



*Because every child
needs a home.*

Financial Statements
for the Year Ended June 30, 2013
(With Comparative Totals for 2012)
and Independent Auditors' Reports

COCOON HOUSE
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WATSON & McDONELL, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Cocoon House
Everett, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Cocoon House (a Washington nonprofit corporation), which comprise the statement of financial position as of June 30, 2013, the related statements of activities, functional expenses, 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 the 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.

Auditors' 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 amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 auditors consider 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cocoon House as of June 30, 2013, and the changes in its net assets and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Summarized Comparative Information

The financial statements of Cocoon House as of June 30, 2012, were audited by other auditors whose report dated February 12, 2013, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the 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 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 additional 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 October 15, 2013, on our consideration of Cocoon House'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 Cocoon House's internal control over financial reporting and compliance.

Watson & McDermott, PLLC

October 15, 2013

COCOON HOUSE
Statement of Financial Position
June 30, 2013
(With Comparative Totals for 2012)

	2013	2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 226,314	\$ 97,430
Government grants receivable	240,745	228,667
Current portion of United Way pledge receivable	185,000	188,605
Current portion of promises to give	215,000	229,925
Other receivables		1,013
Prepaid expenses and other	41,418	37,249
TOTAL CURRENT ASSETS	908,477	782,889
Promises to give, less current portion	321,795	45,000
United Way pledge receivable, less current portion	348,928	
Promises to give, restricted for long-term assets		90,000
Reserves		466,005
Investments	621,941	744,584
Assets held in trust - endowment	411,167	
Property and equipment, net	3,162,177	3,193,128
TOTAL ASSETS	\$ 5,774,485	\$ 5,321,606
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$ 73,840	\$ 47,708
Accrued liabilities	132,907	100,724
Current portion of long-term debt	14,916	14,916
Current portion of capital lease obligation	10,629	9,734
TOTAL CURRENT LIABILITIES	232,292	173,082
Long-term debt, less current portion	572,308	587,224
Capital lease obligation, less current portion	34,543	45,172
Forgivable loans	1,761,100	1,761,415
TOTAL LIABILITIES	2,600,243	2,566,893
NET ASSETS		
Unrestricted:		
Designated by board for long-term investment - endowment	355,222	
Other unrestricted	1,546,111	2,041,955
Total unrestricted	1,901,333	2,041,955
Temporarily restricted net assets	1,219,414	659,263
Permanently restricted net assets	53,495	53,495
TOTAL NET ASSETS	3,174,242	2,754,713
TOTAL LIABILITIES AND NET ASSETS	\$ 5,774,485	\$ 5,321,606

The accompanying notes should be read with these financial statements.

COCOON HOUSE
Statement of Activities
For the Year Ended June 30, 2013
(With Comparative Totals for 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2013	Total 2012
OPERATING ACTIVITIES					
Public Support and Revenue					
Contracts and grants	\$ 1,523,522			\$ 1,523,522	\$ 1,500,109
Contributions	677,024	\$ 1,040,210		1,717,234	1,222,542
In-kind contributions	46,805			46,805	136,565
Investment income	1,629	2,450		4,079	14,000
Other revenue	3,042			3,042	2,250
Net assets released from restriction	<u>492,509</u>	<u>(492,509)</u>			
Total Public Support and Revenue	<u>2,744,531</u>	<u>550,151</u>		<u>3,294,682</u>	<u>2,875,466</u>
Operating expenses					
Program Services	2,084,140			2,084,140	2,122,154
Supporting services					
Management and general	312,881			312,881	432,528
Fundraising	<u>401,007</u>			<u>401,007</u>	<u>306,591</u>
Total operating expenses	<u>2,798,028</u>			<u>2,798,028</u>	<u>2,861,273</u>
CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES BEFORE DEPRECIATION					
	(53,497)	550,151		496,654	14,193
Depreciation	<u>150,406</u>			<u>150,406</u>	<u>135,244</u>
CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES					
	<u>(203,903)</u>	<u>550,151</u>		<u>346,248</u>	<u>(121,051)</u>
NONOPERATING ACTIVITIES					
Impairment on property and equipment					(11,224)
Capital contributions		10,000			125,000
Release of refundable advances	<u>63,281</u>			<u>63,281</u>	<u>57,208</u>
CHANGE IN NET ASSETS FROM NONOPERATING ACTIVITIES					
	<u>63,281</u>	<u>10,000</u>		<u>73,281</u>	<u>170,984</u>
CHANGE IN NET ASSETS					
	(140,622)	560,151		419,529	49,933
NET ASSETS, BEGINNING OF YEAR	<u>2,041,955</u>	<u>659,263</u>	<u>\$ 53,495</u>	<u>2,754,713</u>	<u>2,704,780</u>
NET ASSETS, END OF YEAR	<u>\$ 1,901,333</u>	<u>\$ 1,219,414</u>	<u>\$ 53,495</u>	<u>\$ 3,174,242</u>	<u>\$ 2,754,713</u>

The accompanying notes should be read with these financial statements.

COCOON HOUSE
Statement of Functional Expenses
For the Year Ended June 30, 2013
(With Comparative Totals for 2012)

	Housing	Outreach	Prevention	Total Program Services	Management and General	Fundraising	Total 2013	Total 2012
Salaries and wages	\$ 735,699	\$ 269,199	\$ 210,147	\$ 1,215,045	\$ 231,894	\$ 185,227	\$ 1,632,166	\$ 1,596,304
Payroll taxes and benefits	<u>223,739</u>	<u>65,802</u>	<u>43,103</u>	<u>332,644</u>	<u>42,606</u>	<u>38,575</u>	<u>413,825</u>	<u>397,039</u>
	959,438	335,001	253,250	1,547,689	274,500	223,802	2,045,991	1,993,343
Supplies	26,462	11,854	3,565	41,881	5,045	24,670	71,596	63,780
Communications	14,531	11,911	1,730	28,172	2,565	5,945	36,682	32,522
Professional fees	90,036	36,082	66,853	192,971	11,083	31,475	235,529	259,950
Travel	5,165	13,730	2,578	21,473	1,175	910	23,558	29,559
Insurance	23,359	5,992	4,134	33,485	4,547	3,307	41,339	36,675
Occupancy	56,513	39,306	9,832	105,651	6,387	12,885	124,923	114,192
Assistance to individuals	18,134	12,566	794	31,494			31,494	41,264
Food and beverage	38,355	6,752	2,873	47,980	730	37,049	85,759	88,892
In-kind supplies and services	4,072	913	702	5,687		46,805	52,492	136,565
Staff training	4,047	2,084	1,522	7,653	1,418	3,010	12,081	10,055
Miscellaneous	<u>12,127</u>	<u>6,307</u>	<u>1,570</u>	<u>20,004</u>	<u>5,431</u>	<u>11,149</u>	<u>36,584</u>	<u>54,476</u>
	1,252,239	482,498	349,403	2,084,140	312,881	401,007	2,798,028	2,861,273
Depreciation	<u>132,813</u>	<u>8,596</u>	<u>1,153</u>	<u>142,562</u>	<u>6,320</u>	<u>1,524</u>	<u>150,406</u>	<u>135,244</u>
Total expenses	<u>\$ 1,385,052</u>	<u>\$ 491,094</u>	<u>\$ 350,556</u>	<u>\$ 2,226,702</u>	<u>\$ 319,201</u>	<u>\$ 402,531</u>	<u>\$ 2,948,434</u>	<u>\$ 2,996,517</u>

The accompanying notes should be read with these financial statements.

COCOON HOUSE
Statement of Cash Flows
For the Year Ended June 30, 2013
(With Comparative Totals for 2012)

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Reconciliation of increase (decrease) in net assets to net cash provided (used) by operating activities		
Increase (decrease) in net assets	\$ 419,529	\$ 49,933
Depreciation	150,406	135,244
Loss on property and equipment impairment		11,224
Capital contributions	(10,000)	(125,000)
Unrealized gain on investments	(4,079)	
Release of refundable advances for long-term assets	(63,281)	(57,208)
Loss on uncollectible promises to give		5,718
(Increase) decrease in operating assets:		
Government grants receivable	(12,078)	93,274
United Way pledge receivable	(345,323)	(21,165)
Promises to give	(171,870)	(227,193)
Other receivables	1,013	1,262
Prepaid expenses and other	(4,169)	60,458
Increase (decrease) in operating liabilities:		
Accounts payable	26,132	(58,409)
Accrued liabilities	32,183	(16,524)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>18,463</u>	<u>(148,386)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investments and reserves	1,210,589	266,508
Purchases of investments	(1,029,029)	(33,282)
Purchases of property and equipment	(119,455)	(302,649)
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>62,105</u>	<u>(69,423)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash received for refundable advances, long-term	62,966	63,269
Principal payments on long-term debt and capital lease obligation	(24,650)	(17,639)
Proceeds from capital contributions	10,000	35,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>48,316</u>	<u>80,630</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	128,884	(137,179)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>97,430</u>	<u>234,609</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 226,314</u>	<u>\$ 97,430</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Equipment acquired through capital lease		<u>\$ 57,629</u>
Cash paid for interest	<u>\$ 4,459</u>	<u>\$ 825</u>

The accompanying notes should be read with these financial statements.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 1 - NATURE OF THE AGENCY

The mission of Cocoon House (the Agency) is to foster personal growth and healthy relationships to strengthen and empower at-risk homeless youth and their families. To carry out this mission the Agency has developed a continuum of services to serve homeless, at-risk and highly disconnected youth in Snohomish County, providing housing, prevention and street outreach services.

Housing Services

Shelter Services: In 1991, the Agency opened Cocoon House Central, then the only self-referral emergency shelter for youth in Snohomish County of Washington State. The shelter is open seven days a week and provides shelter, food, intensive case management, mental health counseling, chemical dependency education/counseling/treatment, life skills training, and access to medical care and supportive services for youth ages 13-17. To meet the growing need, the Agency opened the doors to its second shelter, the Arlington-based Cocoon House North, in December 2006. During 2013, the Agency completed site renovation necessary to repurpose the North site from an emergency shelter to a long-term maternity group home for 13-17 year old pregnant or parenting teen moms.

In April 2010, the Agency opened the newly constructed Cocoon House East in Monroe as a 90-day stay transitional shelter in response to a major service gap in the region. In 2013, the agency adjusted the program to offer an 6-bed emergency teen shelter for 13-17 year olds for up to 21 days. An array of age-appropriate support services similar to those found at the other shelters is available to residents at Cocoon House East. These services focus on securing long-term housing (often transitional and subsidized), gaining employment, education for training, and developing life skills necessary to be able to live independently.

During the year ended June 30, 2013, shelter services provided a total of 1,117 bed nights for 163 youth, 48 of whom had repeat shelter stays; for the year, shelter services had a total of 228 intakes and 225 exits of which 88% were into a safe housing situation.

Transitional Housing (Complex): The Agency also operates Cocoon Complex (the Complex) licensed as a 22-bed long-term transitional housing facility designed to offer or host all critical services to teens on-site. Available services include intensive case management, drug/alcohol assessment/ counseling/treatment, mental health care, education support and life skills training as well as housing, food, and basic needs for youth ages 13-17 that have no other housing options. By regulation, youth can live at the Complex for up to 21 months or until their 18th birthday. The Complex provides a permanent way off the street for youth who need a place to live and grow. It is considered a very unique program in Washington State. During the year ended June 30, 2013, 76 youth called the Complex home for a combined total of 5,545 bed nights; 59 of the youth who exited the Complex moved to a safe housing situation and 54 were in school, had a GED, or achieved their high school diploma.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 1 - NATURE OF THE AGENCY, CONTINUED

Street Outreach

Street Outreach Program: The Street Outreach Program features mobile outreach and a teen drop-in center to engage and assist youth ages 13-20 in Snohomish County. Youth advocates and outreach workers work in teams during non-traditional/flexible hours to conduct outreach where youth are, such as in parks, campgrounds, cheap motels and vacant buildings, and on the streets. The advocates work with youth to meet their basic needs, distributing food, emergency supplies, clothing, hygiene and first aid kits, and referral information. When possible, they develop a trusting relationship with youth and provide increasingly intensive case management in an effort to assist the youth to make positive and safe choices that ultimately result in their leaving the streets. During the year ended June 30, 2013, the advocates, outreach workers and teen center staff had over 11,000 direct contacts with youth; 449 teens accessed services at the teen drop in center and 304 teens benefited from case management.

Prevention Services for Parents and Teens

Project SAFE: The Agency launched Project SAFE in 2001 following a three-year planning and development effort. The program design is focused on helping parents develop skills and attitudes that will help the family weather the storms of adolescence. The project provides family services to prevent youth from disconnecting with the family. Services include: (a) phone line consultation with a Master's Level Therapist to provide easily accessed expert guidance to parents, including information and referrals, support and practical hands-on advice; (b) psycho-educational workshops designed to give parents the information and skills they need to more effectively parent their teen; (c) weekly drop in support group facilitated by a Master's Level Therapist for ongoing support with the daily struggles of raising teens and (d) resource information and publications for parents. During the year ended June 30, 2013, over 350 parents benefited from these services.

WayOUT: In 2003, Snohomish County requested the Agency to administer this established program developed specifically to serve youthful offenders referred by the juvenile courts. Today the program receives referrals from a wide variety of agencies. WayOUT is an interactive workshop for youth and their parents or guardians. Together, through a variety of experiential exercises, they work on communication, decision-making, and understanding personal differences. Third-party program reviewers concluded that every \$1 spent on the WayOUT program results in tax payers saving approximately \$7.89 in avoided costs such as legal proceedings, juvenile detention, and incarceration. During the year ended June 30, 2013, 128 parents/guardians and 127 youth participated in WayOUT seminars for a total of 255 participants.

All of the program statistics noted above were provided by program management and are unaudited.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of financial presentation

The Agency reports information regarding its financial position and activities according to three classes of net assets based on the absence or existence and nature of donor-imposed restrictions:

- ◆ Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
- ◆ Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that can be fulfilled by actions of the Agency pursuant to those stipulations or that expire with the passage of time and unappropriated earnings on permanently restricted net assets.
- ◆ Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be held in perpetuity, allowing only the income from the assets to be expended.

Restricted and unrestricted revenue and support

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

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily restricted or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restriction.

Cash and cash equivalents

For the purpose of the statement of cash flows, the Agency considers as cash equivalents all highly liquid investments, which can be converted into known amounts of cash and have a maturity period of 90 days or less at the time of purchase. Excluded from this definition of cash equivalents are amounts in the investment and reserve portfolios.

The Agency maintains its cash in bank deposit accounts which, at times, exceed federally-insured limits. The Agency has not experienced any losses in such accounts.

Fair value of financial assets and liabilities

Financial Accounting Standards Board Codification, Subtopic 820-10, *Fair Value Measurements and Disclosures*, establishes a hierarchy for measuring fair value utilizing a three-level valuation based on observable and unobservable inputs. Observable inputs are based on market data obtained from independent sources. Unobservable inputs reflect market assumptions based on the best information available. The fair value hierarchy prioritizes the inputs as follows:

- Level 1 inputs are based on unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 inputs include quoted prices in active markets for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-derived valuations whose inputs are observable.
- Level 3 inputs are based on value drivers that are unobservable.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Fair value of financial assets and liabilities, continued

See Note 5 for a discussion of assets measured at fair value on a recurring basis.

Grants receivable

Grants receivable are stated at unpaid balances. Management provides for probable uncollectible amounts through a charge to bad debt expense and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to receivables. Management has deemed all amounts to be collectable at June 30, 2013; accordingly no allowance for doubtful accounts has been recorded.

Government contracts and grants

The Agency recognizes revenue from cost reimbursable contracts when eligible costs are incurred. Revenue from performance-based contracts is recognized when performance is completed. When the contract revenue recognized exceeds cash advances received, a receivable is recorded. When cash advances exceed the contract revenue recognized, a liability, deferred revenue, is recorded.

Use of estimates

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

Functional expense classification and allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the program services benefited.

Property, equipment and building improvements

Property, equipment and building improvements purchased by the Agency are stated at cost. Assets costing more than \$5,000 with an estimated useful life of greater than one year are capitalized. Replacements and major repairs are expensed. Depreciation is provided on the straight-line method over the assets' estimated useful lives as follows:

	<u>Years</u>
Buildings and improvements	27.5 - 39
Furniture and equipment	3 - 7
Vehicles	5

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Impairment

The Agency reviews its investment in real estate for impairment whenever events or changes in circumstances indicate that the carrying value of such property may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the real estate to the future net undiscounted cash flow expected to be generated by the rental property and any estimated proceeds from the eventual disposition of the real estate. If the real estate is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of the real estate exceeds the fair value of such property. There were no impairment losses recognized in 2013.

Reserves

Reserves consist of funds internally set aside by the Agency for operating and maintenance purposes for all its housing facility and shelters. During the year ended June 30, 2013, the reserves were re-designated for general use.

Donated goods and services

Donations of non-cash assets are recorded at their fair values in the period received. Donated services that create or enhance non-financial assets or require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at their fair values when received. During the year ended June 30, 2013, the Agency received donated sundries and retail gift cards valued at \$46,805.

In addition, the Association received donated services for education and cultural programs, administration and auction, that do not meet the recognition requirements for presentation in the financial statements. Approximately 1030 hours were contributed by volunteers during 2013.

Income tax

Cocoon House is a Washington nonprofit corporation, exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. It has been classified as an organization that is not a private foundation under Section 509(a) of the Internal Revenue Code. The Agency's income tax filings are subject to examination by various taxing authorities. The Agency's open examination periods are 2009 and thereafter.

The Agency follows the provisions of uncertain tax positions as addressed in FASB Accounting Standards Codification Subtopic 740-10, *Income Taxes*. The Agency believes that it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are material to the financial statements.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Comparative amounts

For comparative purposes, the financial statements include certain prior-year summarized information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the Agency's financial statements for the year ended June 30, 2012, from which the summarized information was derived.

Reclassification

Certain reclassifications have been made to the 2012 financial statement presentation to correspond to the current year's format.

NOTE 3 – INVESTMENTS, RESERVES AND ASSETS HELD IN TRUST

Investments, reserves and assets held in trust consisted of the following at June 30,:

	<u>2013</u>	<u>2012</u>
<u>Investments</u>		
Mutual funds	\$ 609,899	
Certificates of deposit and money market funds		\$ 744,584
Cash	<u>12,042</u>	
	<u>\$ 621,941</u>	<u>\$ 744,584</u>
 <u>Reserves:</u>		
Certificates of deposit		<u>\$ 466,005</u>
 <u>Assets held in trust:</u>		
<u>Board-designated endowment</u>		
Greater Everett Community Trust	\$ 355,222	
 <u>Donor-restricted endowment</u>		
Certificates of deposit		
Greater Everett Community Trust	<u>55,945</u>	
	<u>\$ 411,167</u>	

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 3 – INVESTMENTS, RESERVES AND ASSETS HELD IN TRUST, CONTINUED

Investment return for the year ended June 30, 2013, consisted of the following:

	Non- Endowment Funds	Assets Held in Trust	Total
Net gain on investments	\$ 1,981	\$ 2,098	\$ 4,079

NOTE 4 - ASSETS HELD IN TRUST

In May 2013, the Agency transferred certain investments to The Greater Everett Community Foundation (the Foundation) to be held in perpetuity, with the income to be used for current operations. These amounts are administered by the Foundation and are accounted for and designated by the Foundation as the Cocoon House Board Designated Endowment Fund and Cocoon House Donor Designated Endowment Fund.

Under the agreement between the Agency and the Foundation, the members of the Board of Directors of the Agency may make a written request for the return of these funds. The Foundation will return funds if it is deemed consistent with the mission and purposes of the Agency and the charitable and philanthropic purposes of The Foundation. However, the Foundation retains variance power over these funds.

NOTE 5 - FAIR VALUE MEASUREMENTS

The valuation methodologies used to measure fair value have been consistently applied. Assets and liabilities measured at fair value on a recurring basis have been classified in accordance with the fair value measurement hierarchy described in Note 2. As described in Note 4, the Agency has an interest in a portion of the Foundation's investment portfolio, but does not have a direct claim to a portion of each individual stock, bond or investment within the investment portfolio. FASB Accounting Standards Codification (FASC) Subtopic 820-10-20, *Fair Value Measurements and Disclosures* notes that the unit of account determines what is being measured at fair value. The unit of account of an affiliated agency fund is at the aggregate level of the asset, not at the level of underlying investments held within the Foundation's investment portfolio. Since the Foundation investment portfolio is comprised of many different investments with varying levels of observable inputs, the valuation of the entire portfolio cannot be directly corroborated with observable market data. Therefore, the Agency reports the funds as falling within level three of the fair value measurement standards.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 5 - FAIR VALUE MEASUREMENTS, CONTINUED

The following presents information for investments classified within Level 3 for the year ended June 30, 2013:

Balance, July 1, 2012	\$ -
Transfer of funds	411,574
Investment income	1,196
Management fees	<u>(1,603)</u>
Balance, June 30, 2013	<u>\$ 411,167</u>
Change in unrealized gains or losses for the period included in the change in net assets for assets held at the end of the reporting period	<u>\$ 1,196</u>

The market value of all other investments was based on quoted prices in active markets for identical assets and falls within level 1.

NOTE 6 - PROMISES TO GIVE AND UNITED WAY PLEDGE RECEIVABLE

Unconditional promises to give that are expected to be collected in one year are stated at net realizable value. Unconditional promises to give that are expected to be collected in future years are stated at the present value of their estimated future cash flows. The discounts on those amounts are computed using a discount rate applicable to the years in which the promises are received. Amortization of the discount is included in contribution revenue. During 2013, long-term receivables were discounted using a 4 percent annual rate. No discount was recorded as of June 30, 2012, as the discount was considered immaterial. In accordance with financial accounting standards, unconditional promises to give are recognized as support in the period the promise is received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are not included in support until the conditions are substantially met. The Agency provides for losses on promises to give using the allowance method. The allowance is based on past experience. It is the Agency's policy to charge off uncollectible promises to give when management determines the receivable will not be collected. Management believes that promises to give are fully collectible.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 6 - PROMISES TO GIVE AND UNITED WAY PLEDGE RECEIVABLE, CONTINUED

The promises to give and United Way receivable balances were as follows at June 30,:

	<u>2013</u>	<u>2012</u>
Due to be collected -		
In less than one year	\$ 400,000	\$ 418,530
One to five years	<u>720,481</u>	<u>45,000</u>
	1,120,481	463,530
Less discount	<u>(49,758)</u>	<u> </u>
	<u>\$ 1,070,723</u>	<u>\$ 463,530</u>

At June 30, 2013, 70 percent of the Agency's net promises to give were from two donors.

NOTE 7 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following balances at June 30,:

	<u>2013</u>	<u>2012</u>
Land	\$ 516,279	\$ 516,279
Buildings and building improvements	3,517,159	3,403,804
Furniture and equipment	234,107	228,006
Vehicle	<u>65,148</u>	<u>65,148</u>
	4,332,693	4,213,237
Less depreciation	<u>(1,170,516)</u>	<u>(1,020,109)</u>
	<u>\$ 3,162,177</u>	<u>\$ 3,193,128</u>

NOTE 8 - UNEMPLOYMENT SELF INSURANCE

At June 30, 2013, the Agency was self-insured for unemployment claims. At June 30, 2013, the agency recorded a liability of \$18,292, which is the maximum amount the Agency would pay for claims that have been filed based on reports provided by the State of Washington.

NOTE 9 - ENDOWMENT FUND

Permanently restricted net assets are donations restricted by the donor to be held in perpetuity, with the income to be used to support the donor-restricted activity of the Association. At June 30, 2013, the Agency had one endowment fund.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 9 - ENDOWMENT FUND, CONTINUED

The Sarri Gilman Fund is a donor-restricted endowment that requires the Agency to maintain the corpus but allows it to spend the earnings for general purposes. The Agency's policy is to spend an appropriate investment income earned on the endowment in the year it is received.

The board-designated endowment fund consists of funds set aside for long-term purposes and placed in the custody of the Foundation, as described in Note 4.

The board of directors of the Agency has interpreted the Washington State Prudent Management of Institutional Funds Act (PMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Agency classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Agency in a manner consistent with the standard of prudence required by PMIFA. In accordance with PMIFA, The Agency considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Agency and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Agency and
- (7) The investment policies of the Agency.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 9 - ENDOWMENT FUND, CONTINUED

The following describes the net asset composition of the endowment funds at June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Sarri Gilman Endowment Fund		\$ 2,450	\$ 53,495	\$ 55,945
Board-designated endowment fund	\$ 355,222			\$ 355,222
Total	<u>\$ 355,222</u>	<u>\$ 2,450</u>	<u>\$ 53,495</u>	<u>\$ 411,167</u>

The following describes the changes in the endowment funds for the year ended June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year			\$ 53,495	\$ 53,495
Designated by board	\$ 355,574			355,574
Investment income (loss)	<u>(352)</u>	<u>\$ 2,450</u>		<u>2,098</u>
Endowment net assets, end of year	<u>\$ 355,222</u>	<u>\$ 2,450</u>	<u>\$ 53,495</u>	<u>\$ 411,197</u>

NOTE 10 - FUNDRAISING EVENT

The Agency conducted major fundraising events with the following activity for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Gross revenue	\$ 271,080	\$ 167,483
Direct expenses	<u>(75,565)</u>	<u>(91,087)</u>
	<u>\$ 195,515</u>	<u>\$ 76,396</u>

Gross revenue is included in contributions revenue in the statement of activities. Direct expenses are included in fundraising in the statements of activities and the statement of functional expenses.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 11 - LONG-TERM DEBT

Interest has not been imputed on the note payable that carries below-market rate interest as it is payable to a governmental entity or carries legal restrictions. The restrictions require the Agency to use the property for low-income housing.

The note payable at June 30, was:

	2013	2012
Noninterest bearing note payable to State of Washington, Department of Community Development with annual principal payment of \$14,916; matures January 2049; contains a covenant running with the land limiting the use to low-income homeless youth and teen parent families for the term of the loan; any change in use, sale or refinance of the property before maturity would require repayment of the loan balance plus a pro-rata share of net proceeds/appreciation; collateralized by a deed of trust on the property with a carrying value of \$928,430	\$ 587,224	\$ 602,140
Less current portion	<u>(14,916)</u>	<u>(14,916)</u>
	<u>\$ 572,308</u>	<u>\$ 587,224</u>

Aggregate maturities of notes payable for the next five years and thereafter are as follows:

2014	\$	14,916
2015		14,916
2016		14,916
2017		14,916
2018		14,916
Thereafter		<u>512,644</u>
		<u>\$ 587,224</u>

NOTE 12 - FORGIVABLE LOANS

The Agency has received forgivable loans to help fund various facility projects. Under terms of the agreements, the proceeds must be used for the specific purpose intended in the loan documents.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 12 - FORGIVABLE LOANS, CONTINUED

As management believes the conditions of forgiveness related to these loans are substantially met ratably over the terms of the agreements and that the Agency has the present intention and ability to maintain the conditions of forgiveness, the proceeds from these forgivable loans have been recognized as refundable advances and ratably recognized as revenue over the period of restricted use. The revenue is presented as release of refundable advances on the statement of activities. The original loan balance plus a possible pro-rata share of net proceeds/appreciation or accrued interest, if any, is generally due if the Agency changes the use of the facilities from the intended purpose or if the property is sold or refinanced and removed from acceptable use before the period of restricted use ends. Each forgivable loan has specific agreements and covenants surrounding the use of the property and the terms of forgiveness depend on adherence to the terms of the agreements.

Forgivable loans consisted of the following at June 30,:

	2013	2012
<u>Complex:</u>		
Note payable to Snohomish County for \$258,334; with no interest accruing and no principal payments due if Agency uses the property to provide transitional housing for youth; matures June 2035; collateralized by a deed of trust on the property with a carrying value of \$928,430	\$ 142,084	\$ 148,542
Note payable to Snohomish County Trust Fund for \$250,000; with no interest accruing and no principal payments due if Agency continuously uses the property for low-income youth transitional housing; matures April 2044; collateralized by a deed of trust on the property with a carrying value of \$928,430; subordinated to the note payable to the State of Washington (see Note 11)	155,000	160,000
<u>Central Shelter:</u>		
Note payable to Snohomish County for \$160,366; with no interest accruing and no principal payments due if the Agency continuously uses the property to provide short-term shelter and supportive services for homeless youth; matures June 2020; collateralized by a deed of trust on the property with a carrying value of \$271,195	56,128	64,146

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 12 - FORGIVABLE LOANS, CONTINUED

	2013	2012
<p>Note payable to State of Washington Department of Community, Trade, and Economic Development for \$284,315; with no interest accruing and no principal payments due if the Agency continuously uses the property to provide emergency shelter for low-income youths between the ages of 13 and 17; matures December 2045; collateralized by a deed of trust on the property with a carrying value of \$469,116</p>	\$ 227,453	\$ 234,560
<u>East Shelter</u>		
<p>Note payable to State of Washington Department of Community, Trade, and Economic Development for \$842,349; with no interest accruing and no principal payments due if the Agency continuously uses the property to provide emergency shelter for low-income youth; matures December 2049; collateralized by a deed of trust on the property with a carrying value of \$970,002</p>	763,974	785,195
<p>Note payable to Snohomish County for \$95,640; with no interest accruing and no principal payments due if the Agency continuously uses the property to provide emergency shelter for low-income youth; matures September 2049; collateralized by a deed of trust on the property with a carrying value of \$970,002</p>	88,100	90,547
<u>U-Turn Resource Drop-in Center</u>		
<p>Note payable to City of Everett for \$63,269; bears interest at 3% per annum; with no interest and no principal payments due if the Agency continuously uses the property to provide housing for low-income youth; matures May 2037; collateralized by a deed of trust on the property with a carrying value of \$390,011</p>	60,316	62,847

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 12 - FORGIVABLE LOANS, CONTINUED

	2013	2012
<u>U-Turn Resource Drop-in Center, continued</u>		
Note payable to City of Everett for \$60,000; bears interest at 3% per annum; with no interest and no principal payments due if the Agency continuously uses the property to provide housing for low-income youth; matures January 2038; collateralized by a deed of trust on the property with a carrying value of \$390,011	59,000	
	\$ 1,761,100	\$ 1,761,415

NOTE 13 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following program purposes at June 30,:

	2013	2012
Program activities	\$ 654,719	\$ 361,453
Future periods	533,928	188,605
Acquisition of capital assets	10,000	90,000
Sara's fund	13,304	13,397
SEIN Fund	3,429	3,185
SILK Sponsorship		2,623
Unappropriated endowment earnings	2,450	
Kids programs	1,584	
	\$ 1,219,414	\$ 659,263

NOTE 14 - LEASES

Operating leases

The Agency has a non-cancelable agreement to lease office equipment expiring in August 2015 with monthly payments of \$353. Rent expense for this equipment was \$4,236 during 2013. The future minimum lease payments under the operating leases are as follows:

2014	\$	4,236
2015		4,236
2016		706
	\$	9,178

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 14 - LEASES, CONTINUED

Capital lease

The asset and liability under capital lease are recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. The assets, consisting of computers, servers, and phones, are amortized over the lesser of the lease term or their estimated productive lives. Amortization of the assets under capital lease is included in depreciation expense. The carrying value of assets under capital leases as of June 30, 2013, was \$57,629, net of accumulated depreciation of \$13,447.

Future minimum payments required under the capital lease as of June 30 are as follows:

2014	\$ 14,193
2015	14,193
2016	14,193
2017	<u>10,645</u>
Total minimum lease payments	53,224
Less amount representing interest	<u>(8,052)</u>
	<u>\$ 45,172</u>

NOTE 15 - COMMITMENTS AND CONTINGENCIES

As discussed in Notes 11 and 12, the Agency has agreed to significant restrictions on the use of land and buildings in accordance with financing agreements.

A substantial portion of the public support of the Agency is derived from grants and contracts administered by various federal, state and local government agencies. Support from these grants and contracts is subject to audit, which could result in reimbursement to the grantor agencies. Revenue from the government totaled 56 percent of total public support and revenue for the year ended June 30, 2013. Receivables from government grants totaled 18 percent of total grants and promises receivable at June 30, 2013.

Amounts received from grantor agencies are subject to audit and adjustments by the grantor agency. Any disallowed cost, including amounts already collected, may constitute a liability for the agency. The amounts, if any, of expenditures which may be disallowed by the grantor are recorded at the time that such amounts can be reasonably determined, normally on notification by the government agency.

COCOON HOUSE
Notes to Financial Statements
For the Year Ended June 30, 2013

NOTE 16 - SUBSEQUENT EVENTS

The Agency has evaluated subsequent events through October 15, 2013, which is the date the financial statements were available to be issued, and has determined that there are no subsequent events that require disclosure.

SUPPLEMENTARY INFORMATION

COCOON HOUSE
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2013

Federal Grantor / Pass-Through Grantor Program Title	Federal CFDA Number	Federal Grantor / Pass-Through Grantor Number	Expenditures
US Department of Health and Human Services			
Direct Programs			
Education and Prevention Grants to Reduce Sexual Abuse of Runaway, Homeless and Street Youth			
	93.557	90YO0173-01/02	\$ 104,079
			<u>104,079</u>
Basic Center Grant			
	93.623	90CY2433/03	15,415
Basic Center Grant			
	93.623	90CY6422-02	110,033
			<u>125,448</u>
Transitional Living for Homeless Youth			
	93.550	10CX0051/05	49,781
Transitional Living for Homeless Youth			
	93.550	90CX6886/01	142,129
Transitional Living for Homeless Youth			
	93.550	90CX7029/01	12,195
			<u>204,105</u>
Total US Department of Health and Human Services			<u>433,632</u>
US Department of Housing and Urban Development			
Pass-Through Programs From:			
Snohomish County			
Community Development Block Grant/Entitlement Grants			
	14.218	HCD-1993-19	170,073
	14.218	HCD-1993-42	54,927
	14.218	HCD-1993-39	33,334
			<u>258,334</u>

COCOON HOUSE
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2013

Federal Grantor / Pass-Through Grantor Program Title	Federal CFDA Number	Federal Grantor / Pass-Through Grantor Number	Expenditures
US Department of Housing and Urban Development, Continued			
Pass-Through Programs From:			
Snohomish County, Continued			
Mortgage Loan (Central Shelter)	14.218	HCD-1996-36	\$ 32,168
Mortgage Loan (Central Shelter)	14.218	HCD-1998-44	98,754
Mortgage Loan (Central Shelter)	14.218	HCD-1996-56	28,945
Mortgage Loan (Central Shelter)	14.218	HCD-1995-53	499
			<u>160,366</u>
Community Development Block Grant	14.218	HCS-12-24-1203-077	<u>34,538</u>
City of Everett			
Mortgage Loan (U-Turn)	14.218	Building Acquisition	63,269
Renovation Loan (U-Turn)	14.218	Building Renovation	60,000
			<u>123,269</u>
			<u>576,507</u>
Emergency Shelter Grant	14.231	HCS-12-31-1201-077	<u>24,761</u>
Supportive Housing Program	14.235	HCS-12-50-1165-077	<u>126,953</u>
Total US Department of Housing and Urban Development			<u>728,221</u>
Total Expenditures of Federal Awards			<u>\$ 1,161,853</u>

COCOON HOUSE
Notes to Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2013

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal award activity of Cocoon House (the Agency), under programs of the federal government for the year ended June 30, 2013. The information in the Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the Agency, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Agency.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

NOTE C - SUBRECIPIENTS

Of the federal expenditures presented in the schedule, the Agency provided none of the federal awards to subrecipients.

NOTE D - LOANS WITH CONTINUING COMPLIANCE REQUIREMENTS

The funds for the loans were passed through from the U.S. Department of Housing and Urban Development's Community Development Block Grant program, CFDA 14.218. Loans are forgivable on the maturity dates as long as Cocoon House remains in compliance with certain program regulations through maturity.

<u>Purpose</u>	<u>Maturity Date</u>	<u>Outstanding Balance</u>
Complex	Jun 2035	\$ 258,334
Central Shelter	Jun 2020	160,366
U-Turn Facility Acquisition	May 2037	63,269
U-Turn Facility Renovation	Jan 2038	<u>60,000</u>
		<u>\$ 541,969</u>

WATSON & McDONELL, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

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

Board of Directors
Cocoon House
Seattle, Washington

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 Cocoon House (the Agency), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 15 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Agency'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 Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Agency'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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control 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.

Watson & McDermott, PLLC

October 15, 2013

WATSON & McDONELL, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

Board of Directors
Cocoon House
Seattle, Washington

Report on Compliance for Each Major Federal Program

We have audited Cocoon House's (the Agency) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Agency's major federal programs for the year ended June 30, 2013. The Agency's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Agency'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 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 the Agency'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 Agency's compliance.

Opinion on Each Major Federal Program

In our opinion, the Agency 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, 2013.

Report on Internal Control Over Compliance

Management of the Agency 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 Agency'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 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 the Agency'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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Watson & McDermott, PLLC

October 15, 2013

COCOON HOUSE
 Schedule of Findings and Questioned Costs
 For the Year Ended June 30, 2013

A. SUMMARY OF AUDITORS' RESULTS

1. *Financial Statements*

The auditors' report expresses an unmodified opinion on the financial statements of Cocoon House.

Internal control over financial reporting:

Material weaknesses identified: _____ Yes X No

Significant deficiencies identified that are not considered to be material weaknesses: _____ Yes X None reported

Noncompliance material to financial statements noted: _____ Yes X No

2. *Federal Awards*

Internal control over major programs:

Material weaknesses identified: _____ Yes X No

Significant deficiencies identified that are not considered to be material weaknesses: _____ Yes X None reported

3. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? _____ Yes X No

4. The programs tested as major programs were:

<u>CFDA</u>	<u>Name of Federal program</u>	<u>Compliance Opinion</u>
#14.218	Community Development Block Grants	Unmodified
#93.550	Transitional Living for Homeless Youth	Unmodified

5. The threshold for distinguishing type A and B programs was \$300,000.

6. Cocoon House was determined not to be a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT - None

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT - None

COCOON HOUSE
Status of Prior Year (2012) Findings
For the Year Ended June 30, 2013

D. PRIOR AUDIT FINDINGS

Finding identification number: 2012-02

Name of Program: Transitional Living for Homeless Youth

CFDA Number: 93.550

Federal Agency: U.S. Department of Health and Human Services

Summary: Employee vacation amounts were not allocated in accordance with the percentage allocation noted on the employee time card. In addition, there was one instance where an employee time card showed 7.60 hours allocated to one grant, however, 14.11 hours were charged.

Status: Corrective action was taken.

Finding identification number: 2012-03

Name of Program: Transitional Living for Homeless Youth

CFDA Number: 93.550

Federal Agency: U.S. Department of Health and Human Services

Name of Program: Community Development Block Grants/Entitlement Grants

CFDA Number: 14.218

Federal Agency: U.S. Department of Housing and Urban Development

Summary: The underlying support for programmatic progress reports submitted to funding agencies had multiple reported metrics for which support for the reported results does not appear to be retained, or the underlying records reviewed support different outcomes than the reported results.

Status: Corrective action was taken.