SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

WINDES & MCCLAUGHRY
ACCOUNTANCY CORPORATION
Certified Public Accountants & Consultants

EXCEEDING EXPECTATIONS SINCE 1926

CONTENTS

WINDES & McCLAUGHRY ACCOUNTANCY CORPORATION
Certified Public Accountants & Consultants
EXCEEDING EXPECTATIONS SINCE 1926

Landmark Square
111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802

Mailing Address:
Post Office Box 87
Long Beach, CA 90801-0087

T: (562) 435-1191
F: (562) 495-1665

www.windes.com

Other Offices:
Irvine
Los Angeles
Torrance

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
San Diego – Imperial Counties
Developmental Services, Inc.

We have audited the accompanying consolidated statements of financial position of San Diego – Imperial Counties Developmental Services, Inc., a California nonprofit corporation, as of June 30, 2012 and 2011, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of San Diego – Imperial Counties Developmental Services, Inc. as of June 30, 2012 and 2011, and the changes in their net assets and their cash flows for the years 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 December 11, 2012 on our consideration of the San Diego – Imperial Counties Developmental Services, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the consolidated financial statements. The accompanying schedules of consolidating statement of financial position and consolidating statement of activities are also presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Windes & McClaughry

Long Beach, California
December 11, 2012

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	June 30, 2012	June 30, 2011
ASSETS		
Cash and cash equivalents	$ 4,778,625	$ 19,573,695
Cash – client trust funds	3,254,420	2,002,865
Restricted cash	2,538,306	2,424,810
Contracts receivable from state and federal agencies	17,747,805	2,798,187
Investments	739,862	769,443
Sundry receivables, prepaids, and other assets	619,993	617,549
Due from state-accrued leave and retirement benefits	16,441,255	13,624,991
Property and equipment, net	9,109,646	9,194,933
TOTAL ASSETS	$ 55,229,912	$ 51,006,473

LIABILITIES AND NET DEFICIT

	2012	2011
LIABILITIES		
Accounts payable	$ 21,802,281	$ 21,075,129
Accrued payroll	591,893	389,334
Due to state		785,384
Amounts payable under retirement plan	58,321,018	31,659,730
Accrued leave benefits	1,800,518	1,610,618
Amounts held for clients	3,043,586	1,949,921
Bonds payable	8,500,000	8,750,000
	94,059,296	66,220,116
COMMITMENTS AND CONTINGENCIES (Notes 8, 9 and 10)		
NET DEFICIT		
Unrestricted	(38,829,384)	(15,213,643)
TOTAL LIABILITIES AND NET DEFICIT	$ 55,229,912	$ 51,006,473

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

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF ACTIVITIES

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011
CHANGE IN UNRESTRICTED NET ASSETS		
SUPPORT AND REVENUE		
Contracts – state and federal agencies	$ 255,046,497	$ 250,154,521
Interest and dividend income	136,528	215,854
Unrealized and realized gain (loss) on investments, net	(43,770)	62,749
Donations	42,832	47,078
Rental related and other income	743,737	412,607
	255,925,824	250,892,809
EXPENSES		
Program Services		
Client services	28,223,410	28,066,245
Residential care	61,427,539	59,618,620
Day care and training	84,892,094	80,763,609
Medical programs	2,700,278	2,752,996
Respite service	19,669,901	20,923,210
Independent living costs	15,977,783	16,782,777
Transportation services	13,216,400	12,752,093
Prevention services	2,275,354	2,747,315
Other purchased services	17,059,914	16,064,285
	245,442,673	240,471,150
Supporting Services		
General and administrative	10,063,968	10,184,600
Total Expenses	255,506,641	250,655,750
CHANGE IN NET DEFICIT BEFORE PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	419,183	237,059
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC POST-RETIREMENT BENEFIT COST	(24,034,924)	5,685,599
CHANGE IN NET DEFICIT	(23,615,741)	5,922,658
NET DEFICIT AT BEGINNING OF YEAR	(15,213,643)	(21,136,301)
NET DEFICIT AT END OF YEAR	($ 38,829,384)	($ 15,213,643)

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

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2012

	Program Services				
	Client Services	Residential Care	Day Care and Training	Medical Programs	Respite Service
Salaries	$ 19,784,361				
Employee health and retirement benefits	7,705,599				
Payroll taxes	285,119				
Total salaries and related expenses	27,775,079				
Purchase of services		$ 61,427,539	$ 84,892,094	$ 2,700,278	$ 19,669,901
Facility maintenance					
Postage					
General expenses	55,707				
ARCA dues					
Accounting fees					
Printing					
Insurance					
Board expenses					
Legal fees					
Utilities					
Public information and education					
Staff training					
Outside services					
Depreciation and amortization					
Telephone					
Building rent					
Equipment purchases, rental, and maintenance					
Interest expense					
Travel	392,624				
	$ 28,223,410	$ 61,427,539	$ 84,892,094	$ 2,700,278	$ 19,669,901

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

					Supporting Services	
Independent Living Costs	Transportation Services	Prevention Services	Other Purchased Services	Total	General and Administrative	Total Expenses
				$ 19,784,361	$ 3,262,032	$ 23,046,393
				7,705,599	1,031,290	8,736,889
				285,119	47,010	332,129
				27,775,079	4,340,332	32,115,411
$ 15,977,783	$ 13,216,400	$ 2,275,354	$ 17,059,914	217,219,263		217,219,263
					639,942	639,942
					191,661	191,661
				55,707	595,297	651,004
					68,954	68,954
					69,989	69,989
					45,513	45,513
					310,731	310,731
					20,020	20,020
					269,505	269,505
					252,714	252,714
					214,023	214,023
					20,278	20,278
					282,452	282,452
					212,485	212,485
					196,312	196,312
					1,318,560	1,318,560
					512,281	512,281
					466,884	466,884
				392,624	36,035	428,659
$ 15,977,783	$ 13,216,400	$ 2,275,354	$ 17,059,914	$ 245,442,673	$ 10,063,968	$ 255,506,641

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2011

	Program Services				
	Client Services	Residential Care	Day Care and Training	Medical Programs	Respite Service
Salaries	$ 19,460,756				
Employee health and retirement benefits	7,869,995				
Payroll taxes	293,047				
Total salaries and related expenses	27,623,798				
Purchase of services		$ 59,618,620	$ 80,763,609	$ 2,752,996	$ 20,923,210
Facility maintenance					
Postage					
General expenses	101,469				
ARCA dues					
Accounting fees					
Printing					
Insurance					
Board expenses					
Legal fees					
Utilities					
Public information and education					
Staff training					
Outside services					
Depreciation and amortization					
Telephone					
Building rent					
Equipment purchases, rental, and maintenance					
Interest expense					
Travel	340,978				
	$ 28,066,245	$ 59,618,620	$ 80,763,609	$ 2,752,996	$ 20,923,210

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

Independent Living Costs	Transportation Services	Prevention Services	Other Purchased Services	Total	Supporting Services General and Administrative	Total Expenses
				$ 19,460,756	$ 3,290,379	$ 22,751,135
				7,869,995	1,414,594	9,284,589
				293,047	49,548	342,595
				27,623,798	4,754,521	32,378,319
$ 16,782,777	$ 12,752,093	$ 2,747,315	$ 16,064,285	212,404,905		212,404,905
					511,934	511,934
					185,293	185,293
				101,469	574,781	676,250
					68,099	68,099
					53,664	53,664
					49,943	49,943
					61,927	61,927
					16,784	16,784
					335,586	335,586
					253,011	253,011
					245,888	245,888
					20,473	20,473
					272,946	272,946
					189,537	189,537
					181,495	181,495
					1,208,879	1,208,879
					540,346	540,346
					618,318	618,318
				340,978	41,175	382,153
$ 16,782,777	$ 12,752,093	$ 2,747,315	$ 16,064,285	$ 240,471,150	$ 10,184,600	$ 250,655,750

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net deficit	($ 23,615,741)	$ 5,922,658
Adjustments to reconcile change in net deficit to net cash from operating activities:		
Depreciation	192,367	169,419
Amortization of bond issuance costs	20,118	20,118
Unrealized and realized (gain) loss on investments	43,770	(62,749)
(Increase) decrease in:		
Cash – client trust funds	(1,251,555)	(188,040)
Restricted cash	(113,496)	168,178
Contracts receivable from state and federal agencies	(14,949,618)	15,526,110
Sundry receivables, prepaids, and other assets	(22,562)	58,615
Due from state-accrued leave and retirement benefits	(2,816,264)	(2,392,814)
Increase (decrease) in:		
Accounts payable	727,152	176,089
Accrued payroll	202,559	(563,265)
Due to state	(785,384)	785,384
Amounts payable under retirement plan	26,661,288	(3,259,334)
Accrued leave benefits	189,900	(33,451)
Amounts held for clients	1,093,665	187,889
Net Cash Provided By (Used In) Operating Activities	(14,423,801)	16,514,807
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(103,030)	(434,817)
Proceeds from sale of investments	88,841	350,584
Purchase of property and equipment	(107,080)	(338,291)
Net Cash Used In Investing Activities	(121,269)	(422,524)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in line of credit		(19,245,000)
Repayment of bonds payable	(250,000)	(250,000)
Net Cash Used In Financing Activities	(250,000)	(19,495,000)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(14,795,070)	(3,402,717)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	19,573,695	22,976,412
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 4,778,625	$ 19,573,695

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

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2012 AND 2011

NOTE 1 – Summary of Significant Accounting Policies

Basis of Presentation

San Diego – Imperial Counties Developmental Services, Inc. (SDICDSI) is a nonprofit public benefit corporation, the primary purpose of which is to contract with the State of California Department of Developmental Services (DDS) and other governmental agencies to operate a regional center for persons with developmental disabilities and their families. The regional center was organized in accordance with the provisions of the Lanterman Developmental Disabilities Services Act (the Act) of the Welfare and Institutions Code of the State of California. Contracts with the state and other agencies are generally renewed on an annual basis and provide a limit on expenditures and the respective contract funding. The period of expenditure reimbursement may, in some cases, extend beyond one year. Required services provided include outreach, diagnosis, assessment, counseling, prevention services, public information and education, and advocacy to persons with developmental disabilities and their families residing in San Diego and Imperial Counties.

The Act includes governance provisions regarding the composition of the regional center's board of directors. The Act states that the board shall be comprised of individuals with demonstrated interest in, or knowledge of, developmental disabilities, and other relevant characteristics, and requires that a minimum of 50% of the governing board be persons with developmental disabilities or their parents or legal guardians; and that no less than 25% of the members of the governing board shall be persons with developmental disabilities. In addition, a member of a required advisory committee, composed of persons representing the various categories of providers from which the regional center purchases client services, shall serve as a member of the regional center board. To comply with the Act, SDICDSI's board of directors includes persons with developmental disabilities, or their parents or legal guardians, who receive services from the regional center and a client service provider of the regional center.

The regional center contract between SDICDSI and the DDS stipulates that funded expenditures are not to exceed $249,625,315 and $248,085,618 for the 2011-2012 and 2010-2011 contract years, respectively. Actual net expenditures under the regional center contract for the 2011-2012 and 2010-2011 contracts was $250,901,001 and $246,897,526, respectively, as of June 30, 2012.

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Basis of Presentation (Continued)

As discussed above, SDICDSI operates under contracts with the DDS. Contract revenue is funded on a cost reimbursement basis. The net deficits reported as of June 30, 2012 and 2011 on the statements of financial position are primarily the result of the implementation of an accounting standard regarding the reporting of SDICDSI's defined benefit pension plan. As further discussed in Note 9, the accounting standard required SDICDSI to recognize as a charge to net assets the actuarial losses and prior service cost which had not yet been recognized as components of periodic benefit costs. For purposes of reporting periodic benefit costs, the unrecognized actuarial losses and prior service costs will continue to be amortized into plan expenses over future years. Periodic benefit costs under the defined benefit pension plan are reimbursed under the DDS contract as SDICDSI funds the plan.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of SDICDSI and the San Diego – Imperial Counties Developmental Services Foundation (the Foundation) hereafter referred to as, collectively, the Organization. Intercompany transactions and accounts are eliminated in the accompanying consolidated financial statements.

The Foundation is a separately incorporated, nonprofit organization in which SDICDSI is the sole member and elects the Chair and Board members. The Foundation was organized to provide fund-raising and other services to benefit children and adults with developmental disabilities residing in San Diego and Imperial Counties.

Financial Statement Presentation

The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. As of June 30, 2012 and 2011, the Organization had no temporarily or permanently restricted net assets.

Contributions

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

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Use of Estimates and Assumptions

Management uses estimates and assumptions in preparing consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported support, revenues, and expenses. Principal areas requiring the use of estimates include useful lives of property and equipment and defined benefit pension plan assumptions. Actual results could vary from the estimates that were assumed in preparing the consolidated financial statements.

Cash and Cash Equivalents and Concentration of Credit Risk

For purposes of the consolidated statements of cash flows, the Organization considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

At June 30, 2012 and throughout the year, the Organization has maintained cash balances with one of its financial institutions in excess of federally insured limits. Given the current economic environment and risks in the banking industry, there is risk that these deposits may not be readily available or covered by insurance.

Contracts Receivable from State and Federal Agencies

Contracts receivable from state and federal agencies and contract support are recorded on the accrual method as related expenses are incurred.

Investments

Investments are recorded at fair market value. Unrealized gains and losses are included in the change in net assets (deficit).

Property and Equipment

Pursuant to the terms of the DDS contract, SDICDSI equipment purchases become the property of DDS and, accordingly, are charged as expense when incurred. Property and equipment pertaining to the Foundation and corporate funds are stated at cost and depreciated using the straight-line method over their estimated useful lives.

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Long-Lived Assets

The Organization reviews long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Organization records impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. Any long-lived assets held for disposal are reported at the lower of their carrying amounts or fair value less costs to sell.

Leave and Retirement Benefits

SDICDSI has accrued a liability for leave benefits earned and retirement obligations discussed in Note 9. However, such benefits are reimbursed under the DDS contract only when actually paid. SDICDSI has also recorded a receivable from the DDS for the accrued benefits to reflect the future reimbursement of such benefits.

Defined Benefit Pension Plan

The Organization recognizes the funded status of a benefit plan, measured as the difference between plan assets at fair value and the benefit obligation, in the statements of financial position, with an offsetting charge or credit to net assets. Gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net period benefit cost will be recognized each year as a separate charge or credit to net assets (deficit).

Allocation of Expenses

The consolidated statements of functional expenses allocates expenses to the program and supporting service categories based on a direct-cost basis for purchase of services expenses, including salaries and related expenses. Operating expenses are allocated to supporting services, except for travel, which is allocated on a direct-cost basis.

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Income Tax Status

The Organization has received tax-exempt status from the Internal Revenue Service and California Franchise Tax Board under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the Revenue and Taxation Code. Tax-exempt status is generally granted to nonprofit entities organized for charitable or mutual benefit purposes.

The Organization recognizes the financial statement benefit of tax positions, such as its filing status as tax-exempt, only after determining that the relevant tax authority would more likely than not sustain the position following an audit. The Organization is subject to potential income tax audits on open tax years by any taxing jurisdiction in which it operates. The statute of limitations for federal and California state purposes is generally three and four years, respectively.

Subsequent Events

The Organization's management has evaluated subsequent events from the consolidated statements of financial position date through December 11, 2012, the date at which the consolidated financial statements were available to be issued for the year ended June 30, 2012, and determined there are no other items to disclose.

NOTE 2 – Cash-Client Trust Funds

SDICDSI functions as custodian for receipt of certain governmental payments and resulting disbursements made on behalf of regional center clients. The cash balances are segregated from the operating cash accounts of SDICDSI and are restricted for client support. The following is a summary of the client trust operating cash activity:

	For the Fiscal Year Ended June 30, 2012	2011
Social Security and other client support received	$ 26,128,820	$ 24,961,312
Residential care and other disbursements	25,035,155	24,773,423
Support over disbursements	1,093,665	187,889
Changes to reconcile support over disbursements to net cash for support and care activities:		
Increase (decrease) in amounts due to SDICDSI	158,842	(25,763)
(Increase) decrease in receivable from state and federal agencies	(952)	25,914
Increase in cash	1,251,555	188,040
Cash at beginning of year	2,002,865	1,814,825
Cash at end of year	$ 3,254,420	$ 2,002,865

NOTE 3 – Restricted Cash

Pursuant to the terms of a Bond agreement, various funds have been established. (See Note 8.) Restricted cash has been set aside as follows:

	June 30, 2012	2011
Reserve fund	$ 940,000	$ 943,436
Debt services	562,872	557,401
Capital improvements	1,035,434	923,973
	$ 2,538,306	$ 2,424,810

NOTE 4 – Contract Advances from State

As of June 30, 2012 and 2011, the DDS had advanced SDICDSI $57,096,345 and $49,849,411, respectively, under the regional center contracts. For financial statement presentation, to the extent there are claims receivable, these advances have been offset against the claims receivable from the DDS.

	June 30,	
	2012	2011
Contracts receivable	$ 74,844,150	$ 52,647,598
Contract advances	(57,096,345)	(49,849,411)
Net contracts receivable	$ 17,747,805	$ 2,798,187

NOTE 5 – Investments

The Organization accounts for investments at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Accounting standards have established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Organization has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

NOTE 5 – Investments (Continued)

The following table sets forth by level, within the fair value hierarchy, investment assets at fair value:

	Assets at Fair Value as of June 30, 2012			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed Income				
U.S. Treasury	$ 31,178	$ 31,178		
Equities	23,080	23,080		
Mutual Funds				
Equity based	685,604	685,604		
Total assets at fair value	$ 739,862	$ 739,862	None	None

	Assets at Fair Value as of June 30, 2011			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed Income				
U.S. Treasury	$ 28,639	$ 28,639		
Mutual Funds				
Equity based	740,804	740,804		
Total assets at fair value	$ 769,443	$ 769,443	None	None

NOTE 5 – Investments (Continued)

Investment income is summarized as follows:

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011
Interest and dividends	$ 24,823	$ 15,242
Unrealized and realized gain (loss), net	(43,770)	62,749
	($ 18,947)	$ 77,991

NOTE 6 – Property and Equipment

Property and equipment consists of the following:

	June 30, 2012	June 30, 2011	Estimated Useful Lives
Building and improvements	$ 5,542,184	$ 5,435,104	10-40 years
Equipment	33,824	33,824	5 years
	5,576,008	5,468,928	
Less accumulated depreciation	(1,466,362)	(1,273,995)	
	4,109,646	4,194,933	
Land	5,000,000	5,000,000	
	$ 9,109,646	$ 9,194,933	

NOTE 7 – Line of Credit

At June 30, 2012, SDICDSI had a revolving line of credit agreement with a bank, which expired September 28, 2012, whereby it could borrow up to $39,300,000. Borrowings were secured by substantially all assets of SDICDSI with interest payable monthly at an interest rate of 3.25% at June 30, 2012. There were no amounts outstanding at June 30, 2012.

NOTE 7 – Line of Credit (Continued)

Subsequent to year-end, SDICDSI extended the agreement, which will allow the Organization to borrow up to $39,900,000 through October 15, 2013. Borrowings are secured by substantially all assets of the Organization with interest payable monthly at an interest rate equal to the lender's reference rate.

NOTE 8 – Bonds Payable

In September 2002, the Foundation issued $10,750,000 Certificates of Participation Series 2002 bonds (the Certificates) through the County of San Diego. The bonds are secured by a deed of trust with assignment of rents and fixture filing. The proceeds received from the sale of the Certificates were used by the Foundation to purchase the main office building and related capital improvements, to fund a reserve and project fund for the Certificates, and to pay certain delivery costs of the Certificates. The Foundation incurred bond issuance costs in the amount of $492,898, included in sundry receivables, prepaids and other assets, which are amortized under the interest method over the life of the related bonds payable. Total accumulated amortization as of June 30, 2012 and 2011 was $197,829 and $177,711, respectively.

The Certificates' interest rates and maturity dates are:

Term Certificates, 4.5%, due September 1, 2012	$ 250,000
Term Certificates, 5.5%, due September 1, 2017	2,250,000
Term Certificates, 5.5%, due September 1, 2027	6,000,000
	$ 8,500,000

NOTE 8 – Bonds Payable (Continued)

Future principal payments on the bonds are as follows:

Year Ending June 30,	
2013	$ 250,000
2014	250,000
2015	500,000
2016	500,000
2017	500,000
Thereafter	6,500,000
	$ 8,500,000

Future amortization on bond issuance costs are as follows:

Year Ending June 30,	
2013	$ 20,118
2014	20,118
2015	20,118
2016	20,118
2017	20,118
Thereafter	194,479
	$ 295,069

NOTE 9 – Defined Benefit Pension Plan

Effective July 1, 2004, SDICDSI adopted a defined benefit pension plan to provide retirement benefits for all employees. The benefits under the plan are funded in accordance with the insurance company contracts. SDICDSI is required to contribute an amount to the plan, after employee contributions to the retirement plan of 6.2%, which is necessary to purchase the contracts that will fund the retirement benefits.

The following table sets forth the plan's funded status:

RECONCILIATION OF BENEFIT OBLIGATION

	June 30, 2012	June 30, 2011
Change in benefit obligation		
Obligation at beginning of year	$ 62,216,587	$ 57,709,337
Service cost	2,613,707	2,680,866
Interest cost	3,566,513	3,120,134
Actuarial (gain) loss	23,163,026	(428,498)
Benefit paid	(977,577)	(865,252)
Benefit obligation at end of year	90,582,256	62,216,587
Change in plan assets		
Fair value of plan assets at beginning of year	30,556,857	22,790,273
Actual return on plan assets	(869,529)	4,676,591
Employer contribution	3,551,487	3,955,245
Benefit paid	(977,577)	(865,252)
Fair value of plan assets at end of year	32,261,238	30,556,857
Funded status	(58,321,018)	(31,659,730)
Net amount recognized in the consolidated statement of financial position	($ 58,321,018)	($ 31,659,730)

NOTE 9 – Defined Benefit Pension Plan (Continued)

Net periodic postretirement benefit cost consists of the following components:

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011
Service cost	$ 2,613,707	$ 2,680,866
Interest cost	3,566,513	3,120,134
Expected return on plan assets	(2,184,130)	(1,848,400)
Amortization of transition obligation	2,021,844	2,021,844
Amortization of net loss	159,917	407,066
Net periodic benefit cost	$ 6,177,851	$ 6,381,510

All previously unrecognized actuarial gains or losses are reflected in the consolidated statements of financial position. The plan items not yet recognized as a component of periodic plan expenses, but included as a separate charge to net assets, are:

	June 30, 2012	June 30, 2011
Unamortized net transition obligation	$ 10,109,222	$ 12,131,066
Unamortized net loss	33,571,059	7,514,291
	$ 43,680,281	$ 19,645,357

The above net amounts recognized as a separate charge to net assets (deficit) do not have an offsetting accrual from the DDS to reflect the future reimbursement of such benefits. The Organization has accrued a receivable from the DDS for the balance of the accrued benefit obligation of $14,640,737 and $12,014,373 as of June 30, 2012 and 2011, respectively, representing the portion of the accrued benefit obligation which has been recognized as plan expense.

The accumulated benefit obligation was $72,564,896 and $50,672,089 at June 30, 2012 and 2011, respectively. The unamortized net transition obligation as of June 30, 2012 is $10,109,222, with remaining amortization of five years. Annual amortization is $2,021,844.

NOTE 9 – Defined Benefit Pension Plan (Continued)

Assumptions

Weighted-average assumptions used to determine benefit obligations were as follows:

	June 30, 2012	June 30, 2011
Discount rate	4.12%	5.71%
Rate of compensation increase	3.50%	3.50%

Weighted-average assumptions used to determine net periodic benefit cost were as follows:

	June 30, 2012	June 30, 2011
Discount rate	5.71%	5.71%
Expected long-term return on plan assets	6.75%	7.50%
Rate of compensation increase	3.50%	3.00%
Increase in IRS limits	3.00%	3.00%

Weighted-average asset allocations at year-end were as follows:

Asset Category	June 30, 2012	June 30, 2011	Target Allocation
Equity securities	62%	63%	55%
Debt securities	38%	37%	45%
	100%	100%	100%

The investment objective of the plan is to provide a rate of return commensurate with a moderate degree of risk of loss of principal and return volatility. The pension plan assets are invested in a Group Annuity Contract through Minnesota Life Insurance Company. Investment responsibility for the assets is assigned to an Investment Policy Committee of the board of directors of SDICDSI. The assets of the plan are periodically rebalanced to remain within the desired target allocations.

NOTE 9 – Defined Benefit Pension Plan (Continued)

Assumptions (Continued)

Historical rates of return for individual asset classes and future estimated returns are used to develop expected rates of return. These rates of return are applied to the plan's investment policy to determine a range of expected returns.

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of June 30, 2012:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$ 225,238		$ 225,238	
Mutual funds				
Fixed income	11,999,904	$ 11,999,904		
Equities	20,036,096	20,036,096		
Total	$ 32,261,238	$ 32,036,000	$ 225,238	None

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of June 30, 2011:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$ 1,027,005		$ 1,027,005	
Mutual funds				
Fixed income	10,241,320	$ 10,241,320		
Equities	19,288,532	19,288,532		
Total	$ 30,556,857	$ 29,529,852	$ 1,027,005	None

NOTE 9 – Defined Benefit Pension Plan (Continued)

Estimated Future Benefit Payments

The following estimated future benefit payments, which reflect expected future service, as appropriate, are expected to be paid on a fiscal year basis:

Year Ending June 30,	
2013	$ 1,299,522
2014	$ 1,469,600
2015	$ 1,516,517
2016	$ 1,718,538
2017	$ 2,196,617
2018-2022	$18,973,853

Contributions

The Organization expects to contribute at least the minimum funding requirement to this plan in the fiscal year ending in 2013. In addition, it may contribute additional amounts not yet determined.

NOTE 10 – Commitments and Contingencies

Leases – As Lessee

SDICDSI leases facilities and certain equipment under operating leases expiring in various years through 2027. These leases, which may be renewed for periods up to five years, generally require the lessee to pay all maintenance, insurance, and property taxes and contain a termination clause in the event the annual contract between the DDS and SDICDSI is not renewed. Several leases are subject to periodic adjustment based on price indices or cost increases.

NOTE 10 – Commitments and Contingencies (Continued)

Leases – As Lessee (Continued)

Rental expense for facilities and equipment for the years ended June 30, 2012 and 2011 was approximately $2,989,000 and $2,812,000, respectively. SDICDSI is leasing its main office from the Foundation. The Foundation received approximately $1,671,000 of rental income and common area and utility expense reimbursements from SDICDSI, which was eliminated upon consolidation against the total building rental expense of SDICDSI of approximately $2,989,000 for the year ended June 30, 2012. The Foundation received approximately $1,603,000 of rental income and common area and utility expense reimbursements from SDICDSI, which was eliminated upon consolidation against the total building rental expense of SDICDSI of approximately $2,812,000 for the year ended June 30, 2011.

Future minimum lease payments by SDICDSI for operating leases are as follows:

Year Ending June 30,	Related Party-Foundation	Other	Total
2013	$ 1,522,128	$ 1,168,066	$ 2,690,194
2014	1,567,792	1,261,204	2,828,996
2015	1,614,825	1,270,851	2,885,676
2016	1,663,270	1,024,564	2,687,834
2017	1,713,168	544,571	2,257,739
Thereafter	20,228,742	4,080,855	24,309,597
	$ 28,309,925	$ 9,350,111	$ 37,660,036

NOTE 10 – Commitments and Contingencies (Continued)

Leases – As Lessor

The following is a schedule by years of the Foundation's future minimum rents receivable under noncancellable operating leases that have initial or remaining lease terms in excess of one year as of June 30, 2012:

Year Ending June 30,	Related Party-SDICDSI	Other	Total
2013	$ 1,522,128	$ 86,510	$ 1,608,638
2014	1,567,792	78,334	1,646,126
2015	1,614,825		1,614,825
2016	1,663,270		1,663,270
2017	1,713,168		1,713,168
Thereafter	20,228,742		20,228,742
	$ 28,309,925	$ 164,844	$ 28,474,769

The following schedule provides an analysis of the Foundation's investment in property and equipment held for lease by major classes:

	June 30, 2012	June 30, 2011
Land and buildings	$ 9,400,000	$ 9,400,000
Building improvements	1,142,184	1,035,104
	10,542,184	10,435,104
Less accumulated depreciation	(1,432,538)	(1,240,171)
	$ 9,109,646	$ 9,194,933

NOTE 10 – Commitments and Contingencies (Continued)

Agreement with Insurance Company

SDICDSI had entered into an agreement with an insurance company that requires an irrevocable standby letter of credit for workers' compensation insurance. SDICDSI will pay or reimburse the insurance company for all premiums, administrative expenses, and claims incurred through March 1, 2006 up to a retained limit of $250,000 per incident. This agreement required SDICDSI to establish, in favor of the insurance company, an irrevocable standby letter of credit for $200,000 as security for the agreement. Effective March 1, 2006, SDICDSI changed its workers' compensation carrier and acquired non-participating coverage. The standby letter of credit of $200,000 related to the prior policy is being maintained as security for any potential prior policy claims.

Contingencies

In accordance with the terms of the DDS contract, an audit may be performed by an authorized state representative. Should such audit disclose any unallowable costs, SDICDSI may be liable to the state for reimbursement of such costs. In the opinion of the SDICDSI's management, the effect of any disallowed costs would be immaterial to the consolidated financial statements at June 30, 2012, and for the year then ended.

SDICDSI is dependent on continued funding provided by the DDS to operate and provide services for its clients. SDICDSI's contract with DDS provides funding for services under the Lanterman Act. In the event that the operations of SDICDSI result in a deficit position at the end of any contract year, which has occurred for the 2011/2012 contract year, DDS may reallocate surplus funds within the state of California system to supplement SDICDSI's funding. Should a system-wide deficit occur, DDS is required to report to the Governor of California and the appropriate fiscal committee of the State Legislature and recommend actions to secure additional funds or reduce expenditures. DDS's recommendations are subsequently reviewed by the Governor and the Legislature and a decision is made with regard to specific actions, including the possible suspension of the entitlement.

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

NOTE 10 – Commitments and Contingencies (Continued)

Contingencies (Continued)

SDICDSI has elected to self-insure its unemployment insurance. SDICDSI is required to reimburse the state of California for benefits paid to its former employees. In addition, SDICDSI has elected to self-insure a portion of its employee benefits based on actual costs of dental services performed.

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

NOTE 11 – Intermediate Care Facility (ICF) Billing

The Centers for Medicare and Medicaid Services (CMS) has approved federal financial participation in the funding of the day and transportation services related to the SDICDSI's ICF services retroactive to July 2007. The federal rules allow for only one provider of the ICF service, requiring all the Medicaid funding for the ICF resident to go through the applicable vendors. SDICDSI is in the process at June 30, 2012, due to the change in funding, of collecting the funding provided under the federal program from applicable vendors retroactive to July 2007, and remitting the funds to the DDS. SDICDSI receives a 1.5% administrative fee based on the funds received to cover the additional workload.

As of June 30, 2012, SDICDSI's activity related to the above funding was as follows:

Total billed from vendors for years ended June 30, 2008 and 2009	$ 17,823,886
Total amount due to state	$ 17,560,478
Administrative fee	263,408
	$ 17,823,886

During the year ended June 30, 2012, SDICDSI collected $17,796,405 from vendors, of which $17,353,751 was remitted to the state during the fiscal year 2012. Administrative fee income of $261,876 was recognized in other income for the year ended June 30, 2012.

NOTE 12 – Supplemental Disclosure of Cash Flow Information

Interest expense paid during the years ended June 30, 2012 and 2011 was $470,634 and $622,068, respectively.

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012

Federal Grantor/ Pass-Through Grantor/ Grant Title	Federal CFDA Number	Grant Identification Number	Grant Expenditures
U.S. Department of Education			
Passed through State of California Department of Developmental Services			
Early Intervention Services (IDEA) Cluster:			
Special Education – Grants for Infants and Families	84.181	HD099017	$ 2,253,478

Basis of Presentation

The Schedule of Expenditures of Federal Awards includes the federal award activity of San Diego – Imperial Counties Developmental Services, Inc. and is prepared based on state contract budget allocations. 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 consolidated financial statements.

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SUPPLEMENTARY INFORMATION
CONSOLIDATING STATEMENT OF FINANCIAL POSITION
JUNE 30, 2012

	SDICDSI	Foundation	Elimination Entries	Consolidated Balance
ASSETS				
Cash and cash equivalents	$ 4,146,848	$ 631,777		$ 4,778,625
Cash – client trust funds	3,254,420			3,254,420
Restricted cash		2,538,306		2,538,306
Contracts receivable from state and federal agencies	17,747,805			17,747,805
Investments		739,862		739,862
Sundry receivables, prepaids, and other assets	294,961	325,032		619,993
Due from state-accrued leave and retirement benefits	16,441,255			16,441,255
Property and equipment, net		9,109,646		9,109,646
TOTAL ASSETS	$ 41,885,289	$ 13,344,623		$ 55,229,912
LIABILITIES				
Accounts payable	$ 21,518,752	$ 283,529		$ 21,802,281
Accrued payroll	591,893			591,893
Amounts payable under retirement plan	58,321,018			58,321,018
Accrued leave benefits	1,800,518			1,800,518
Amounts held for clients	3,043,586			3,043,586
Bonds payable		8,500,000		8,500,000
	85,275,767	8,783,529		94,059,296
NET ASSETS (DEFICIT)				
Unrestricted	(43,390,478)	4,561,094		(38,829,384)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	$ 41,885,289	$ 13,344,623		$ 55,229,912

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SUPPLEMENTARY INFORMATION
CONSOLIDATING STATEMENT OF FINANCIAL POSITION
JUNE 30, 2011

	SDICDSI	Foundation	Elimination Entries	Consolidated Balance
ASSETS				
Cash and cash equivalents	$ 19,092,147	$ 481,548		$ 19,573,695
Cash – client trust funds	2,002,865			2,002,865
Restricted cash		2,424,810		2,424,810
Contracts receivable from state and federal agencies	2,798,187			2,798,187
Investments		769,443		769,443
Sundry receivables, prepaids, and other assets	279,916	337,633		617,549
Due from state-accrued leave and retirement benefits	13,624,991			13,624,991
Property and equipment, net		9,194,933		9,194,933
TOTAL ASSETS	$ 37,798,106	$ 13,208,367		$ 51,006,473
LIABILITIES				
Accounts payable	$ 20,788,968	$ 286,161		$ 21,075,129
Accrued payroll	389,334			389,334
Due to state	785,384			785,384
Amounts payable under retirement plan	31,659,730			31,659,730
Accrued leave benefits	1,610,618			1,610,618
Amounts held for clients	1,949,921			1,949,921
Bonds payable		8,750,000		8,750,000
	57,183,955	9,036,161		66,220,116
NET ASSETS (DEFICIT)				
Unrestricted	(19,385,849)	4,172,206		(15,213,643)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	$ 37,798,106	$ 13,208,367		$ 51,006,473

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SUPPLEMENTARY INFORMATION
CONSOLIDATING STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2012

	SDICDSI	Foundation	Elimination Entries	Consolidated Balance
SUPPORT AND REVENUE				
Contracts – state and federal agencies	$ 255,046,497			$ 255,046,497
Interest and dividend income	111,705	$ 24,823		136,528
Unrealized and realized loss on investments		(43,770)		(43,770)
Donations		42,832		42,832
Rental related and other income	707,589	1,706,716	($ 1,670,568)	743,737
	255,865,791	1,730,601	(1,670,568)	255,925,824
EXPENSES				
Program Services				
Client services	28,167,703	55,707		28,223,410
Residential care	61,427,539			61,427,539
Day care and training	84,892,094			84,892,094
Medical programs	2,700,278			2,700,278
Respite service	19,669,901			19,669,901
Independent living costs	15,977,783			15,977,783
Transportation services	13,216,400			13,216,400
Prevention services	2,275,354			2,275,354
Other purchased services	17,059,914			17,059,914
	245,386,966	55,707		245,442,673
Supporting Services				
General and administrative	10,448,530	1,286,006	(1,670,568)	10,063,968
Total Expenses	255,835,496	1,341,713	(1,670,568)	255,506,641
CHANGE IN NET ASSETS (DEFICIT) BEFORE PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	30,295	388,888		419,183
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	(24,034,924)			(24,034,924)
CHANGE IN NET ASSETS (DEFICIT)	(24,004,629)	388,888		(23,615,741)
NET ASSETS (DEFICIT) AT BEGINNING OF YEAR	(19,385,849)	4,172,206		(15,213,643)
NET ASSETS (DEFICIT) AT END OF YEAR	($ 43,390,478)	$ 4,561,094	None	($ 38,829,384)

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SUPPLEMENTARY INFORMATION
CONSOLIDATING STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

	SDICDSI	Foundation	Elimination Entries	Consolidated Balance
SUPPORT AND REVENUE				
Contracts – state and federal agencies	$ 250,154,521			$ 250,154,521
Interest and dividend income	199,635	$ 16,219		215,854
Unrealized and realized gain on investments		62,749		62,749
Donations		47,078		47,078
Rental related and other income	296,598	1,719,267	($ 1,603,258)	412,607
	250,650,754	1,845,313	(1,603,258)	250,892,809
EXPENSES				
Program Services				
Client services	27,964,776	101,469		28,066,245
Residential care	59,618,620			59,618,620
Day care and training	80,763,609			80,763,609
Medical programs	2,752,996			2,752,996
Respite service	20,923,210			20,923,210
Independent living costs	16,782,777			16,782,777
Transportation services	12,752,093			12,752,093
Prevention services	2,747,315			2,747,315
Other purchased services	16,064,285			16,064,285
	240,369,681	101,469		240,471,150
Supporting Services				
General and administrative	10,492,580	1,295,278	(1,603,258)	10,184,600
Total Expenses	250,862,261	1,396,747	(1,603,258)	250,655,750
CHANGE IN NET ASSETS (DEFICIT) BEFORE PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	(211,507)	448,566		237,059
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	5,685,599			5,685,599
CHANGE IN NET ASSETS (DEFICIT)	5,474,092	448,566		5,922,658
NET ASSETS (DEFICIT) AT BEGINNING OF YEAR	(24,859,941)	3,723,640		(21,136,301)
NET ASSETS (DEFICIT) AT END OF YEAR	($ 19,385,849)	$ 4,172,206	None	($ 15,213,643)

WINDES & MCCLAUGHRY
ACCOUNTANCY CORPORATION
Certified Public Accountants & Consultants
EXCEEDING EXPECTATIONS SINCE 1926

Landmark Square
111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802

Mailing Address:
Post Office Box 87
Long Beach, CA 90801-0087

T: (562) 435-1191
F: (562) 495-1665

www.windes.com

Other Offices:
Irvine
Los Angeles
Torrance

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*

To the Board of Directors of
San Diego – Imperial Counties
Developmental Services, Inc.

We have audited the consolidated financial statements of San Diego – Imperial Counties Developmental Services, Inc. as of and for the year ended June 30, 2012, and have issued our report thereon dated December 11, 2012. 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

Management of San Diego – Imperial Counties Developmental Services, Inc. is responsible for establishing and maintaining effective control over financial reporting. In planning and performing our audit, we considered San Diego – Imperial Counties Developmental Services, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of San Diego – Imperial Counties Developmental Services, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether San Diego – Imperial Counties Developmental Services, Inc's. consolidated 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 consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of San Diego – Imperial Counties Developmental Services, Inc's. in a separate letter dated December 11, 2012.

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

Windes & McClaughry

Long Beach, California
December 11, 2012

WINDES & McCLAUGHRY
ACCOUNTANCY CORPORATION
Certified Public Accountants & Consultants
EXCEEDING EXPECTATIONS SINCE 1926

Landmark Square
111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802

Mailing Address:
Post Office Box 87
Long Beach, CA 90801-0087

T: (562) 435-1191
F: (562) 495-1665

www.windes.com

Other Offices:
Irvine
Los Angeles
Torrance

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors of
San Diego – Imperial Counties
Developmental Services, Inc.

Compliance

We have audited San Diego – Imperial Counties Developmental Services, Inc.'s compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct material effect on each of San Diego – Imperial Counties Developmental Services, Inc.'s major federal programs for the year ended June 30, 2012. San Diego – Imperial Counties Developmental Services, Inc.'s 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 San Diego – Imperial Counties Developmental Services, Inc.'s management. Our responsibility is to express an opinion on San Diego – Imperial Counties Developmental Services, Inc.'s 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 San Diego – Imperial Counties Developmental Services, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of San Diego – Imperial Counties Developmental Services, Inc.'s compliance with those requirements.

In our opinion, San Diego – Imperial Counties Developmental Services, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

Internal Control Over Compliance

Management of San Diego – Imperial Counties Developmental Services, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered San Diego – Imperial Counties Developmental Services, Inc.'s internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine the 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, 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 San Diego – Imperial Counties Developmental Services, Inc.'s internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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.

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

Windes & McClaughry

Long Beach, California
December 11, 2012

SAN DIEGO – IMPERIAL COUNTIES DEVELOPMENTAL SERVICES, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued – Unqualified

Internal control over financial reporting

1. Material weakness(es) identified? – No

2. Significant deficiencies identified that are not considered to be material weaknesses? – None reported

3. Noncompliance material to consolidated financial statements noted? – No

Federal Awards

Internal control over major programs

1. Material weakness(es) identified? – No

2. Significant deficiencies identified that are not considered to be material weakness(es)? – None reported

3. Type of auditors' report issued on compliance for major programs? – Unqualified

4. Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? – No

5. Identification of major programs: Early Intervention Services (IDEA) Cluster – Special Education – Grants for Infants and Families, CFDA #84.181

6. Dollar threshold used to distinguish between Type A and Type B programs was $300,000.

7. Auditee qualified as low-risk auditee? – Yes

SECTION II - FINANCIAL STATEMENTS FINDINGS

None

SECTION III – MAJOR FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None