REGIONAL CENTER OF ORANGE COUNTY, INC.
Santa Ana, California

FINANCIAL STATEMENTS
June 30, 2017

REGIONAL CENTER OF ORANGE COUNTY, INC.
Santa Ana, California

FINANCIAL STATEMENTS
June 30, 2017

CONTENTS

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Regional Center of Orange County, Inc.
Santa Ana, California

Report on the Financial Statements

We have audited the accompanying financial statements of Regional Center of Orange County, Inc. (the Center), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2017, and the changes in its net assets, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 7 to the financial statements, the beginning net assets as of July 1, 2016 have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of expenditures of federal awards as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards)* is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated May 17, 2018 on our consideration of the Center'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* in considering the Center's internal control over financial reporting and compliance.

Crowe Horwath LLP

Crowe Horwath LLP

Costa Mesa, California
May 17, 2018

REGIONAL CENTER OF ORANGE COUNTY, INC.
STATEMENT OF FINANCIAL POSITION
June 30, 2017

ASSETS	
Cash and cash equivalents	$ 11,749,092
Cash - held for clients	1,007,976
Contracts receivable - state of California, net	16,941,322
Receivable from Intermediate Care Facility vendors	6,619,255
Other receivables	214,563
Deposits and prepaid expenses	634,324
Other assets	929,579
Receivable from state for accrued vacation and sick leave benefits	1,730,152
Receivable from state for deferred rent	2,494,094
Total assets	$ 42,320,357
LIABILITIES AND NET ASSETS	
Liabilities	
Accounts payable	$ 35,634,105
Due to state	52,523
Other liabilities	1,176,676
Amounts held for clients	1,187,596
Pension benefit obligations	63,758,647
Accrued vacation and sick leave benefits	1,730,152
Deferred rent	2,494,094
Total liabilities	106,033,793
Net deficit	
Unrestricted	(63,713,436)
Total liabilities and net assets	$ 42,320,357

See accompanying notes to financial statements.

REGIONAL CENTER OF ORANGE COUNTY, INC.
STATEMENT OF ACTIVITIES
Year ended June 30, 2017

Support and revenue	
Contracts - state of California	$ 364,303,089
Intermediate Care Facility supplemental services income	10,646,904
Interest income	132,154
Contributions	19,024
Total support and revenue	375,101,171
Expenses	
Client Services	
Purchase of services	336,333,366
Salaries and benefits	30,627,359
Other client service	26,782
Total client services expenses	366,987,507
Administration	
Operating expenses	7,003,451
Salaries and benefits	3,257,578
Total administration expenses	10,261,029
Total expenses	377,248,536
Change in net assets before pension benefit changes other than net periodic benefit costs	(2,147,365)
Pension benefit changes other than net periodic benefit costs	8,446,963
Change in unrestricted net assets	6,299,598
Net assets at beginning of year	52,942
Prior period adjustment (Note 7)	(70,065,976)
Net deficit at beginning of year, as restated	(70,013,034)
Unrestricted net deficit, end of year	$ (63,713,436)

See accompanying notes to financial statements.

REGIONAL CENTER OF ORANGE COUNTY, INC.
STATEMENT OF CASH FLOWS
Year ended June 30, 2017

Cash flows from operating activities	
Change in net assets	$ 6,299,598
Adjustments to reconcile change in net assets to net cash from operating activities	
Pension benefit obligation adjustment to net assets	(8,446,963)
Deferred rent	151,570
Change in operating assets and liabilities	
Cash - held for clients	231,335
Contracts receivable - state of California	(177,250)
Receivable from Intermediate Care Facility vendors	(683,725)
Other receivables	(99,003)
Deposits and prepaid expenses	70,642
Other assets	150,112
Receivable from state for accrued vacation and sick leave benefits	(243,728)
Receivable from state for deferred rent	(151,570)
Accounts payable	4,544,823
Due to state	(14,967,888)
Other liabilities	120,142
Amounts held for clients	(124,991)
Pension benefit obligations	2,139,634
Accrued vacation and sick leave benefits	243,728
Net cash used in operating activities	(10,943,534)
Net change in cash and cash equivalents	(10,943,534)
Cash and cash equivalents, beginning of year	22,692,626
Cash and cash equivalents, end of year	$ 11,749,092
Supplemental cash flow information	
Cash paid for interest	$ 11,249

See accompanying notes to financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background Information: Regional Center of Orange County, Inc. (the Center) is a private, nonprofit corporation that operates under a contract with the State of California Department of Developmental Services (DDS) to provide services to individuals with developmental disabilities. Services provided include out-of-home placement, respite, day training, behavior modification, and transportation. There are 21 such centers throughout the state.

The Center was incorporated in 1977 as a California nonprofit corporation. The Center was organized in accordance with the provisions of the Lanterman Developmental Disabilities Services Act (the Act) of the Welfare and Institutions Code of the State of California.

The Act includes governance provisions regarding the composition of the 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 Center purchases client services, shall serve as a member of the regional center board. To comply with the Act, the Center's board of directors includes persons with developmental disabilities, or their parents or legal guardians, who receive services from the Center and a client service provider of the Center.

Basis of Accounting: The financial statements of the Center have been prepared on the accrual basis of accounting and, accordingly, revenues are recognized when earned and expenses are recognized when the obligation is incurred. Reimbursements from the state are considered earned when a qualifying expense is incurred.

Financial Statement Presentation: The Center is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Accordingly, the net assets of the Center are classified and reported as described below:

> *Unrestricted Net Assets* - Net assets that are not subject to donor-imposed restrictions.
>
> *Temporarily Restricted Net Assets* - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Center and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities as net assets released from restrictions.
>
> *Permanently Restricted Net Assets* - Net assets subject to donor-imposed restrictions that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions. Such income generally includes interest, dividends, and realized and unrealized earnings from the corpus.

As of June 30, 2017, the Center had no temporarily or permanently restricted net assets.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates and Assumptions: Management uses estimates and assumptions in preparing 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 revenues and expenses. Actual results could vary from the estimates that were assumed in preparing the financial statements.

Cash and Cash Equivalents and Concentration of Credit Risk: For purposes of the statements of cash flows, the Center considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. At June 30, 2017 and at various times during the year, the Center maintained cash balances in its financial institutions in excess of federally insured limits. The Center has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash.

Contracts Receivable - State of California: Contracts receivable - state of California are recorded on the accrual basis as related expenses are incurred.

Receivables from Intermediate Care Facility Vendors and Due to State: The Centers for Medicare and Medicaid Services (CMS) approved federal financial participation in the funding of day and related transportation services purchased by the Center for consumers who reside in Intermediate Care Facilities (ICFs). CMS agreed that the day and related transportation services are part of the ICF service; however, the federal rules allow for only one provider of the ICF service. Accordingly, all the Medicaid funding for the ICF residents must go through the applicable ICF provider. The Center receives a 1.5% administrative fee based on the funds received to cover the additional workload.

The DDS has directed the Center to prepare billings for these services on behalf of the ICFs and submit a separate state claim report for these services. The Center was directed to reduce the amount of their regular state claim to DDS by the dollar amount of these services.

Reimbursement for these services will be received from the ICFs. DDS advances the amount according to the state claim to the ICFs. The ICFs are then required to pass on the payments received, as well as the Center's administrative fee to the Center within 30 days of receipt of funds from the State Controller's Office.

Prior to the year ended June 30, 2012, the Center paid the day and transportation providers and billed the DDS and were reimbursed by the DDS on a monthly basis. For the first five years of the ICF implementation, the DDS paid the applicable amounts to the ICFs in arrears in quarterly batches. The ICFs were directed to remit to the Center the amount received less its administration and quality assurance fees. After the Center receives the net payments from the ICFs, the Center was directed to remit the amount to the DDS, net of its administration fee. Amounts received from the ICFs and due to the DDS are reported as due to state on the statement of financial position.

State Equipment: Pursuant to the terms of the contract with the DDS, equipment consisting principally of office equipment and furniture and fixtures is not capitalized, but rather is recorded as an expenditure upon acquisition as title remains with the state, and it is not probable that the Center will be permitted to keep such assets when the contract with the state terminates. For the year ended June 30, 2017, equipment purchases totaled $868.

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Obligation for Retirement Pension Benefits: The Center is required to recognize the funded status of the California Public Employee's Retirement System (CalPERS) pension plans, measured as the difference between plan assets at fair value and the pension obligation, in the statement of financial position, with an offsetting charge or credit to net assets or net deficit. The center has accrued a liability for the CalPERS pension. However, such benefits are reimbursed under the state contract only when actually paid.

Deferred Rent: The Center leases office facilities under lease agreements that are subject to scheduled acceleration of rental payments. The scheduled rent increases are expensed on a straight-line basis over the life of the lease. The deferred rent liability represents the difference between the cash payments made and the amount expensed since inception of the lease. The Center has recorded a receivable from the state for the deferred rent liability to reflect the future reimbursement of the additional rent expense recognized. However, such expenses are reimbursed under the state contract only when actually paid.

Contributions: Contributions received, including unconditional promises to give, are recognized as revenues in the period received, or at such time, the contribution is promised and its collection is reasonably assured. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Contributions received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. As of June 30, 2017, the Center has not recorded any unconditional promises to give. The Center received contributions of $19,024 for the year ended June 30, 2017.

Tax Status: The Center is a nonprofit organization exempt from federal and state income taxes under Section 501(c) (3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code. The Center is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in the furtherance of the purpose for which it was granted exemption. No income tax provision has been recorded as net income from any unrelated trade or business and, in the opinion of management, is not material to the financial statements taken as a whole.

ASC Topic 740, *Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, disclosure, and transition. The Center 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 purposes is generally three and four years, respectively. Management believes that no such uncertain tax positions requiring accrual or disclosure exist at June 30, 2017.

Recently Issued Accounting Pronouncements: In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position and disclosing key information about leasing arrangements for lessees and lessors. The new standard applies a right-of-use model that requires, for all leases with a lease term of more than 12 months, that requires lessees to record an asset for the lease term and a liability for the obligation to make lease payments. The ASU is effective for fiscal years beginning after December 15, 2019 with early adoption permitted. Management is currently evaluating the impact of this ASU on its financial statements.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, with the stated purpose of improving financial reporting by not-for-profit entities. The main provisions of the ASU would require a not-for-profit entity to: (a) present two classes of net assets on the statement of financial position entitled “net assets with donor restrictions” and “net assets without donor restrictions,” (b) present changes in each of the two classes of net assets on the statement of activities, (c) disclose quantitative and qualitative information surrounding liquidity and availability of resources (d) disclose the amount and purpose of governing board designations, appropriations, and other self-imposed limits on the use of resources, (e) present expenses by both their natural classification and functional classification, (f) disclose methods used to allocate costs among program and support functions, (g) report investment return net of external and direct internal investment expenses, and (h) use the placed-in-service approach for reporting expirations of restrictions on gifts used to acquire or construct long-lived assets in the absence of explicit donor stipulations. The ASU is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. The provisions of the ASU must be applied on a retrospective basis for all years presented, although certain optional practical expedients are available for the periods prior to adoption. Management is currently evaluating the impact of this ASU on their financial statements.

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to June 30, 2017 to determine the need for any adjustments to and/or disclosures within the financial statements for the year ended June 30, 2017. Management has performed their analysis through May 17, 2018, the date the financial statements were available to be issued.

NOTE 2 – CASH HELD FOR CLIENTS AND UNEXPENDED CLIENT SUPPORT

The Center functions as custodian for the 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 the Center and are restricted for client support. At June 30, 2017, $1,007,976 was held on the behalf of clients by the Center for purchase of services.

During the year ended June 30, 2017, the Center purchased $6,207,629 of client services in this agency capacity. Because the Center is acting as an agent in processing these transactions, no revenue or expense is reflected on the accompanying statement of activities.

NOTE 3 – CONTRACTS WITH THE STATE

The Center’s major source of revenue is from the state of California. Each fiscal year, the Center enters into a new contract with the state for a specified funding amount subject to budget amendments. Revenue from the state is recognized monthly when a claim for reimbursement of actual expenses is filed with the state. These reimbursement claims are paid at the state’s discretion, either through direct payments to the Center or by applying the claims reimbursements against advances already made to the Center.

(Continued)

NOTE 3 – CONTRACTS WITH THE STATE (Continued)

As of June 30, 2017, the DDS had advanced the Center $8,488,726 under the regional center contracts. For financial statement presentation, to the extent that there are claims receivable, these advances have been offset against the claims receivable from the DDS contracts as of June 30, 2017:

Contracts receivable	$ 25,430,047
Contract advances	(8,488,726)
Net contracts receivable	$ 16,941,321

The Center has received its contract with the state for the fiscal year ending June 30, 2018. This contract provides for initial funding of $381,794,996.

NOTE 4 – SHORT-TERM BORROWINGS

The Center established a revolving line of credit with a financial institution in March 2017 for $44,500,000. The line of credit matured on September 30, 2017, and was subsequently renewed through September 30, 2018. The line of credit is/was secured by substantially all assets of the Center with interest due monthly at the bank's reference rate. The interest rate was 4.25% at June 30, 2017. There was no outstanding balance at June 30, 2017.

NOTE 5 – RETIREMENT PLAN

The Center contributes to the California Public Employees' Retirement Systems (CalPERS) for retirement benefits. CalPERS is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within California. Substantially all of the Center's employees participate in CalPERS.

FASB Accounting Standards Codification (ASC) 715-30, *Defined Benefit Plans – Pension*, requires the Regional Center to recognize the funded status of a defined benefit retirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in unrestricted net assets in the year in which the change occurs.

The Center has two retirement plans with CalPERS. The first plan is a 2%-at-age-55 formula, which closed as of December 31, 2012. All employees hired prior to January 1, 2013 participate in this plan. The second plan is a 2%-at-age-62 formula which was established by the Public Employees' Pension Reform Act of 2013 (PEPRA) and all employees hired on or after January 1, 2013 participate in this plan. The total required employee contributions are 7% of earnings for the 2%-at-age-55 plan and 6.25% of earnings for the 2%-at-age-62 plan. The Center is required to contribute the remaining amounts necessary to fund the benefits for its employees, using the actuarial basis adopted by the CalPERS Board of Administration.

The CalPERS Board of Administration adopted changes to the demographic assumptions based on the most recent experience study. The most significant of these is the improvement in post-retirement mortality acknowledging the greater life expectancies in membership and expected continued improvements. The actuarial assumptions and methods used in CalPERS public agency valuations are approved by the Board of Administration upon the recommendation of the Chief Actuary.

(Continued)

NOTE 5 – RETIREMENT PLAN (Continued)

The excess of the total actuarial accrued liability over the market value of plan assets is called the unfunded actuarial accrued liability. Funding requirements are determined by adding the normal cost and an amortization of the unfunded liability as a level percentage of assumed future payrolls.

The net periodic benefit cost for the year ended June 30, 2017 is as follows:

Service cost (including expenses)	$ 7,160,424
Interest cost	4,892,395
Contributions by employees	(1,661,699)
Expected return on assets	(4,536,832)
Net periodic benefit cost	$ 5,854,288

Net periodic benefit cost is included in salaries and benefits expenses on the statement of activities.

Pension benefit changes other than net periodic benefit costs during the year ended June 30, 2017 are as follows:

Assumption change	$ 5,780,634
Investment experience	2,666,329
Changes other than net periodic benefit costs	$ 8,446,963

Benefit obligation and funded status as of June 30, 2017 are as follows:

Change in benefit obligation	
Benefit obligation, beginning of year	$ 133,272,748
Service cost	7,160,424
Interest cost	4,892,395
Assumption change (gain)	(5,780,634)
Benefits and expenses paid	(2,110,901)
Benefit obligation, end of year	137,434,032
Change in fair value of plan assets	
Fair value of plan assets, beginning of year	63,206,772
Expected investment income	4,536,832
Employer contributions	3,714,654
Contributions by employees	1,661,699
Benefit payments	(2,110,901)
Investment experience	2,666,329
Fair value of plan assets, end of year	73,675,385
Plan net pension liability	$ (63,758,647)

(Continued)

NOTE 5 – RETIREMENT PLAN (Continued)

The changes in the projected benefit obligation as of June 30, 2017 due to assumptions different than those used in this valuation are as follows:

Change in Assumption		Projected Benefit Obligation
Current discount rate falls 1% to 2.9%	$	32,703,716
Current discount rate rises 1% to 4.9%	$	(24,399,029)

Amount recognized in the statements of financial position as of June 30, 2017 is $63,758,647.

The assumptions used in the measurement of the benefit obligations at June 30, 2017 are as follows:

Discount rate	3.9%
Expected long-term return on plan assets	7.0%
Rate of compensation increase	3.4%-12.2%

This discount rate was derived from the Above Median Citigroup Pension Discount Curve as of the end of June 2017 using the expected payouts from the Plan. The curve produced by Citigroup uses bond market data close to the measurement date to produce zero coupon yields for AA-rated non-callable bonds. For durations beyond the yield curve provided we extend the curve by using the last available rate. The rate used as of the beginning of the fiscal year (used to calculate the expense for the year) was 3.90%.

The long-term rate of return on plan assets is the expected return used by CalPERS for their pension fund and was derived based on their long term expectation of asset returns in consultation with CalPERS investment staff and advisors. The annual pension expense under ASC 715 is based on the expected return on plan assets during the fiscal year.

For the mortality rate, the actuary used the Bickmore Scale 2018, which is a two-dimensional mortality improvement scale reflecting both age and year of mortality improvement. The underlying base scale is Scale MP-2017 which has two segments – (1) historical improvement rates for the period 1951-2013 and (2) an estimate of future mortality improvement for years 2014-2016 using the Scale MP-2017 methodology but utilizing the assumptions obtained from Scale MP-2015. The Bickmore scale then transitions from the 2016 improvement rate to the Social Security Administration (SSA) Intermediate Scale linearly over the 10 year period 2017-2026.

(Continued)

NOTE 5 – RETIREMENT PLAN (Continued)

After this transition period, the Bickmore Scale uses the constant mortality improvement rate from the SSA Intermediate Scale from 2026-2040.The SSA's Intermediate Scale has a final step down in 2041 which is reflected in the Bickmore scale for years 2041 and thereafter. Over the ages 95 to 115, the SSA improvement rate is graded to zero.

The Plan is reported as a pension trust fund, and is accounted for using the accrual basis of accounting. Contributions to the Plan are recognized in the period in which the contributions are due pursuant to legal requirements. Member contribution rates are defined by law and depend on the respective employer's benefit formulas. Member and employer contribution rates are determined by periodic actuarial valuations. Actuarial valuations are based on the benefit provisions and employee groups of each employer. Benefits and refunds are recognized when currently due and payable in accordance with the terms of each rate plan.

The actual allocations for the pension assets and target allocations by asset class as of June 30, 2017 are as follows:

Current Asset Class	Percentage of Plan Assets	Target Allocation
Global equity	48.3 %	46.0%
Private equity	8.0	8.0
Global fixed income	19.4	20.0
Liquidity	4.8	4.0
Real assets	11.2	13.0
Inflation sensitive assets	7.8	9.0
Other	0.5	0.0
	100.0%	100.0%

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 principles generally accepted in the United States of America establish 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 unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs are unadjusted quoted prices for identical assets or liabilities in active markets that the Center has the ability to access.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

(Continued)

NOTE 5 – RETIREMENT PLAN (Continued)

The fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement in its entirety. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Plan assets of $73,675,385 are held in a pooled investment account managed by CalPERS and are considered level three investments.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the fiscal years ending June 30:

2018	$	2,531,254
2019		2,924,005
2020		3,247,323
2021		3,616,331
2022		3,977,875
2023-2027		25,966,848

NOTE 6 – COMMITMENTS AND CONTINGENCIES

Commitments: The Center is obligated under certain operating leases for office equipment, field and main office facilities. The lease terms expire in various years through August 2027. The terms of the leases provide for payment of minimum annual rentals, insurance, and property taxes.

Future aggregate minimum annual lease payments under noncancelable operating leases having initial terms in excess of one year as of June 30 are as follows:

2018	$	3,034,560
2019		3,126,482
2020		3,218,800
2021		1,640,329
2022		479,607
Thereafter		2,762,431
	$	14,262,209

Total rent expense for the year ended June 30, 2017 was $2,935,300.

Contingencies: In accordance with the terms of the contract with the DDS, an audit may be performed by an authorized DDS representative. Should such audit disclose any unallowable costs, the Center may be liable to the DDS for reimbursement of such costs. In the opinion of the Center's management, the effect of any disallowed costs would be immaterial to the financial statements at June 30, 2017.

The Center is dependent on continued funding provided by the DDS to operate and provide services for its clients. The Center's contract with the DDS provides funding for services under the Lanterman Act. In the event that the state determines that the Center has insufficient funds to meet its contractual obligations, the state shall make its best effort to secure additional funding and/or provide the Center with regulatory relief.

(Continued)

NOTE 6 – COMMITMENTS AND CONTINGENCIES (Continued)

The Center has elected to self-insure its unemployment insurance using the prorated cost-of-benefits method. Under this method, the Center is required to reimburse the State of California Employment Development Department for benefits paid to certain former employees. The Center had $367,587 in a reserve cash account to pay for any potential unemployment claims at June 30, 2017.

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

NOTE 7 – RESTATEMENT

Accounting principles generally accepted in the United States of America require that the unfunded projected benefit obligation be measured as of the current fiscal year end, that the funded status be recognized as an asset or liability in its statements of financial position and that the funded status be recognized in unrestricted net assets in the year in which the change occurs. Management has not been recording the unfunded projected benefit obligation due to the plan being inappropriately identified as a multi-employer plan and as such the inappropriate GAAP was applied in prior years. As a result, the July 1, 2016 unrestricted net asset balance account has been restated to reflect these adjustments. The impact of these restatements has been summarized in the schedule below:

	As Originally Reported	Effect of Change	As Restated
Statement of Activities:			
Net assets, June 30, 2016	$ 52,942	$ -	$ 52,942
Reduction in net position to record unfunded retirement obligation	-	(70,065,976)	(70,065,976)
Net deficit, July 1, 2016	$ 52,942	$ (70,065,976)	$ (70,013,034)

The impact of the change in net assets for the prior year ended June 30, 2016, is not determinable.

SUPPLEMENTARY INFORMATION

REGIONAL CENTER OF ORANGE COUNTY, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2017

Federal Grantor/Pass-Through Entity Program or Cluster Title	CFDA Number	Identification Number	Federal Expenditures
U.S. Department of Education			
Passed through State of California Department of Developmental Services			
Special Education – Grants for Infants and Families with Disabilities	84.181	H181A150037	$ 874,243

See accompanying notes to schedule of expenditure of federal awards.

NOTE I – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal award activity of Regional Center of Orange County, Inc. for the year ended June 30, 2017. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of Regional Center of Orange County, Inc. operations, it does not present the financial position, changes in net assets, or cash flows of Regional Center of Orange County, Inc.

Expenditures reported on the Schedule are reported on the accrual basis of accounting and based on state contract budget allocations. Regional Center of Orange County, Inc. has elected not to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance.

Expenditures are recognized following cost principles contained in Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S 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*

Board of Directors
Regional Center of Orange County, Inc.
Santa Ana, California

We have audited, in accordance with the 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, the financial statements of Regional Center of Orange County, Inc. (the Center), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 17, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Center's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs, as items 2017-001 and 2017-002, which we consider to be material weaknesses.

(Continued)

Compliance and Other Matters

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

The Center's Response to Findings

The Center's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The Center's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely 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 effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Crowe Horwath LLP

Crowe Horwath LLP

Costa Mesa, California
May 17, 2018

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Board of Directors
Regional Center of Orange County, Inc.
Santa Ana, California

Report on Compliance for Each Major Federal Program

We have audited Regional Center of Orange County, Inc.'s (the Center) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Center's major federal programs for the year ended June 30, 2017. The Center's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Center's major federal programs based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 the Center'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 on compliance for each major federal program. However, our audit does not provide a legal determination of the Center's compliance.

Opinion on Each Major Federal Program

In our opinion, the Center complied, in all material respects, with the types of 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, 2017.

(Continued)

Report on Internal Control Over Compliance

Management of the Center is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Center's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 the Center'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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Crowe Horwath LLP

Crowe Horwath LLP

Costa Mesa, California
May 17, 2018

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:	Unmodified
Internal control over financial reporting:	
Material weakness(es) identified?	X Yes ___ No
Significant deficiency(ies) identified?	___ Yes X None reported
Noncompliance material to financial statements noted?	___ Yes X No

Federal Awards

Internal control over major federal programs:	
Material weakness(es) identified?	___ Yes X No
Significant deficiencies identified not considered to be material weaknesses?	___ Yes X None reported
Type of auditor's report issued on compliance for major federal programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	___ Yes X No
Identification of major federal programs: CFDA Number 84.181	Special Education – Grants for Infants and Families with Disabilities
Dollar threshold used to distinguish between type A and type B programs:	$ 750,000
Auditee qualified as low-risk auditee?	___ Yes X No

SECTION II – FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

2017-001 Information Systems (Material Weakness in Internal Control)

Criteria
Internal controls over information systems are a key component of an organization's control environment. Entities should have policies and procedures regarding user access and monitor changes to user security profiles. This includes maintaining records supporting the removal of access to information systems on a timely basis for terminated employees. Additionally, passwords should be changed on a regular basis.

Condition
During our assessment of information system controls, we noted the following:

- There is no segregation of duties among users with administrative rights in the financial reporting system and those with an operational role.
- Management did not have a process in place to monitor the propriety of changes to user accounts. This includes changes for user accounts which are new users, terminated users, and users with changes to operational roles. Additionally, management does not have a formalized policy/process in place for granting or removing access to user accounts. Management does not maintain evidence of timely removal of user accounts for which there is no longer a business need.
- The password policy of the Center is not designed to change passwords on a frequent basis throughout the fiscal year. Currently the Center's policy is to change passwords once every 365 days.

Cause
Internal controls over users with administrative rights were not properly designed to separate users with administrative rights from those with operational roles in the financial reporting system. In addition, internal controls were not properly designed to enable management to evaluate the propriety of changes to user account profiles in the financial reporting system and to document that access for terminated employees were removed in a timely manner. Lastly, the password policy has not been updated to reflect current industry standards.

Context

- There are two users with operational responsibilities in the financial reporting system who have the ability to make changes to user account security settings.
- There were 32 terminated employees which management was not able to provide records indicating access to information systems had been removed in a timely manner.
- The password policy impacts all users of the information systems at the Center.

Effect
Improperly designed internal controls over system access will limit management's ability to detect when there is inappropriate activity on user accounts for terminated employees as well as users with the ability to change user security settings when the same user has operational responsibilities in the financial reporting system. Also, when passwords are not changed in a timely manner, there is a risk that the password can become known to multiple users, and management will lose the ability to enforce accountability for unauthorized transactions within the financial reporting system.

Recommendation
We recommend that management remove administrative access rights from those users who perform operational functions in the financial reporting system, and segregate the administrative role to a responsible individual outside of operational roles of the financial reporting system. In addition, we recommend that management establish written policies or procedures to document the removal of access to user accounts. We also recommend that management conduct a comprehensive review of all user accounts to determine if there is a continued business need for each account, and disable those which are no longer needed. Finally, we recommend that management revise their password policy to be more consistent with industry standards where passwords are changed more frequently (30, 45, or 60 days).

Management's response and planned corrective action

Effective June 1, 2018, the management of RCOC's Accounting Department will maintain access for all Uniform Fiscal System (UFS) users. Management employees have no operational role in UFS.

The process for granting, changing or removing access to UFS user accounts will be as follows:

1. The Supervisor/Manager/Director will email the employee's name and the business need for UFS access to the management of RCOC's Accounting Department.
2. The management of RCOC's Accounting Department will determine the level of UFS access consistent with the user's business needs and respond to the Supervisor/Manager/Director who requested UFS access.
3. The emails will provide evidence of timeliness for adding, changing or removing UFS user access.

Effective June 1, 2018, the UFS password policy will be to change passwords every 90 days.

2017-002 Financial Reporting, Pensions (Material Weakness in Internal Control)

Criteria
FASB Accounting Standards Codification (ASC) 715-30, *Defined Benefit Plans - Pension*, requires entities to recognize the funded status of a defined benefit retirement plan as an asset or liability in its statements of financial position and to recognize changes in that funded status in unrestricted net assets in the year in which the change occurs.

Condition
During the course of our audit, we identified the following error in financial reporting that resulted in a restatement of beginning net assets.

The Center contributes to the California Public Employees' Retirement Systems (CalPERS) for retirement benefits. CalPERS is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within California. During prior years, management did not record the unfunded status of the defined benefit retirement plan in its financial statements. However, management obtained an actuarial valuation to record the unfunded status of the defined benefit retirement plan as of June 30, 2016, which resulted in a decrease of beginning net assets by $70,065,976.

Cause
During prior years, management did not record the unfunded status of the defined benefit retirement plan in its financial statements due to the Plan being incorrectly identified as a multi-employer plan, instead of a multiple employer plan in accordance with ASC 715-30. CalPERS provides actuarial valuations in accordance with Governmental Accounting Standards Board (GASB). However, such actuarial valuations are not applicable to the Center, as the Center is a California nonprofit corporation where the appropriate generally accepted accounting principles are based on the standards promulgated by the Financial Accounting Standards Board (FASB).

Context
We identified this as part of our review of benefit plans in place at the Center.

Effect
Prior year net assets were overstated by $70,065,976 for the unfunded status of the defined benefit retirement plan. Management corrected this error through a restatement of beginning net deficit.

Recommendation
We recommend that management continue to implement procedures to obtain actuarial valuations in accordance with ASC 715-30 and record the funded status of the defined benefit retirement plan annually.

Management's Response and Planned Corrective Action

RCOC management will continue to obtain actuarial valuations and record the funded status of the defined benefit retirement plan annually.

SECTION III – FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS INCLUDING AUDIT FINDINGS AS DEFINED IN TITLE 2 U.S. CODE OF FEDERAL REGULATIONS PART 200, UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS

None

SECTION IV – SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

None