Pathways
Financial Statements
September 30, 2007

TABLE OF CONTENTS

ANDERSON, TACKMAN & COMPANY, P.L.C.
Certified Public Accountants

MICHIGAN
Escanaba
Iron Mountain
Kinross
Marquette

PARTNERS

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

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, 2007, which collectively comprise the Pathways' basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Pathways' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Pathways as of September 30, 2007, 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 June 2, 2008, 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 important for assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 5 through 9 and 33 through 34, 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.

Members of the Board
Pathways
Marquette, Michigan 49855

Our audit was conducted for the purpose of forming opinions 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. 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

June 2, 2008

Pathways

MANAGEMENT'S 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, 2007. 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 $381,446. Nets assets are comprised of 100% governmental activities.
- During the year, Pathways expenses were $82,274,765, while revenues from all sources totaled $82,824,064, resulting in an increase in net assets of $549,299.
- The general fund reported an increase in fund balance of $9,082. Revenues were $84,346 over the budgeted amount of $82,893,027 and expenditures and transfers out were $678,742 below the budgeted amount of $83,647,033.

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, 2007 and 2006:

Table 1
Net Assets

	Governmental Activities - 2007	Governmental Activities - 2006
Current assets	$ 6,361,704	$ 4,918,360
Capital assets, net	4,982,825	5,690,896
Total Assets	11,344,529	10,609,256
Current liabilities	7,349,693	6,442,190
Noncurrent liabilities	3,613,390	4,334,919
Total Liabilities	10,963,083	10,777,109
Net Assets:		
Invested in capital assets, net of related debt	2,149,485	2,367,444
Restricted	876,543	784,005
Unrestricted (deficit)	(2,644,582)	(3,319,302)
Total Net Assets	$ 381,446	$ (167,853)

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Net assets of Pathways' governmental activities stood at $381,446. 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 $(2,644,582) 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 2007 and 2006.

Table 2
Changes in Net Assets

	Governmental Activities - 2007	Governmental Activities - 2006
Revenues:		
Program revenues:		
Charges for services	$328,518	$321,493
Operating grants and contributions	77,800,534	77,561,553
General revenues:		
State sources not restricted to specific program	4,137,058	4,057,082
Investment earnings	96,194	68,914
Gain (loss) on sale of capital assets	225,189	81,084
Miscellaneous	236,571	426,813
Total Revenues	82,824,064	82,516,939
Expenses:		
General government	82,268,518	82,995,132
Interest on long-term debt	6,247	10,109
Total Expenses	82,274,765	83,005,241
Change in net assets	549,299	(488,302)
Net assets, beginning	(167,853)	329,650
Prior period adjustments	-	(9,201)
Net Assets, Ending	$381,446	$(167,853)

Pathways' total revenues were $82,824,064. The total cost of all programs and services was $82,274,765, resulting in an increase in net assets of $549,299. The increase in assets is a result of several factors. FY 07 represents the first full year of contracting out group home services as opposed to directly operating them as had been our history. Pathways also experienced significant reductions in hospital utilization both locally and at state hospitals (decreased utilization means decreased expense). In our employee health insurance, in which we are self-insured, we had a very positive year as far as medical claims. Reduced staffing levels also were a factor. Finally, property sales of four group homes also made a positive contribution to net assets.

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

	2007		2006	
	Total Cost of Services	Net Cost of Services	Total Cost of Services	Net Cost of Services
General Government	$ 82,268,518	$4,139,466	$82,995,132	$5,112,086

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 $(1,855,638), an increase of $81,761 from the beginning of the year. Several items contributed to these positive results, including the contracting of group home operations, decreased hospital utilization, reductions in staffing, and the sales of four group homes. Increased state general fund revenue also played a significant part in the increase.

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 on actual year to date expenses and revenue as well as updated projections.

With these adjustments, actual charges to expenditures and transfers out were $678,742 below the final amended budget. Conversely, revenues were $84,346 higher than the final budget projection resulting in a $9,082 increase in fund balance compared to a planned decrease in fund balance of $754,006. Higher than expected inpatient utilization and residential contract costs were the major contributors to this variance.

General fund highlights for the year which resulted in better than expected fiscal performance include the following:

- Reduced inpatient hospital expense
- Reduced salary & benefit expense
- Sale of fixed assets (four group homes)
- Increased state general fund revenue

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal 2007, Pathways had $4,982,825 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 - 2007	Governmental Activities - 2006
Land	$514,694	$540,694
Land improvements	48,636	-
Buildings	4,570,628	4,953,300
Building improvements	404,620	348,889
Leasehold improvements	17,219	10,364
Equipment and furnishings	2,586,557	2,592,023
Vehicles	1,256,822	1,254,588
Accumulated depreciation	(4,416,351)	(4,008,962)
Totals	$ 4,982,825	$ 5,690,896

Debt

At year-end, Pathways had $2,876,731 in notes outstanding as depicted in Table 5 below.

Table 5
Outstanding Debt at Year-End

	Governmental Activities - 2007	Governmental Activities - 2006
Installment contracts payable	$43,391	$139,065
Equipment notes payable	2,833,340	3,261,791
Line of credit	-	61,661
Totals	$2,876,731	$3,462,517

New additions to debt for this year include $122,386 for equipment purchases and $416,926 in refinancing proceeds. See Note J for further details on long-term debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

The Michigan economy continues to be problematic for the FY 2008 year. However, in the last six years of tough economy the public mental health system has been protected. We expect that to continue. The big question mark for Pathways is how rapidly the state will move to general fund (GF) equity in the CMH system. Pathways is historically under-funded as far as our state general fund allocation. The state did respond to this concern in FY 2007 with an additional $500,000 allocation with the intent of continuing into FY 2008. Due to changes in leadership at the Department of Community Health, this funding combination may be in jeopardy. For Pathways, state GF represents 8% of our revenue where the state average for CMH Boards is 15%. If GF does become problematic, Pathways can limit or eliminate some services to GF consumers. Medicaid revenue remains a bright spot in FY 2008 and we should be able to continue to generate Medicaid Savings (which we are able to carry forward into the next year). Medicaid represents over 80% of our revenue. We expect to maintain or increase the reductions we have accomplished in hospital services, salaries and benefits. We expect FY 2008 financial performance to be similar to the previous year.

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, 2007

		Governmental Activities
ASSETS		
Current Assets:		
Cash and cash equivalents	$	1,477,496
Investments		2,487,330
Restricted assets		825,346
Receivables, net:		
Client fees		274,462
Other		1,021,343
Grants		126,958
Due from State of Michigan		(49,710)
Inventory		50,500
Prepaid expenses		147,979
Total Current Assets		6,361,704
Noncurrent Assets:		
Capital assets:		
Land		514,694
Other capital assets		8,884,482
Accumulated depreciation		(4,416,351)
Total Noncurrent Assets		4,982,825
TOTAL ASSETS		11,344,529
LIABILITIES		
Current Liabilities:		
Accounts payable		2,703,956
Due to State of Michigan		105,434
Due to counties - liquor tax		810,298
Accrued payroll and related		626,707
Accrued retirement contribution		104,468
Deferred revenue		2,423,685
Notes payable		575,145
Total Current Liabilities		7,349,693
Noncurrent Liabilities:		
Compensated absences		1,311,804
Notes payable		2,301,586
Total Noncurrent Liabilities		3,613,390
TOTAL LIABILITIES		10,963,083
NET ASSETS		
Invested in capital assets, net of related debt		2,149,485
Restricted for:		
Medicaid risk reserve		866,483
Debt service		10,060
Unrestricted		(2,644,582)
TOTAL NET ASSETS	$	381,446

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

Pathways

Statement of Activities

For the Fiscal Year Ended September 30, 2007

		Program Revenue			
Function/Program	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Net (Expense) Revenue and Changes in Net Assets**
Governmental Activities:					
General government	$ 82,268,518	$ 328,518	$ 77,800,534	$ -	$ (4,139,466)
Interest on long-term debt	6,247	-	-	-	(6,247)
Total Governmental Activities	$ 82,274,765	$ 328,518	$ 77,800,534	$ -	(4,145,713)
		General revenues:			
		State sources not restricted to specific program			4,137,058
		Investment earnings			96,194
		Gain (loss) on disposal of assets			225,189
		Miscellaneous			236,571
		Total general revenues			4,695,012
		Changes in net assets			549,299
		Net assets, beginning of year			(167,853)
		NET ASSETS, END OF YEAR			$ 381,446

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

Pathways

Governmental Funds
Balance Sheet

September 30, 2007

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	$ 1,404,416	$ 22,582	$ 1,426,998
Investments	474,873	113,022	587,895
Accounts receivable:			
Client fees	274,462	-	274,462
Other	1,011,283	10,060	1,021,343
Grants receivable	126,958	-	126,958
Due from State of Michigan	(49,710)	-	(49,710)
Due from other funds	698,472	981	699,453
Inventory	-	50,500	50,500
Restricted assets	825,346	-	825,346
Prepaid expenditures	147,979	-	147,979
TOTAL ASSETS	$ 4,914,079	$ 197,145	$ 5,111,224
LIABILITIES AND FUND BALANCE			
LIABILITIES:			
Accounts payable	$ 2,703,956	$ -	$ 2,703,956
Due to State of Michigan	105,434	-	105,434
Due to counties - liquor tax	810,298	-	810,298
Accrued payroll and related	819,021	-	819,021
Accrued retirement contribution	104,468	-	104,468
Deferred revenue	2,423,685	-	2,423,685
TOTAL LIABILITIES	6,966,862	-	6,966,862
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved, reported in:			
General Fund	(2,052,783)	-	(2,052,783)
Special Revenue Funds	-	187,085	187,085
TOTAL FUND BALANCE	(2,052,783)	197,145	(1,855,638)
TOTAL LIABILITIES AND FUND BALANCE	$ 4,914,079	$ 197,145	$ 5,111,224

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, 2007

Total Fund Balances for Governmental Funds	$	(1,855,638)
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		4,982,825
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.		(2,702,350)
Long-term liabilities, including notes payable, are not due and payable in the current period and therefore are not reported in the funds		(43,391)
Net Assets of Governmental Activities	$	381,446

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, 2007

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:			
State sources	$ 77,403,162	-	$ 77,403,162
Contracts and grants	2,780,340	-	2,780,340
Charges for services	692,728	-	692,728
Local sources	990,868	37,182	1,028,050
Investment income	89,903	6,291	96,194
Other	4,971,453	-	4,971,453
Less deductions from revenue:			
Donated services discounts	(4,677,121)	-	(4,677,121)
Local match - Medicaid draw down	726,040	-	726,040
TOTAL REVENUES	82,977,373	43,473	83,020,846
EXPENDITURES:			
Current operations	82,330,367	101,632	82,431,999
Debt service:			
Principal	-	95,673	95,673
Interest and fiscal charges	-	6,247	6,247
TOTAL EXPENDITURES	82,330,367	203,552	82,533,919
EXCESS REVENUES OVER (UNDER) EXPENDITURES	647,006	(160,079)	486,927
OTHER FINANCING SOURCES (USES):			
Transfers in	-	232,758	232,758
Transfers (out)	(637,924)	-	(637,924)
TOTAL OTHER FINANCING SOURCES (USES)	(637,924)	232,758	(405,166)
NET CHANGE IN FUND BALANCE	9,082	72,679	81,761
Fund balance, beginning of year	(2,061,865)	124,466	(1,937,399)
FUND BALANCE, END OF YEAR	$ (2,052,783)	$ 197,145	$ (1,855,638)

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, 2007

Net Change in Fund Balances - Total Governmental Funds	$	81,761
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.		(69,280)
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 $625,931		637,927
Gain on disposal of capital assets is not reported in the governmental funds, but is reported in the statement of activities.		225,189
Proceeds on sale of capital assets are reported in the governmental funds, but included in the gain on disposal of capital assets amount in the statement of activities.		(421,971)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		95,673
Change in Net Assets of Governmental Activities	$	549,299

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

Pathways

Proprietary Funds
Statement of Net Assets

September 30, 2007

	Internal Service Funds
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 50,498
Investments	1,899,435
Due from other funds	45,166
Total Current Assets	1,995,099
Capital Assets:	
Capital assets	5,797,451
Accumulated depreciation	(2,225,137)
Total Noncurrent Assets	3,572,314
TOTAL ASSETS	5,567,413
LIABILITIES	
Current Liabilities:	
Due to other funds	744,619
Accrued payroll and related	(192,314)
Current maturities of long-term debt	535,167
Total Current Liabilities	1,087,472
Long-term Liabilities:	
Compensated absences	1,311,804
Notes payable	2,298,173
Total Long-term Liabilities	3,609,977
TOTAL LIABILITIES	4,697,449
NET ASSETS	
Restricted	866,483
Unrestricted	3,481
TOTAL NET ASSETS	$ 869,964

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, 2007

	Internal Service Funds
OPERATING REVENUES:	
Charges for services	$ 3,039,728
TOTAL OPERATING REVENUES	3,039,728
OPERATING EXPENSES:	
Personnel services	2,125,580
Depreciation	625,931
TOTAL OPERATING EXPENSES	2,751,511
OPERATING INCOME (LOSS)	288,217
NON-OPERATING REVENUES (EXPENSES):	
Interest income	106,672
Interest expense	(157,473)
Loss on disposal of assets	(4,655)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(55,456)
OTHER FINANCING SOURCES	
Transfers In	405,166
TOTAL OTHER FINANCING SOURCES	405,166
CHANGE IN NET ASSETS	637,927
Net assets, beginning of year	232,037
NET ASSETS, END OF YEAR	$ 869,964

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, 2007

	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from charges for services	$ 3,039,728
Cash paid for operating expenses	(2,617,314)
NET CASH PROVIDED BY OPERATING ACTIVITIES	422,414
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Increase in due to other funds	53,749
Transfers in	360,000
NET CASH PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	413,749
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	(188,578)
Proceeds on issuance of long-term debt	599,949
Interest payments on long-term debt	(157,474)
Principal payments on long-term debt	(1,090,060)
NET CASH PROVIDED BY CAPITAL FINANCING ACTIVITIES	(836,163)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest income	86,741
Net (increase) in investments	(63,932)
(Increase) in fair market value of investments	19,931
NET CASH PROVIDED BY INVESTING ACTIVITIES	42,740
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	42,740
Cash and cash equivalents, beginning of year	7,758
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 50,498
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net operating (loss)	$ 288,217
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:	
Depreciation expense	625,931
Changes in assets and liabilities:	
(Decrease) in accounts payable	-
Increase in accrued sick and vacation	(126,090)
Increase in accrued payroll and related	(365,644)
TOTAL ADJUSTMENTS	134,197
NET CASH PROVIDED FROM OPERATING ACTIVITIES	$ 422,414

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.

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

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 when purchased.

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 $170,785 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 and investments as reported in the government-wide Statement of Net Assets is presented below:

	Cash	Investments	Total
Unrestricted	$1,572,239	$2,392,587	$3,964,826
Restricted assets	105,911	719,435	825,346
	$1,678,150	$3,112,022	$4,790,172

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

Deposits:	
Cash in demand accounts	$(984,616)
Cash in savings accounts	2,662,766
	$1,678,150

NOTE B – DEPOSITS AND INVESTMENTS (Continued):

Custodial Credit Risk – Deposits
Custodial credit risk is the risk that in the event of a bank failure, Pathways' deposits may not be returned to it. State law does not require and Pathways does not have a deposit policy for custodial credit risk. The carrying amounts of Pathways' deposits with financial institutions was $1,678,150 and the bank balance was $2,885,476. Of the bank balance, $44,828 or approximately 2% was covered by federal depository insurance according to FDIC regulations.

Investments

As of June 30, 2007, Pathways had the following investments.

		Investment in Maturities (in Years)		
Investment Type	Fair Value	Less Than 1	1-5	6-10
Certificates of Deposit	$3,097,600	$1,549,938	$1,495,908	$51,763
Other investments without maturities	$ 14,422			

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of Pathways' investments. Pathways does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk
Michigan statutes (Act 196, PA 1997) authorize Pathways to invest in bonds, other direct obligations and repurchase agreements of the United States, certificates of deposits, savings accounts, deposit accounts or receipts of a bank which is a member of the FDIC and authorized to operate in this state, commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and matures within 270 days from date of purchase, bankers' acceptances of the United States banks, obligations of the State of Michigan and its political subdivisions, external investment pools, and certain mutual funds. Michigan law prohibits security in the form of collateral, surety bond, or another form for the deposit of public money.

Pathways has no investment policy that would further limit its investment choices. Ratings are not required for the type of investments listed above. Pathways investments are in accordance with statutory authority.

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, 2007 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, 2007 is as follows:

NOTE D – CAPITAL ASSETS (Continued):

	Balance at 10/01/06	Additions	Disposals	Transfers	Balance at 9/30/07
Capital assets not being depreciated:					
Land	$ 540,694	$ -	$ 26,000	$-	$514,694
Capital assets being depreciated:					
Land improvements	-	22,104	5,385	31,917	48,636
Buildings	4,953,300	-	341,000	(41,672)	4,570,628
Building improvements	348,889	61,484	15,508	9,755	404,620
Leasehold improvements	10,364	6,855	-	-	17,219
Equipment and furnishings	2,592,023	37,499	42,965	-	2,586,557
Vehicles	1,254,588	60,636	58,402	-	1,256,822
Total Capital Assets	9,699,858	188,578	489,260	-	9,399,176
Less accumulated depreciation:					
Land improvements	-	3,683	729	9,790	12,744
Buildings	1,412,866	181,101	174,705	(6,673)	1,412,589
Building improvements	64,891	37,409	11,699	(3,117)	87,484
Leasehold improvements	230	919	-	-	1,149
Equipment and furnishings	1,603,947	316,878	42,287	-	1,878,538
Vehicles	927,028	155,221	58,402	-	1,023,847
Total Accumulated Depreciation	4,008,962	695,211	287,822	-	4,416,351
Capital Assets, net	$5,690,896	$(506,633)	$201,438	$-	$4,982,825

Depreciation expense was charged to governmental activities as follows:

Governmental Activities:	
General government	$69,280
Internal service funds charged to above activities	625,931
Total	$695,211

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, 2007, the amount of unpaid claims in the accompanying financial statements is $192,314.

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.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES (Continued):

The amount of vested leave as of September 30, 2007 is as follows:

Paid time off		$1,145,460
Sick Leave		138,045
Compensation Time		28,299
	TOTAL	$1,311,804

NOTE G – LINE OF CREDIT:

As of September 30, 2005, Pathways had a secured credit agreement with maximum borrowings of $300,000 to be utilized for equipment purchases by October 20, 2005. At September 30, 2007, the outstanding balance was $0 as reported in the Internal Service Building & Equipment Fund. The interest rate was 4.95% per annum.

A summary of changes in short-term debt for the year ended September 30, 2007 is as follows:

	Balance 10/1/06	Additions	Deductions	Balance 9/30/07
Line of Credit - General	$ -	$ -	$ -	$ -
Line of Credit – Equipment	61,661	60,636	122,297	-
Totals	$61,661	$60,636	$122,297	$ -

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 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. VEMA plan was discontinued as of 9/30/2006.

NOTE I – DEFINED CONTRIBUTION PENSION PLAN (Continued):

	FICA Alternative	VEMA	Retirement Non-Bargaining	Retirement - Delta Technical/ Support Unit	Retirement- Delta Professional Unit
Employees Covered	All regular status full and part-time employees	All non-union 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	255	0	104	22	11
Mandatory Employee Contributions	None	None	None	None	None
Mandatory Employer Contributions	5.00% or 6.20%	N/A	5.00%	5.00%	5.00%
Vesting Requirements	Immediate	Immediate	4 years (25% per year)	4 years (25% per year)	4 years (25% per year)
Actual Employee Contributions	$24,765	$0	$2,298	$0	$0
Actual Employer Contributions	676,428	0	204,195	26,946	29,915
Total Contributions	$701,193	$0	$206,493	$26,946	$29,915

NOTE J – LONG-TERM DEBT:

Changes in long-term debt principal during the year ended September 30, 2007 are summarized as follows:

	Balance 10/1/06	Additions	Deductions	Balance 9/30/07
Installment contracts	$139,065	$-	$95,674	$43,391
Equipment Fund – Notes payable	3,261,791	539,313	967,764	2,833,340
Total Long-Term Debt	$3,400,856	$539,313	$1,063,438	$2,876,731

NOTE J – LONG-TERM DEBT (Continued):

Long-term debt at September 30, 2007 consists of the following:

	Issue Date	Original Amount	Interest Rate	Monthly Payment	Principal	Interest	Total
Installment Contracts:							
Maple Ridge	04/06/1995	$170,346	70% Bank Base Rate	$1,507.33	$11,084	$1,793	$12,877
Wood Ridge	05/01/1995	140,765	70% Bank Base Rate	1,218.12	16,410	2,439	18,849
Lincoln House and Lake Bluff	06/23/1998	186,410	5.61%	2,034.00	15,897	417	16,314
Total Installment Contracts					43,391	4,649	48,040
Equipment Fund - Notes Payable:							
Phone System	02/22/2002	643,000	4.90%	9,075.28	139,457	5,393	144,850
Equipment	08/26/2004	464,350	3.45%	10,369.91	101,642	1,608	103,250
Cedar Hills, North Bluff, Gwinn	06/22/2004	448,233	4.95%	2,595.00	414,404	92,782	507,186
DeFant Building	10/05/2004	2,050,000	5.10%	16,318.26	1,754,812	595,018	2,349,830
Equipment	05/27/2005	174,861	3.65%	3,927.05	75,767	2,430	78,197
Equipment	04/24/2006	299,950	4.95%	6,911.10	194,180	12,632	206,812
Great Plains System	06/24/2005	145,855	0.00%	4,051.53	40,515	-	40,515
Vehicle	07/15/2007	200,000	4.95%	3,776.59	112,563	7,789	120,352
Total Notes Payable					2,833,340	717,652	3,550,992
					$2,876,731	$722,301	$3,599,032

As of September 30, 2007, the aggregate maturities of long-term debt are as follows:

Fiscal Year	Principal	Interest	Total
2008	$560,225	$131,677	$691,902
2009	313,090	109,834	422,924
2010	212,274	95,795	308,069
2011	139,370	87,589	226,959
2012	501,055	77,390	578,445
2013-2017	779,140	199,955	979,095
2018-2022	371,577	20,061	391,638
TOTALS	$2,876,731	$722,301	$3,599,032

NOTE K – DEFICIT NET ASSETS/FUND BALANCE:

The General Fund had a deficit in total fund balance at September 30, 2007 of $(2,061,865). Pathways' position is that the deficit is a result of under-estimating allowance for doubtful accounts in prior years and reduction in Medicaid funding below costs of providing services. Pathways plans to reduce the deficit through reduction in costs. Pathways filed a financial deficit correction plan on February 23, 2007, which was accepted by the Michigan Department of Treasury, and includes eliminating the deficit and increasing the combined unrestricted fund balance to $5,000,000 by 2010.

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):

	Transfer In		Transfer Out
Special Revenue Funds	$130,838	General Fund	$637,924
Debt Service Fund	101,920		
Internal Service Funds	405,166		
TOTALS	$637,924	TOTALS	$637,924

NOTE N – DEFINED BENEFIT RETIREMENT PLAN:

The following information is based upon the latest available actuarial valuation (as of December 31, 2006).

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.

NOTE N – DEFINED BENEFIT RETIREMENT PLAN (Continued):

Annual Pension Cost

For the year ended September 30, 2007, Pathways' annual pension cost of $1,396,452 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, 2004 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)
12/31/04	$41,194,698	$27,322,805	$13,871,893	66%	$6,352,834	218%
12/31/05	43,104,571	28,323,039	14,781,532	66%	6,212,613	238%
12/31/06	45,154,704	29,836,806	15,317,898	66%	5,560,215	275%

Schedule of Employer Contributions

Fiscal Year Ending September 30	Valuation Date December 31	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2005	2002	$1,194,816	100%	-
2006	2003	1,298,472	100%	-
2007	2004	1,396,452	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 2000 U.S. Census, and is approximately 8.33%, 50.00%, 33.34%, and 8.33% for Alger, Marquette, Delta and Luce Counties respectively. The 2005 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, 2007 was $370,878 with 61 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.

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, 2007

	Budgeted Amounts Original	Budgeted Amounts Final	Actual GAAP Basis	Variance with Final Budget Positive (Negative)
REVENUES:				
State sources:				
Medicaid - Mental health	$ 71,653,089	$ 71,862,325	$ 71,953,206	$ 90,881
Medicaid - Substance abuse	798,653	798,653	797,867	(786)
Medicaid - Child waiver	455,674	455,674	432,902	(22,772)
Mediciad fee for service	60,333	60,333	82,129	21,796
General funding	4,255,438	4,167,616	4,137,058	(30,558)
Contracts and grants:				
Mental health	276,904	325,587	432,404	106,817
Substance abuse	2,450,000	2,300,000	2,347,936	47,936
Charges for services:				
Client fees except Medicaid	606,252	606,252	578,801	(27,451)
Client fees work center	172,500	172,500	113,927	(58,573)
Local sources:				
County appropriations	600,972	600,972	600,972	-
County liquor tax	435,798	435,798	367,338	(68,460)
Contributions	15,250	25,000	22,558	(2,442)
Interest income	67,000	67,000	89,903	22,903
Other revenues	5,472,587	5,363,841	4,971,453	(392,388)
Less deductions from revenues:				
Donated services discount	(5,074,562)	(5,074,562)	(4,677,121)	397,441
Local match - Medicaid draw down	726,038	726,038	726,040	2
TOTAL REVENUES	82,971,926	82,893,027	82,977,373	84,346
EXPENDITURES:				
Current operations:				
Personnel services	12,711,412	12,711,412	12,066,259	645,153
Personnel benefits	5,517,508	5,521,508	5,272,510	248,998
Board & committee	37,400	37,400	29,788	7,612
Office supplies and other	911,116	911,116	748,012	163,104
Contract services	14,536,010	14,129,397	14,216,921	(87,524)
Transportation	387,200	387,200	365,405	21,795
Building rental	633,207	633,207	661,236	(28,029)
Equipment rental	874,835	874,835	802,586	72,249
Repairs & maintenance	325,000	325,000	345,678	(20,678)
Utilities and related	326,448	326,448	307,632	18,816
Insurance	288,950	288,950	218,839	70,111
Staff development	154,000	154,000	120,651	33,349
Staff travel	243,171	243,171	190,047	53,124
Miscellaneous	12,000	12,000	14,528	(2,528)
QAAP assessment & other State obligations	5,713,841	5,713,841	2,804,523	2,909,318
Substance abuse programs	2,876,000	2,876,000	5,796,023	(2,920,023)
Other CMH - Medicaid	38,369,729	38,369,729	38,369,729	-
TOTAL EXPENDITURES	83,917,827	83,515,214	82,330,367	1,184,847
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	$ (945,901)	$ (622,187)	$ 647,006	$ 1,269,193

Pathways

General Fund
Schedule of Revenues, Expenditures and Changes in
Fund Balance - Budget and Actual
For the Fiscal Year Ended September 30, 2007

	Budgeted Amounts		Actual	Variance with
				Final Budget
			GAAP	Positive
	Original	Final	Basis	(Negative)
OTHER FINANCING SOURCES (USES):				
Transfers (out)	$ (131,819)	$ (131,819)	$ (637,924)	$ (506,105)
TOTAL OTHER FINANCING SOURCES (USES)	(131,819)	(131,819)	(637,924)	(506,105)
NET CHANGE IN FUND BALANCE	(1,077,720)	(754,006)	9,082	763,088
Fund balance, beginning of year, as restated	(2,061,865)	(2,061,865)	(2,061,865)	-
FUND BALANCE, END OF YEAR	$ (3,139,585)	$ (2,815,871)	$ (2,052,783)	$ 763,088

OTHER SUPPLEMENTARY INFORMATION

Pathways

Nonmajor Governmental Funds
Combining Balance Sheet

September 30, 2007

	Special Revenue Funds: Ray of Sunshine Fund		Special Revenue Funds: Nordic Woven Originals		Debt Service Fund		Total Nonmajor Governmental Funds	
ASSETS								
Cash and cash equivalents	$	22,232	$	350	$	-	$	22,582
Investments		113,022		-		-		113,022
Accounts receivable - other		-		-		10,060		10,060
Inventory		-		50,500		-		50,500
Due from other funds		981		-		-		981
TOTAL ASSETS		$136,235		$50,850		$10,060		$197,145
LIABILITIES AND FUND BALANCE								
FUND BALANCE:								
Reserved for:								
Debt service	$	-	$	-	$	10,060	$	10,060
Unreserved		136,235		50,850		-		187,085
TOTAL FUND BALANCE		136,235		50,850		10,060		197,145
TOTAL LIABILITIES AND FUND BALANCE	$	136,235	$	50,850	$	10,060	$	197,145

Pathways

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

For the Fiscal Year Ended September 30, 2007

	Special Revenue Funds			
	Ray of Sunshine Fund	**Nordic Woven Originals**	**Debt Service Fund**	**Total Governmental Funds**
REVENUES:				
Private contributions	$ 26,033	$ -	-	$ 26,033
Sales	-	11,149	-	11,149
Investment income	6,291	-	-	6,291
TOTAL REVENUES	32,324	11,149	-	43,473
EXPENDITURES:				
Current operations	10,495	91,137	-	101,632
Debt service:				
Principal	-	-	95,673	95,673
Interest and fiscal charges	-	-	6,247	6,247
TOTAL EXPENDITURES	10,495	91,137	101,920	203,552
EXCESS REVENUES OVER (UNDER) EXPENDITURES	21,829	(79,988)	(101,920)	(160,079)
OTHER FINANCING SOURCES (USES):				
Transfers in	-	130,838	101,920	232,758
TOTAL OTHER FINANCING SOURCES (USES)	-	130,838	101,920	232,758
NET CHANGE IN FUND BALANCE	21,829	50,850	-	72,679
Fund balance, beginning of year	114,406	-	10,060	124,466
FUND BALANCE, END OF YEAR	$ 136,235	$ 50,850	$ 10,060	$ 197,145

Pathways

Internal Service Funds
Combining Statement of Net Assets

September 30, 2007

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
ASSETS				
Current assets:				
Cash and cash equivalents	$ 45,189	$ 5,309	$ -	$ 50,498
Investments	1,083,427	816,008	-	1,899,435
Due from other funds	-	45,166	-	45,166
Total current assets	1,128,616	866,483	-	1,995,099
Capital assets:				
Land and improvements	-	-	288,330	288,330
Buildings and building improvements	-	-	2,866,135	2,866,135
Vehicles	-	-	836,567	836,567
Office equipment	-	-	221,271	221,271
Information technology equipment	-	-	1,585,148	1,585,148
Accumulated depreciation	-	-	(2,225,137)	(2,225,137)
Total noncurrent assets	-	-	3,572,314	3,572,314
TOTAL ASSETS	1,128,616	866,483	3,572,314	5,567,413
LIABILITIES				
Current liabilities:				
Due to other funds	5,645	-	738,974	744,619
Accrued payroll and related	(192,314)	-	-	(192,314)
Current maturities of long-term debt	-	-	535,167	535,167
Total current liabilities	(186,669)	-	1,274,141	1,087,472
Long-term liabilities:				
Compensated absences	1,311,804	-	-	1,311,804
Notes payable	-	-	2,298,173	2,298,173
Total long-term liabilities	1,311,804	-	2,298,173	3,609,977
TOTAL LIABILITIES	1,125,135	-	3,572,314	4,697,449
NET ASSETS				
Restricted	-	866,483	-	866,483
Unrestricted	3,481	-	-	3,481
TOTAL NET ASSETS	$ 3,481	$ 866,483	$ -	$ 869,964

Pathways

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

For the Fiscal Year Ended September 30, 2007

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
OPERATING REVENUES:				
Charges for services	$ 2,251,669	$ -	$ 788,059	$ 3,039,728
TOTAL OPERATING REVENUES	2,251,669	-	788,059	3,039,728
OPERATING EXPENSES:				
Personnel services	2,125,580	-	-	2,125,580
Depreciation	-	-	625,931	625,931
TOTAL OPERATING EXPENSES	2,125,580	-	625,931	2,751,511
OPERATING INCOME (LOSS)	126,089	-	162,128	288,217
NON-OPERATING REVENUES (EXPENSES):				
Investment income	59,300	47,372	-	106,672
Interest expense	-	-	(157,473)	(157,473)
(Loss) on disposal of assets	-	-	(4,655)	(4,655)
TOTAL NON-OPERATING REVENUES (EXPENSES)	59,300	47,372	(162,128)	(55,456)
OTHER FINANCING SOURCES (USES)				
Transfers In	360,000	45,166	-	405,166
TOTAL OTHER FINANCING SOURCES (USES)	360,000	45,166	-	405,166
CHANGE IN NET ASSETS	545,389	92,538	-	637,927
Net assets, beginning of year	(541,908)	773,945	-	232,037
NET ASSETS, END OF YEAR	$ 3,481	$ 866,483	$ -	$ 869,964

Pathways

Internal Service Funds
Combining Statement of Cash Flows

For the Fiscal Year Ended September 30, 2007

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash received from charges for services	$ 2,251,669	$ -	$ 788,059	$ 3,039,728
Cash paid for operating expenses	(2,617,314)	-	-	(2,617,314)
NET CASH PROVIDED (USED) BY OPERATING ACTIVATES	(365,645)	-	788,059	422,414
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:				
Increase (decrease) in due to other funds	5,645	-	48,104	53,749
Transfers in	360,000	-	-	360,000
NET CASH PROVIDED (USED) BY NON-CAPITAL FINANCING ACTIVITIES	365,645	-	48,104	413,749
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	-	-	(188,578)	(188,578)
Proceeds on issuance of long-term debt	-	-	599,949	599,949
Interest payments on long-term debt	-	-	(157,474)	(157,474)
Principal payments on long-term debt	-	-	(1,090,060)	(1,090,060)
NET CASH (USED) BY CAPITAL FINANCING ACTIVITIES	-	-	(836,163)	(836,163)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest income	43,154	43,587	-	86,741
Net (increase) in investments	(17,146)	(46,786)	-	(63,932)
(Increase) in fair market value of investments	16,146	3,785	-	19,931
NET CASH PROVIDED BY INVESTING ACTIVITIES	42,154	586	-	42,740
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	42,154	586	-	42,740
Cash and cash equivalents, beginning of year	3,035	4,723	-	7,758
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 45,189	$ 5,309	$ -	$ 50,498
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:				
Net operating income (loss)	$ 126,089	$ -	$ 162,128	$ 288,217
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation expense	-	-	625,931	625,931
Changes in assets and liabilities:				
(Decrease) in accounts payable	-	-	-	-
(Decrease) in accrued sick and vacation	(126,090)	-	-	(126,090)
(Decrease) in accrued payroll and related	(365,644)	-	-	(365,644)
TOTAL ADJUSTMENTS	(491,734)	-	625,931	134,197
NET CASH PROVIDED FROM OPERATING ACTIVITIES	$ (365,645)	$ -	$ 788,059	$ 422,414

SUPPLEMENTAL REPORTS

ANDERSON, TACKMAN & COMPANY, P.L.C.
Certified Public Accountants

MICHIGAN
Escanaba
Iron Mountain
Kinross
Marquette

PARTNERS

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

Green Bay
Milwaukee

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Members of the Board
Pathways
Marquette, Michigan

We have audited the financial statements of the governmental activities, the business type activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2007, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated June 2, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathways' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purposes of expressing our opinions on the effectiveness of the Pathways' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Pathways' internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Pathways' ability to initiate, authorize, record, process, or report financial data reliable in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Pathways' financial statements that is more than inconsequential will not be prevented or detected by the Pathways' internal control. We consider the deficiencies described in a separate letter to management (items 07-01 through 07-03) dated June 2, 2008 to be significant deficiencies.

Members of the Board
Pathways
Marquette, Michigan

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

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 (items 07-04) dated June 2, 2008.

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

June 2, 2008

ANDERSON, TACKMAN & COMPANY, P.L.C.
Certified Public Accountants

MICHIGAN
Escanaba
Iron Mountain
Kinross
Marquette

PARTNERS

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

WISCONSIN
Green Bay
Milwaukee

INDEPENDENT AUDITOR'S REPORT

June 2, 2008

To the Board of Directors of Pathways
200 W. Spring Street
Marquette, MI 49855

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways for the year ended September 30, 2007, and have issued our report thereon dated June 2, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated August 27, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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 opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered 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.

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Pathways' compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on Copper Pathways' compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Pathways' compliance with those requirements.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of the accounting policies and their application. The significant accounting policies used by the Pathways are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year. We noted no transactions entered into by Pathways during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

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

> Management has estimated the donated service discount expense for the year, as well as the related allowance for doubtful accounts and third-party contractual allowances. These estimates are based on the accounts receivable mix, current payment plan methods, and the accounts receivable aging categories. The percentages used are based upon reimbursement levels and prior experience. Our conclusions regarding the reasonableness of these estimates are based upon historical trends, review of payment levels, evaluation of mix, and a discussion with management as to collectibility.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on Pathways' financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Pathways, either individually or in the aggregate, indicate matters that could have a significant effect on Pathways' financial reporting process.

Disagreements with Management

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

Consultation with Other Independent Accountants

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

Issues Discussed Prior to Retention of Independent Auditors

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

Board of Directors of Pathways
Marquette, MI 49855

Difficulties Encountered in Performing the Audit
We encountered no significant difficulties in dealing with management performing and completing our audit.

Conclusion
This information is intended solely for the use of the Pathways' Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,
Anderson, Tackman & Company, PLC
Certified Public Accountants

PATHWAYS
FEDERAL FINANCIAL ASSISTANCE
For the Year Ended September 30, 2007

TABLE OF CONTENTS

ANDERSON, TACKMAN & COMPANY, P.L.C.
Certified Public Accountants

MICHIGAN
Escanaba
Iron Mountain
Kinross
Marquette

PARTNERS

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

Green Bay
Milwaukee

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

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, 2007, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated June 2, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies that adversely affects the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control.

Members of the Board
Pathways
Marquette, Michigan 49855

We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting, 07-01 through 07-04.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

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 no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards.*

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

June 2, 2008

ANDERSON, TACKMAN & COMPANY, P.L.C.
Certified Public Accountants

MICHIGAN
Escanaba
Iron Mountain
Kinross
Marquette

WISCONSIN
Green Bay
Milwaukee

PARTNERS

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

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, 2007. 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, 2007.

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 the requirements that could have a direct and material effect on a major federal program in order to determine our

Members of the Board
Pathways
Marquette, Michigan 49855

auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Pathway's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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, 2007, and have issued our report thereon dated June 2, 2008. Our audit was performed for the purpose of forming our opinions 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

June 2, 2008

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2007

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:						
State Incentive Grant (SIG)		93.243	07 B1 MI SAPT	10/1/06-9/30/07	$ 172,041	$ 172,041
Marquette County Substance Abuse & Violence Prevention Coalition		93.276	5 H79 SP13154-02	9/30/06-9/29/07	100,000	100,000
Omnibus Budget Reconciliation Act		93.778	N/A	10/1/06-9/30/07	83,888	83,888
Family Psychoeducation		93.958	20071292	10/1/06-9/30/07	55,000	49,385
Wraparound Services for Adults		93.958	20071287	10/1/06-9/30/07	100,000	79,226
Motivational Interviewing, Training & Supervision		93.958	20071287	10/1/06-9/30/07	25,292	25,292
Brantley Drop-In Center		93.958	20071287	10/1/06-9/30/07	8,200	6,638
						160,541
Block Grant for Prevention and Treatment of Substance Abuse:						
Substance Abuse Coordinating Agency	*	93.959	07 B1 MI SAPT	10/1/06-9/30/07	64,332	64,332
Prevention	*	93.959	07 B1 MI SAPT	10/1/06-9/30/07	547,722	504,522
Treatment	*	93.959	7 B1 MI SAPT	10/1/06-9/30/07	865,200	901,198
Women and Family	*	93.959	7 B1 MI SAPT	10/1/06-9/30/07	84,000	91,202
						1,561,254
Total U.S. Department of Health & Human Services						2,077,724
U.S. Department of Housing & Urban Development:						
Passed through the Michigan Department of Community Health						
Shelter Plus Care		14.238	20070486	10/1/06-9/30/07	39,804	$ 3,935
Total U.S. Department of Housing & Urban Development						3,935
TOTAL FEDERAL FINANCIAL ASSISTANCE						$ 2,081,659

*** Denotes a major program**

PATHWAYS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2007

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	$504,522
Treatment	93.959	901,198
Women and Family	93.959	91,202
Substance Abuse and Mental Health Services-Projects of Regional and National Significance:		
State Incentive Grant (SIG)	93.243	172,041

Section I - Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: Unqualified
- Internal control over financial reporting:
  Significant deficiencies were identified.
  No material weaknesses were identified.
- No noncompliance items material to the financial statements were identified.

Federal Awards

- Internal Control over major programs:
  No significant deficiencies were identified.
  No 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 SIGNIFICANT DEFICIENCIES WERE NOTED:

07-01 *Condition:* The accounting system at Pathways contains general ledger accounts that are not being reconciled on a timely basis, of which the accounts receivable system is the most significant.

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 the accounts receivable general ledger accounts on a monthly basis and any adjustments to be made should be processed timely.

Management Response: Management concurs and will reconcile the module on a monthly basis.

- THE FOLLOWING SIGNIFICANT DEFICIENCIES WERE NOTED:

07-02 *Condition/Criteria:* At September 30, 2007, Anderson Tackman & Co., PLC assisted Pathways in preparation of the financial statements and footnotes required in the annual audit report in accordance with accounting principles generally accepted in the United States of America.

Effect: A statement required to be communicated in writing under Statement on Auditing Standards #112.

Cause of Condition: The staff of the governmental unit does not have adequate time to prepare all the information included in the annual financial statements.

Recommendation: Pathways needs to allocate time for the preparation of the GAAP-compliant financial statements on a timely basis.

Management Response: Management concurs.

07-03 *Condition/Criteria:* Employees' timecards from Delta office are not being submitted to the payroll department.

Effect: Payroll is processed from a timesheet summary and has resulted in inefficiencies in payroll processing as subsequent errors are discovered and need to be corrected via reprocessing. Pathways' control over payroll costs and their accurate recording, ensuring that wages are paid for work actually performed and timely and accurate preparation of financial statements are compromised.

Cause of Condition: Failure of original document submission for preparation of payroll.

Recommendation: Pathways should hold all employees responsible for the accuracy of their timecards and their submission to their supervisor for an approval. All the timecards should be forwarded to the human resources director and the payroll department on time to ensure timely and accurate payroll processing.

Management Response: Management concurs.

07-04 *Condition/Criteria:* At September 30, 2007 Pathways had an unrestricted equity deficit in its general fund, as shown in Footnote K to the financial statements. Public Act 275 of 1980 requires that all deficits in any fund balance of local units be disclosed and enumerated upon in the Footnotes of the financial statements. In accordance with the Act, a corrective action plan for the deficit is required to be filed with the State Treasurer within 90 days of the end of the fiscal year. Pathways filed the deficit elimination plan for the 2006 fiscal year.

Effect: Pathways is in compliance with State Law.

Cause of Condition: Failure of operating revenues to cover operating expenditures in the current and prior years.

Recommendation: Pathways needs either to increase operating revenues or decrease operating expenditures in the future.

Management Response: Management concurred and filed the deficit plan with the State of Michigan.

Section III - Federal Award Findings and Questioned Costs

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

PATHWAYS
SCHEDULE OF PRIOR YEAR FEDERAL AWARD FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2007

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