
FUND BALANCE, END OF YEAR	$ 1,577,469	$ 1,315,053	$ 388,231	$ (926,822)

OTHER SUPPLEMENTARY INFORMATION

Pathways

Nonmajor Governmental Funds
Combining Balance Sheet

September 30, 2004

	Special Revenue Fund: Ray of Sunshine Fund	Debt Service Fund	Total Nonmajor Governmental Funds
ASSETS			
Cash and cash equivalents	$ 75,723	$ -	$ 75,723
Accounts receivable - other	-	10,060	10,060
Due from other funds	2,185	-	2,185
TOTAL ASSETS	$ 77,908	$ 10,060	$ 87,968
LIABILITIES AND FUND BALANCE			
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved	77,908	-	77,908
TOTAL FUND BALANCE	77,908	10,060	87,968
TOTAL LIABILITIES AND FUND BALANCE	$ 77,908	$ 10,060	$ 87,968

Pathways

Nonmajor Governmental Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2004

	Special Revenue Fund Ray of Sunshine Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Private contributions	$ 17,672	-	$ 17,672
Interest income	1,578	-	1,578
TOTAL REVENUES	19,250	-	19,250
EXPENDITURES:			
Current operations	-	-	-
Debt service:			
Principal	-	235,700	235,700
Interest and fiscal charges	-	25,036	25,036
TOTAL EXPENDITURES	-	260,736	260,736
EXCESS REVENUES OVER (UNDER) EXPENDITURES	19,250	(260,736)	(241,486)
OTHER FINANCING SOURCES (USES):			
Transfers in	58,658	260,736	319,394
Transfers (out)	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	58,658	260,736	319,394
NET CHANGE IN FUND BALANCE	77,908	-	77,908
Fund balance, beginning of year	-	10,060	10,060
FUND BALANCE, END OF YEAR	$ 77,908	$ 10,060	$ 87,968

Pathways

Internal Service Funds
Combining Statement of Net Assets

September 30, 2004

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
ASSETS				
Current assets:				
Cash and cash equivalents	$ 965,714	$ 23,196	$ -	$ 988,910
Due from local units	-	736,840	-	736,840
Due from other funds	-	-	-	-
Total current assets	965,714	760,036	-	1,725,750
Capital assets:				
Land and improvements	-	-	71,532	71,532
Buildings	-	-	434,391	434,391
Vehicles	-	-	501,185	501,185
Office equipment	-	-	81,793	81,793
Information technology equipment	-	-	952,832	952,832
Accumulated depreciation	-	-	(557,057)	(557,057)
Total noncurrent assets	-	-	1,484,676	1,484,676
TOTAL ASSETS	965,714	760,036	1,484,676	3,210,426
LIABILITIES				
Current liabilities:				
Accounts payable	-	-	-	-
Due to other funds	-	-	49,623	49,623
Accrued payroll and related	150,771	-	-	150,771
Current maturities of long-term debt	-	-	296,226	296,226
Total current liabilities	150,771	-	345,849	496,620
Long-term liabilities:				
Compensated absences	1,379,666	-	-	1,379,666
Notes payable	-	-	1,138,827	1,138,827
Total long-term liabilities	1,379,666	-	1,138,827	2,518,493
TOTAL LIABILITIES	1,530,437	-	1,484,676	3,015,113
NET ASSETS				
Invested in capital assets, net of related debt	-	-	-	-
Restricted	-	760,036	-	760,036
Unrestricted	(564,723)	-	-	(564,723)
TOTAL NET ASSETS	$ (564,723)	$ 760,036	$ -	$ 195,313

Pathways

Internal Service Funds
Combining Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2004

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
OPERATING REVENUES:				
Charges for services	$ 2,423,098	$ -	$ 322,176	$ 2,745,274
Other	2,491	-	-	2,491
TOTAL OPERATING REVENUES	2,425,589	-	322,176	2,747,765
OPERATING EXPENSES:				
Personnel services	2,340,157	-	-	2,340,157
Other services and charges	87,586	-	1,743	89,329
Depreciation	-	-	279,540	279,540
TOTAL OPERATING EXPENSES	2,427,743	-	281,283	2,709,026
OPERATING INCOME (LOSS)	(2,154)	-	40,893	38,739
NON-OPERATING REVENUES (EXPENSES):				
Interest income	31,746	5,909	-	37,655
Interest expense	-	-	(40,893)	(40,893)
Transfers from local units	-	-	-	-
TOTAL NON-OPERATING REVENUES (EXPENSES)	31,746	5,909	(40,893)	(3,238)
CHANGE IN NET ASSETS	29,592	5,909	-	35,501
Net assets, beginning of year	(594,315)	762,740	-	168,425
Prior period adjustment for Medicaid risk carryforward	-	(8,613)	-	(8,613)
Net assets, beginning of year, as restated	(594,315)	754,127	-	159,812
NET ASSETS, END OF YEAR	$ (564,723)	$ 760,036	$ -	$ 195,313

Pathways

Internal Service Funds
Combining Statement of Cash Flows

For the Fiscal Year Ended September 30, 2004

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash received from charges for services	$ 2,410,233	$ -	$ 322,176	$ 2,732,409
Other operating revenues	15,356	-	-	15,356
Cash paid for operating expenses	(2,420,412)	-	(1,743)	(2,422,155)
NET CASH PROVIDED (USED) BY OPERATING ACTIVATES	5,177	-	320,433	325,610
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:				
(Increase) decrease in due from other funds	-	22,726	-	22,726
Increase (decrease) in due to other funds	-	-	(344,845)	(344,845)
(Increase) in due from local units	-	(5,439)	-	(5,439)
Transfers from local units	-	-	-	-
NET CASH PROVIDED (USED) BY NON-CAPITAL FINANCING ACTIVITIES	-	17,287	(344,845)	(327,558)
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	-	-	(515,049)	(515,049)
Proceeds on issuance of long-term debt	-	-	1,199,263	1,199,263
Interest payments on long-term debt	-	-	(40,893)	(40,893)
Principal payments on long-term debt	-	-	(618,909)	(618,909)
NET CASH (USED) BY CAPITAL FINANCING ACTIVITIES	-	-	24,412	24,412
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest income	34,855	5,909	-	40,764
(Increase) in fair market value of investments	(3,109)	-	-	(3,109)
NET CASH PROVIDED BY INVESTING ACTIVITIES	31,746	5,909	-	37,655
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	36,923	23,196	-	60,119
Cash and cash equivalents, beginning of year	928,791	-	-	928,791
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 965,714	$ 23,196	$ -	$ 988,910
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:				
Net operating income (loss)	$ (2,154)	$ -	$ 40,893	$ 38,739
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation expense	-	-	279,540	279,540
Changes in assets and liabilities:				
(Decrease) in accounts payable	-	-	-	-
Increase in accrued sick and vacation	987	-	-	987
Increase in accrued payroll and related	6,344	-	-	6,344
TOTAL ADJUSTMENTS	7,331	-	279,540	286,871
NET CASH PROVIDED FROM OPERATING ACTIVITIES	$ 5,177	$ -	$ 320,433	$ 325,610

SUPPLEMENTAL REPORTS

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

Members of the Board
Pathways
Marquette, Michigan

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2004, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated May 19, 2005. 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.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. These instances are described in a separate letter to management of Pathways dated May 19, 2005.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered Pathway's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting, that, in our judgment could adversely affect Pathway's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described to management in a separate letter dated May 19, 2005.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

Members of the Board
Pathways
Marquette, Michigan

This report is intended solely for the information and use of management, others within the organization, the Board and other federal and state audit agencies and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 19, 2005

Anderson, Tackman & Company, PLC
Certified Public Accountants
Marquette, Michigan 906-225-1166
E-Mail – ATCOMQT@ATCOMQT.COM
Fax – 1-906-225-1714

Partners
John W. Blemberg, CPA | Robert J. Downs, CPA, CVA | Daniel E. Bianchi, CPA

May 19, 2005

To the Board of Directors and
Management of Pathways
200 W. Spring Street
Marquette, Michigan 49855

In planning and performing our audit of the financial statements of Pathways for the year ended September 30, 2004, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control or compliance. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to deficiencies in the design or operation of the internal control structure that, in our judgement, could affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable Conditions

Internal Control System

In any system of internal accounting control one of the main ingredients is a strong reconciliation function. The general ledger contains the accounts and records which are the basis for the preparation of interim financial statements and for them to be free of a material error or irregularity, the necessity for timely reconciliations cannot be overemphasized. We have suggested and good internal control dictates the general ledger accounts be reconciled on a monthly basis and any adjustments to be made be processed timely. The accounts which are most significant in the accounting system that need to be reconciled on a timely basis are:

- Accounts Receivable
- Third Party Revenues
- Third Party Liabilities

It was also noted during our audit that the general ledger and subsidiary computer systems were not integrating appropriately in the above areas resulting in manual journal entries to be made in the general ledger. Information should be consistent between the general ledger and subsidiary billing systems to provide reliable financial data and we recommend management address this computer integration problem.

We also recommend comprehensive financial statements be prepared on at least a semi-annual basis. The need for current financial information throughout a fiscal year cannot be overemphasized.

Instances of Non-Compliance

Uniform Budgeting and Accounting Act (P.A. 621)

The State of Michigan has enacted Public Act 621, the Uniform Budgeting and Accounting Act, to provide for a system of uniform procedures for the preparation and execution of budgets in local units of government. The purpose of P.A. 621 is to require that all local units of government adopt balanced budgets, to establish responsibilities and define the procedure for the preparation, adoption and maintenance of the budget, and to require certain information for the budget process, including data for capital construction projects. The major provisions of P.A. 621 are as follows:

1. Local Units of government must adopt a budget.
2. The budget, including accrued deficits and available unappropriated surpluses, must be balanced.
3. The budget must be amended when necessary.
4. Debt shall not be entered into unless the debt is permitted by law.
5. Expenditures shall not be incurred in excess of the amount appropriated.
6. Expenditures shall not be made unless authorized in the budget.
7. Violations of the act, disclosed in an audit of the financial records, in the absence of reasonable procedures shall be filed with the State Treasurer and reported to the Attorney General.

Pathways was found to be in violation of the legal and contractual provisions of Public Act 621 in certain individual funds as enumerated upon in Footnote R. Pathways was also found to be in violation of the provisions of Public Act 621 by only adopting the fiscal budget at the Finance Committee level subsequent to the start of the fiscal year. We recommend Pathways adopt the fiscal budget at the full Board level prior to the start of each fiscal year.

• • • • •

These comments and recommendations were a result of our year-end audit fieldwork and are submitted as constructive suggestions to assist you in strengthening internal controls. We appreciate the cooperation and courtesy extended to us by you and your staff during our audit and would be pleased to discuss our recommendations with you further at your convenience.

This report is intended solely for the use of management.

Anderson, Tackman & Company, PLC
Certified Public Accountants

PATHWAYS
FEDERAL FINANCIAL ASSISTANCE
For the Year Ended September 30, 2004

F:\ATCO\CLIENTS\PATHWAYS\FFA\FFA 2004.DOC

TABLE OF CONTENTS

ANDERSON, TACKMAN & COMPANY, P.L.C.
CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS
JOHN W. BLEMBERG, CPA
ROBERT J. DOWNS, CPA, CVA
DANIEL E. BIANCHI, CPA

MICHIGAN
ESCANABA
IRON MOUNTAIN
KINROSS
MARQUETTE
WISCONSIN
GREEN BAY
MILWAUKEE

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

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2004, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated May 19, 2005. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*. These instances are described in the accompanying schedule of findings and questioned costs under Section II, item number 04-2.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathways' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting, that, in our judgment could adversely affect Pathways' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs under Section II, item number 04-1.

102 W. WASHINGTON STREET, SUITE 109 MARQUETTE, MICHIGAN 49855 (906)225-1166 FAX: (906) 225-1714
E-MAIL: atcomqt@aol.com

Members of the Board
Pathways
Marquette, Michigan 49855

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of management, others within the organization, the Board, 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.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 19, 2005

ANDERSON, TACKMAN & COMPANY, P.L.C.
CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS

JOHN W. BLEMBERG, CPA ROBERT J. DOWNS, CPA, CVA DANIEL E. BIANCHI, CPA

MICHIGAN
ESCANABA
IRON MOUNTAIN
KINROSS
MARQUETTE
WISCONSIN
GREEN BAY
MILWAUKEE

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Members of the Board
Pathways
Marquette, Michigan 49855

Compliance

We have audited the compliance of Pathways with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2004. Pathways' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Pathways' management. Our responsibility is to express an opinion on Pathways' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Pathways' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Pathways' compliance with those requirements.

In our opinion, Pathways complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2004.

Internal Control Over Compliance

The management of Pathways is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Pathways' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

102 W. WASHINGTON STREET, SUITE 109 MARQUETTE, MICHIGAN 49855 (906)225-1166 FAX: (906) 225-1714
E-MAIL: atcomqt@aol.com

Members of the Board
Pathways
Marquette, Michigan 49855

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one ore more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grant agreements that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation what we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2004, and have issued our report thereon dated May 19, 2005. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Pathways' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is 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.

This report is intended solely for the information and use of management, others within the organization, the Board, 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.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 19, 2005

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2004

Federal Grantor/Pass Through Grantor Program Title		Federal C.F.D.A. Number	Project Number	Project Period	Award Amount	Federal Expenditures
U.S. Department of Health & Human Services:						
Passed through the Michigan Department of Community Health:						
Juvenile Justice Diversion		93.958	20041403	10/1/03-9/30/04	$ 62,475	$ 45,569
SED Respite Services		93.958	20041403	10/1/03-9/30/04	8,327	2,544
Luce County Wraparound Services		93.958	20041403	10/1/03-9/30/04	40,000	9,611
						57,724
U.P. Co-Occurring Disorders Project		93.958	20040521	10/1/03-9/30/04	75,000	74,975
Brantley Drop-In Center		93.958	20040521	10/1/03-9/30/04	15,000	14,514
Getting into the Getaway		93.958	20040521	10/1/03-9/30/04	6,670	6,670
Clinical Services Guidelines		93.958	20040521	10/1/03-9/30/04	40,712	35,820
						131,979
Block Grant for Prevention and Treatment of Substance Abuse:						
Substance Abuse Coordinating Agency	*	93.959	20042024	10/1/03-9/30/04	255,250	96,413
Prevention	*	93.959	20042024	10/1/03-9/30/04	739,434	381,326
Treatment	*	93.959	20042024	10/1/03-9/30/04	1,460,995	871,796
Women and Family	*	93.959	20042024	10/1/03-9/30/04	125,710	125,710
						1,475,245
Substance Abuse and Mental Health Services-Projects of Regional and National Significance:						
State Incentive Grant (SIG)		93.243	20042024	10/1/03-9/30/04	204,745	198,944
OBRA		93.778	N/A	10/1/03-9/30/04		96,055
Total U.S. Department of Health & Human Services						1,959,947
U.S. Department of Justice - Office of Juvenile Justice Delinquency Program:						
Passed through Eastern U.P. Substance Abuse Services:						
Connections for Upper Peninsula Youth		16.729	2003-JNFX0063(F-1)	10/1/02-9/30/05	75,000	75,000
Total U.S. Department of Justice						75,000
Corporation for National and Community Service:						
Passed through the Michigan Community Service Commission:						
Michigan's AmeriCorps Promise Fellows Program		94.007	MCSC/FEL/F-51/03	4/1/03-3/31/04	11,650	4,615
Total Corporation for National and Community Service						4,615

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2004

Federal Grantor/Pass Through Grantor Program Title	Federal C.F.D.A. Number	Project Number	Project Period	Award Amount	Federal Expenditures
Federal Emergency Management Agency:					
Direct Award:					
McKinney Homeless Assistance - Emergency Food and Shelter Program	83.523	PL107-73	10/1/03-9/30/04	$ 500	$ 500
Total Federal Emergency Management Agency					500
U.S. Department of Education:					
Passed through the Department of Career Development - Michigan Rehabilitation Services:					
Community Rehabilitation Program - Nordic Woven Originals	84.126	2004-59341-54930	10/1/03-9/30/04	32,285	22,574
Total U.S. Department of Education					22,574
U.S. Department of Housing & Urban Development:					
Passed through the Michigan Department of Community Health					
Shelter Plus Care	14.238	20041334	10/1/03-9/30/04	31,680	14,874
Total U.S. Department of Housing & Urban Development					14,874
TOTAL FEDERAL FINANCIAL ASSISTANCE					$ 2,077,510

*** Denotes a major program**

PATHWAYS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2004

NOTE A - BASIS OF PRESENTATION:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Pathways and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - OVERSIGHT AGENCY:

The U.S. Department of Health and Human Services is the current year's oversight agency for the single audit as determined by the agency providing the largest share of Pathways' federal financial assistance.

NOTE C - SUBRECIPIENTS:

Of the federal expenditures presented in the schedule, Pathways provided federal awards to subrecipients as follows:

Program Title	Federal CFDA Number	Amount Provided to Subrecipient
Block Grant for Prevention and Treatment of Substance Abuse:		
Prevention	93.959	$381,326
Treatment	93.959	871,796
Women and Family	93.959	125,710
Substance Abuse and Mental Health Services-Projects of Regional and National Significance:		
State Incentive Grant (SIG)	93.243	198,944

Section I - Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: Unqualified
- Internal control over financial reporting:
  No material weaknesses were identified.
  There were reportable conditions reported (refer to Section II).
- Noncompliance items material to the financial statements were identified (refer to Section II).

Federal Awards

- Internal Control over major programs:
  No material weaknesses were identified.
  No reportable conditions not considered to be material weaknesses were identified.
- Type of auditors' report issued on compliance for major programs: Unqualified.
- Audit findings that are required to be reported in accordance with Circular A-133, Section .510(a): None.

Major Program

- The program tested as a major program was:
  Block Grant for Prevention and Treatment of Substance Abuse CFDA# 93.959
- Dollar threshold used to distinguish between Type A and Type B programs: $300,000.
- Auditee qualified as low-risk auditee? Yes.

Section II - Financial Statement Findings

- The following reportable conditions were noted:

04-1 ***Condition:*** The accounting system at Pathways contains general ledger accounts that are not being reconciled on a timely basis.

Criteria: Internal controls should be in place to ensure general ledger accounts are reconciled timely.

Effect: The general ledger contains the accounts and records which are the basis for the preparation of the interim financial statements and for the financial statements to be free of a material error or irregularity the general ledger accounts need to be reconciled timely.

Recommendation: Management should reconcile all general ledger accounts on a monthly basis and any adjustments to be made should be processed timely.

Management Response: Management concurs.

Section II - Financial Statement Findings (continued)

- The following noncompliance item was noted:

04-2 ***Condition:*** Pathways was found to be in violation of the legal and contractual provisions of Public Act 621 whereby excesses of expenditures over appropriations existed in certain individual funds as enumerated in Footnote R of the financial statements and the fiscal budget was not adopted at the full Board level prior to the start of the fiscal year.

Criteria: Internal controls should be in place to ensure expenditures do not exceed appropriations and the fiscal budget is adopted in accordance with the provisions of Public Act 621.

Effect: When expenditures exceed appropriations, Pathways is in violation of Public Act 621 and there is a potential negative impact on the financial position.

Recommendation: Pathways should monitor expenditures throughout the fiscal year to ensure expenditures do not exceed appropriations and Pathways should adopt the budget at the full Board level instead of just the Finance Committee level prior to the start of the fiscal year.

Management Response: Management concurs.

Section III - Federal Award Findings and Questioned Costs

- There were no findings and/or questioned costs identified.

PATHWAYS
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2004

There were no prior year findings or questioned costs relating to Pathways' major programs.