Heartland Alliance for Human Needs & Human Rights

Reports required by
Government Auditing Standards
And OMB Circular A-133
June 30, 2012

Contents

McGladrey

Independent Auditor's Report

To the Board of Directors
Heartland Alliance for Human Needs & Human Rights
Chicago, Illinois

We have audited the accompanying consolidated statement of financial position of Heartland Alliance for Human Needs & Human Rights (the Agency) as of June 30, 2012, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Agency as of June 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 18 to the financial statements, the Agency has restated beginning net assets to correct for errors in the application of accounting principles. We audited the adjustments described in Note 18 that were applied to restate the July 1, 2011 financial statement balances. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2013, on our consideration of the Agency's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

McGladrey LLP

Chicago, Illinois
January 17, 2013

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Financial Position
June 30, 2012

Assets		
Cash	$	7,214,914
Restricted cash		1,745,900
Investments		7,751,067
Accounts receivable:		
Program service grants and fees		13,271,122
Pledges receivable		3,801,020
Patient services		248,809
Other		200,255
Allowance for contractual adjustments, discounts and bad debts		(590,595)
Prepaid expenses and other current assets		1,827,402
Escrow and reserve accounts		6,243,986
Investment in limited partnerships		36,125
Investment in affiliates, equity method		485,365
Receivables due from limited partnerships		516,239
Notes receivable		8,278,151
Property and equipment, net		75,724,496
Deferred financing fees, net		1,300,579
Residual interest		6,068,116
Total assets	$	134,122,951
Liabilities and Net Assets		
Liabilities		
Accounts payable and other accrued expenses	$	9,347,741
Accrued payroll and related liabilities		3,079,045
Deferred revenue		8,833,735
Liability for self-insurance claims		1,125,000
Deferred rent liability		226,668
Deferred compensation plan liability		253,756
Accrued interest payable		874,181
Debt obligations		46,930,719
Total liabilities		70,670,845
Net Assets		
Unrestricted:		
Undesignated and controlling interests		41,481,592
Non-controlling interests		9,390,970
Board designated		1,212,579
Total unrestricted net assets		52,085,141
Temporarily restricted		11,178,930
Permanently restricted		188,035
Total net assets		63,452,106
Total liabilities and net assets	$	134,122,951

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

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Activities
Year Ended June 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue:				
Contributions	$ 2,876,729	$ 7,480,322	$ -	$ 10,357,051
Program services:				
Grants, contracts, reimbursements and client fees	62,043,711	85,557	-	62,129,268
Allocation from United Way of Chicago	212,000	-	-	212,000
Contributed services and in-kind revenue	4,048,674	-	-	4,048,674
Patient services, net of contractual adjustments and discounts	1,058,936	-	-	1,058,936
Rental income	4,304,377	-	-	4,304,377
Housing development	820,209	-	-	820,209
Interest and investment income	856,362	-	-	856,362
Other income	1,221,341	-	-	1,221,341
Net assets released from restrictions	6,217,636	(6,217,636)	-	-
	83,659,975	1,348,243	-	85,008,218
Expenses:				
Program services	69,396,039	-	-	69,396,039
Supporting services:				
Management and general	9,910,632	-	-	9,910,632
Fundraising	788,182	-	-	788,182
	80,094,853	-	-	80,094,853
Increase in net assets before non-budgetary items	3,565,122	1,348,243	-	4,913,365
Non-budgetary items:				
Depreciation and amortization	(4,318,539)	-	-	(4,318,539)
Non-cash contribution - Vital Bridges NFP, Inc.	1,547,118	-	-	1,547,118
Increase in net assets before non-controlling interests and other items	793,701	1,348,243	-	2,141,944
Add back loss attributable to non-controlling interests included in above increase	3,111,132	-	-	3,111,132
Increase in net assets attributable to controlling interests	3,904,833	1,348,243	-	5,253,076
Less loss attributable to non-controlling interests	(3,111,132)	-	-	(3,111,132)
Increase in net assets before other items	793,701	1,348,243	-	2,141,944
Other items:				
Capital contributions in limited partnerships and other entities	2,559,886	-	-	2,559,886
Increase in net assets	3,353,587	1,348,243	-	4,701,830
Net assets, beginning of year, as originally stated	49,684,744	9,830,687	188,035	59,703,466
Prior period adjustments	(953,190)	-	-	(953,190)
Net assets, beginning of year, as restated	48,731,554	9,830,687	188,035	58,750,276
Net assets, end of year	$ 52,085,141	$ 11,178,930	$ 188,035	$ 63,452,106

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

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Functional Expenses
Year Ended June 30, 2012

	Program Services									
	National Immigrant Justice Center	Youth and Residential Services	International Programs	Primary Care Services	Housing Services	Employment and Economic Advancement	Mental Health Services	Prevention and Wellness	Social IMPACT	Cross Cultural Services
Salaries and wages	$ 1,913,690	$ 6,349,528	$ 4,671,410	$ 4,061,673	$ 3,071,122	$ 3,637,109	$ 4,194,534	$ 1,898,702	$ 488,308	$ 201,194
Payroll taxes and fringe benefits	443,367	1,709,200	602,920	915,875	954,811	989,518	1,123,340	546,541	125,623	67,320
Staff expenses	111,178	89,906	1,257,988	134,782	57,864	93,019	80,806	61,727	163,807	17,412
Professional expenses	60,532	113,465	677,903	492,591	157,493	125,767	246,020	45,446	50,250	611,590
Office services	64,301	192,326	359,270	269,075	141,677	193,634	159,455	54,034	21,352	18,274
Occupancy	217,461	1,180,193	472,353	498,536	433,503	648,433	359,501	161,168	51,035	36,709
Equipment	13,254	222,567	193,455	182,047	131,225	102,315	83,525	6,081	14,237	9,329
Client support and supplies	1,994	1,831,334	647,423	1,727,394	2,906,458	1,042,575	1,060,681	47,871	951	3,830
Subrecipients	5,000	-	2,575,685	848,535	142,461	290,677	-	29,105	-	-
Contributed services and in-kind expenses	61,907	195,899	-	303,398	-	674,715	135,000	-	-	-
Real estate development and	-	-	-	-	-	-	-	-	-	-
property management	-	-	1,161	490	-	100	352,272	300	-	11
Interest expense	-	-	-	9,097	-	-	12,028	-	-	1,459
Uncollectible accounts	7,408	-	87,267	(11,916)	-	3,397	(43,162)	-	40,156	(28,066)
	2,900,092	11,884,418	11,546,835	9,431,577	7,996,614	7,801,259	7,764,000	2,850,975	955,719	939,062
Depreciation and amortization	2,941	361,390	80,179	360,242	2,701	39,077	46,127	10,050	-	-
	$ 2,903,033	$ 12,245,808	$ 11,627,014	$ 9,791,819	$ 7,999,315	$ 7,840,336	$ 7,810,127	$ 2,861,025	$ 955,719	$ 939,062

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Functional Expenses (Continued)
Year Ended June 30, 2012

	Program Services (Continued)						Supporting Services			
	Research and Policy	Refugee & Immigrant Community Services	Dental Services	Affordable and Supportive Housing	Other Services	Total Program Services	Management and General	Fundraising	Total Supporting Services	Total 2012
Salaries and wages	$ 270,831	$ 143,344	$ 162,756	$ 1,097,884	$ 347,367	$ 32,509,452	$ 6,273,869	$ 264,844	$ 6,538,713	$ 39,048,165
Payroll taxes and fringe benefits	60,714	37,708	19,833	293,820	(1,938,745)	5,951,845	784,779	55,232	840,011	6,791,856
Staff expenses	26,063	5,138	11,186	4,849	43,905	2,159,630	383,196	216,056	599,252	2,758,882
Professional expenses	199,019	27,781	1,387	-	314,623	3,123,867	695,519	29,400	724,919	3,848,786
Office services	15,974	7,219	6,250	-	23,990	1,526,831	528,831	46,224	575,055	2,101,886
Occupancy	34,023	13,880	-	778,367	1,767	4,886,929	854,357	28	854,385	5,741,314
Equipment	7,079	9,817	2,586	-	6	977,523	218,011	2,078	220,089	1,197,612
Client support and supplies	-	7,241	-	-	2,343	9,280,095	(325,226)	14,275	(310,951)	8,969,144
Subrecipients	-	-	-	-	-	3,891,463	(59,565)	-	(59,565)	3,831,898
Contributed services and in-kind expenses	-	13	-	-	-	1,370,932	59,697	160,045	219,742	1,590,674
Real estate development and						-				
property management	-	5	-	1,916,648	110,522	2,381,509	10,343	-	10,343	2,391,852
Interest expense	5,000	417	253	1,211,197	-	1,239,451	86,568	-	86,568	1,326,019
Uncollectible accounts	-	-	-	19,815	21,613	96,512	400,253	-	400,253	496,765
	618,703	252,563	204,251	5,322,580	(1,072,609)	69,396,039	9,910,632	788,182	10,698,814	80,094,853
Depreciation and amortization	-	-	-	3,049,268	2,902	3,954,877	363,662	-	363,662	4,318,539
	$ 618,703	$ 252,563	$ 204,251	$ 8,371,848	$ (1,069,707)	$ 73,350,916	$ 10,274,294	$ 788,182	$ 11,062,476	$ 84,413,392

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

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Cash Flows
Year Ended June 30, 2012

Cash Flows from Operating Activities	
Increase in net assets	$ 2,141,944
Adjustments to reconcile increase in net assets to net cash provided by operating activities:	
Depreciation and amortization	4,184,878
Amortization of deferred financing fees	133,661
Provision for bad debts	298,537
Contributed land and building	(2,458,000)
Unrealized gains on investments	(110,268)
Allocated loss from equity method investment	8,351
Non-cash contribution recognized from Vital Bridges NFP, Inc. acquisition	(1,547,118)
Effects of changes in operating assets and liabilities:	
Restricted cash	(1,035,018)
Accounts receivable:	
Program service grants and fees	1,417,415
Patient services	90,468
Other	976,997
Pledges receivable	(1,050,053)
Prepaid expenses and other current assets	302,398
Accounts payable and other accrued expenses	550,514
Accrued payroll and related liabilities	396,244
Accrued interest payable	700,067
Liability for self-insurance claims	450,000
Deferred rent liability	(9,444)
Deferred compensation plan liability	6,833
Deferred revenue	190,907
Net cash provided by operating activities	5,639,313
Cash Flows from Investing Activities	
Additions to property and equipment	(8,446,439)
Purchases of investments	(1,368,682)
Proceeds from sale of investments	841,422
Issuance of note receivable	(5,472)
Proceeds from notes receivable	168,679
Payments to escrow accounts	(2,205,333)
Proceeds from escrow accounts	1,485,177
Cash acquired through Vital Bridges NFP, Inc. acquisition	431,371
Net cash used in investing activities	(9,099,277)

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

Heartland Alliance for Human Needs & Human Rights

Consolidated Statement of Cash Flows (Continued)
Year Ended June 30, 2012

Cash Flows from Financing Activities		
Capital contributions in limited partnerships and other entities	$	2,559,886
Repayments of borrowings		(2,089,676)
Proceeds from borrowings		1,964,307
Deferred financing fees		(145,658)
Net cash provided by financing activities		2,288,859
Decrease in cash		(1,171,105)
Cash:		
Beginning of year		8,386,019
End of year	$	7,214,914
Supplemental Disclosure of Cash Flow Information		
Interest paid	$	1,326,019
Supplemental Schedule of Noncash Investing and Financing Activities		
Acquisition of Vital Bridges NFP, Inc.:		
Fair value of assets acquired:		
Cash	$	431,371
Investments		101,628
Property and equipment, net		578,000
Other, primarily government receivables		616,927
Liabilities assumed, primarily accounts payable and deferred revenue		(180,808)
Non-cash contribution recognized	$	1,547,118

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

Note 1. Nature of Activities and Significant Accounting Policies

Heartland Alliance for Human Needs & Human Rights (the Agency, or Heartland Alliance) is a leading anti-poverty organization in the Midwestern United States and believes that all people deserve the opportunity to improve their lives. Each year, the Agency helps ensure this opportunity for more than one million people around the world who are homeless, living in poverty, or seeking safety. The Agency's policy efforts strengthen communities; its comprehensive services empower those it serves to rebuild and transform their lives.

The Agency, headquartered in Chicago, Illinois, operates both in the United States and around the world providing a wide array of services that equip people with the four essential tools they need to rebuild their lives – housing, health care, jobs, and justice.

The accompanying consolidated financial statements include the activities of the Agency and its affiliated organizations, Heartland Health Outreach, Inc. (HHO), Heartland Human Care Services, Inc. (HHCS), and Heartland Housing Inc. (HH), whose respective by-laws designate the Agency as their sole voting member. The Agency and these affiliated organizations are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state law.

HHO provides health care that addresses the physical, mental and social needs for those who are homeless or have serious disabling conditions. The Agency goes outside the walls of its clinics and into the community—like the streets and parks—to provide health care.

HHCS assists individuals and families living in poverty to meet their basic human needs and create opportunities for economic success. The Agency relentlessly works with people in harm's way to move them to places of stability and success.

HH develops quality, affordable housing with supportive services that help struggling low-income individuals live with stability and success. The Agency specializes in working with those others see as hard-to-house who'd likely live on the streets without the Agency.

HH is the sole voting member of several corporations which were formed to hold ownership interests in real estate projects. As a result of its level of control and economic interest in these corporations, HH consolidates their balances and activities. These affiliated corporations are as follows:

Argyle Neighborhood Development Corporation (Argyle)
Diversey Neighborhood Development Corporation (Diversey)
Drexel Neighborhood Development Corporation (Drexel)
Ellis Neighborhood Development Corporation (Ellis)
Hollywood Sheridan Neighborhood Development Corporation (Hollywood)
Leland Neighborhood Development Corporation (Leland)
Mayfield Neighborhood Development Corporation (Mayfield)
North Avenue Neighborhood Development Corporation (North Avenue)
South Shore Neighborhood Development Corporation (South Shore)
Sutherland Neighborhood Development Corporation (Sutherland)
Heartland ABLA Rental NFP (ABLA)
Heartland ABLA Rental NFP II (ABLA II)
Heartland Housing Highland, LLC (HH Highland)
1218 W. Highland Avenue, LLC (1218 W. Highland)
Fond du Lac MM, LLC (Fond du Lac MM)
Viceroy GP, LLC (Viceroy)

Drexel, Hollywood, Leland, Mayfield, North Avenue, South Shore, HH Highland, and 1218 W. Highland are taxable as corporations under federal and state law. None of these entities paid taxes in fiscal year 2012. The other corporations are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state law.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Several of the corporations each hold an ownership interest in a limited partnership or limited liability company, which own a real estate project. As a result of their controlling interest, the corporations consolidate the balances and activities of the following:

Drexel Jazz Limited Partnership (Drexel LP)
Hollywood House Limited Partnership (Hollywood LP)
Leland Limited Partnership (Leland LP)
Mayfield Limited Partnership (Mayfield LP)
North Avenue Limited Partnership (North Avenue LP)
1218 W. Highland Avenue, LLC (Prairie LLC)
Fond du Lac Apartments, LLC
Viceroy Limited Parnership (Viceroy LP)

Leland LP, North Avenue LP, and Drexel LP were existing and active organizations prior to 2012 but are being included in the consolidated financial statements for the first time, effective July 1, 2011 (Note 18). Viceroy LP is a new entity, formed in fiscal year 2012.

The Agency, as used in these consolidated financial statements, refers to Heartland Alliance for Human Needs & Human Rights individually or collectively with its affiliated organizations. Significant accounting policies followed by the Agency are as follows:

Basis of accounting: The consolidated financial statements have been prepared using the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

Basis of presentation: The Agency follows the accounting guidance for financial statements of nonprofit organizations which requires that net assets and related revenue, expenses, gains and losses be classified into three classes of net assets - unrestricted, temporarily restricted and permanently restricted, based upon the existence or absence of donor-imposed restrictions. These net asset classes are described as follows:

Unrestricted: Those resources with no legal or donor-imposed restrictions, including designated amounts the Agency's Board of Directors have set aside for discretionary purposes.

Temporarily restricted: Temporarily restricted net assets arise from contributions whose use is limited by donor-imposed restrictions that either expire with the passage of time or can be fulfilled by actions of the Agency pursuant to those restrictions. When a donor restriction expires or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities as net assets released from restriction.

Permanently restricted: Permanently restricted net assets are subject to the restrictions of gift instruments requiring the principal to be maintained intact and the income to be used for the general operating purposes of the Agency.

Principles of consolidation: Due to its control and economic interest, the Agency's consolidated financial statements include the accounts and activities of the various affiliated organizations as described above.

Non-controlling interests are ownership interests in real estate projects that are not attributable to the Agency, HH, or the various HH consolidated entities. The balances and activities of the real estate projects are fully included in the consolidated financial statements, and the non-controlling interests are reflected as a separate component of consolidated unrestricted net assets and changes in unrestricted net assets.

Significant transactions and balances between and among the Agency and its various consolidated affiliates have been eliminated in consolidation.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Revenue recognition: Contributions and promises to give are recorded in the period received as unrestricted, temporarily restricted or permanently restricted support depending on the existence and/or nature of any donor restrictions. A conditional promise to give (such as a matching grant) is recognized when the condition is satisfied.

Bequests are recorded as revenue when the Agency has received notice of an unconditional beneficial interest and the amount can be reasonably estimated.

Contributed land and buildings are recorded as in-kind revenue at estimated fair value, based on appraisals.

Revenues derived from services (primarily through grants) are recorded in the period the services are provided.

Program activity revenue is recorded in the fiscal year the activity takes place. Amounts received as advance payment for these activities are deferred, and are recorded in the financial statements as deferred revenue. Expense-driven grants are recognized as revenue when the qualifying expenses have been incurred and all other grant requirements have been met.

Patient services revenue is reported at estimated net realizable amounts from patients, third-party payers and other payers for medical services rendered, including retroactive adjustments under reimbursement agreements with third-party payers, which are subject to audit by administrating agencies. These adjustments are considered in the recognition of revenue on an estimated basis and are adjusted in future periods, as final settlements are determined. The Agency provides care to certain patients under Medicare and Medicaid payment arrangements. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action.

Concentrations: The Agency and its affiliated organizations receive a substantial portion of its operating funds from grants and awards. These funds are reported as unrestricted revenues as the grants reimburse the Agency and its affiliated organizations for services provided. Grant funding from the federal government represents approximately 52 percent of total support and revenue for the year ended June 30, 2012. If this support were discontinued, it would have a material adverse effect on the Agency.

The Agency did not receive similar levels of funding in fiscal 2012 under the federal government's American Recovery and Reinvestment Act as it did in recent years. Funding under this or similar programs concluded in fiscal year 2011, as scheduled.

Cash: The Agency maintains its cash balances in bank and money market accounts which may exceed Federal Deposit Insurance Corporation limits from time to time. The Agency has not experienced any losses in such accounts and management believes that the Agency is not exposed to any significant credit risk on cash.

Restricted cash: Restricted cash represents funds that are segregated for contractual obligations and for participant pass-through accounts. This cash is available exclusively for designated purposes and not for general operations.

Investments: Investments in equity securities with readily determinable fair values and all debt securities are stated at fair value as of the reporting date, based on quoted market prices. Changes in fair value are recorded as unrealized gains and losses and are included in interest and investment income in the consolidated statement of activities.

Accounts receivable: Accounts receivable is comprised of amounts due from different funding sources, donors and other parties. Program service grants and fees primarily represent amounts owed under multiple government grants. Management closely monitors outstanding balances and allows for, as of year-end, any balances that are not expected to be fully collected.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Accounts receivable also include amounts due for patient services rendered. Patient services receivable where a third-party payer is responsible for the payment are carried at a net amount determined by the original charge for the service provided, less an estimate for contractual adjustments or discounts provided to third-party payers. Patient services receivable due directly from patients are carried at the original charge for the service provided, less amounts covered by third-party payers. An estimated allowance for doubtful accounts is also recorded. Management determines the allowance for doubtful accounts by identifying troubled accounts and by historical experience applied to an aging of accounts. Patient accounts receivable are written-off when deemed uncollectible. Recoveries of accounts receivable previously written-off are recorded as a reduction of the provision for uncollectible accounts when received. The Agency determines when an account is past due based on payer classifications. The Agency does not charge interest on past due accounts. The allowance at June 30, 2012 totaled $104,944.

Pledges receivable are recorded for donors' unconditional promises to give to the Agency and represent future collections on promised amounts. Conditional promises to give are recognized in the consolidated financial statements when the applicable conditions are substantially met. Management reviews outstanding balances and determines an allowance for uncollectible amounts based on historical experience and an analysis of specific accounts. Uncollectible accounts are written-off in the year they are deemed to be worthless. As all balances are deemed fully collectible by management, no allowance has been recorded as of June 30, 2012.

Pledges receivable are also recorded net of a discount to present value applied to the long-term portion of any multi-year pledge. The discount rate used is an estimate made by management and represents a risk-adjusted rate of return. The amount of the computed discount is amortized over the term of the pledge and is recorded as contribution revenue.

Investments (equity method): Under the equity method of accounting, the Agency records its allocable share of income and losses in its investment in various unconsolidated entities.

The Agency has a 25 percent interest in Alliance of Chicago Community Health Services, L3C, totaling $453,865 at June 30, 2012. In addition, the Agency has a 20 percent interest in Lathrop Community Partners LLC, totaling $31,500 at June 30, 2012. These are reflected as investments in unconsolidated affiliates on the statement of financial position. Investments in limited partnerships which are not consolidated are recorded similarly.

Property and equipment: All acquisitions of property and equipment with a cost of $5,000 or more are stated at cost or, if donated, at the approximate fair value at the date of donation. Depreciation is being provided using the straight-line method over the estimated useful lives of the assets which range from 5 to 40 years for buildings and improvements and 3 to 7 years for furniture, equipment, and vehicles. Amortization of leasehold improvements is generally being provided over 5 to 10 years, representing the lesser of the estimated useful lives of the improvements or the term of the lease.

The Agency reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or the fair value less costs to sell.

Deferred financing fees: Certain fees paid in connection with the Agency's debt are capitalized as deferred financing fees and are being amortized using the straight-line method over the term of the loans. Total amortization expense for the year ended June 30, 2012 was $133,661.

Liability for self-insurance claims: Under its self-insurance plan, the Agency accrues the estimated expense of health care claims costs based on claims filed subsequent to year-end and an additional amount for incurred but not yet reported claims based on prior experience. The accrued liability for self-insurance was $1,125,000 at June 30, 2012. Claims payments based on actual claims ultimately filed could differ from this estimate.

Deferred rent liability: Base rent under the lease for the Agency's administrative office is being recognized as rental expense on the straight-line basis over the lease term. The cumulative excess of rental expense recognized over rentals paid is recorded as a deferred rent liability.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Deferred revenue: Deferred revenue is recorded for government funds and other amounts received in advance and which will be recognized as revenue in the year when the related services are provided or expenses are incurred.

Contributed services and in-kind revenue: The Agency records the fair market value of contributed services if the contributed services (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills and would need to be purchased if not provided by donation. The Agency uses the services of various professionals and other volunteers possessing specialized skills without charge for various program and administrative functions. During the year ended June 30, 2012, the Agency received approximately 50,000 hours of these contributed services and has recorded the value of such as revenue and expense in the consolidated statement of activities. The Agency also coordinated over 47,000 hours of donated legal services during the year ended June 30, 2012. However, the Agency acted merely as an intermediary between pro-bono attorneys and beneficiaries of those services, and considers these to be agency transactions. Therefore, the Agency does not recognize these services in its financial statements. Other volunteer services received during the year are also not reflected in the consolidated financial statements because they do not meet the criteria for recognition as contributed services.

Donated supplies are recorded at their fair market value on the date of donation. The Agency has recorded the value of such supplies received as revenue and expense in the consolidated statement of activities. The estimated value of these supplies was determined to be $469,174 for the year ended June 30, 2012.

Rental income: Real estate projects generate apartment rental income which is recognized as revenue when rentals become due. Rental payments received in advance are deferred until earned. All leases between the real estate projects and the tenants are operating leases.

Real estate taxes: The Agency accrues real estate taxes in connection with real estate projects for the period they are assessed; when final tax bills have not been issued for an assessment period, real estate taxes are estimated based on previous assessments and based on known changes to a property's assessed value.

Fair value of financial instruments: The fair value of the Agency's other assets and liabilities that qualify as financial instruments under the accounting guidance on measuring fair value of financial instruments approximates the carrying amounts presented in the consolidated statement of financial position due to the short-term maturity of these investments. The carrying amounts reflected in the consolidated statement of financial position for notes and pledges receivable and debt obligations approximate their respective fair values because discount and interest rates applied are consistent with current market rates. Management has estimated the fair values by discounting expected cash flows using interest rates that management believes are approximately equal to the interest rates currently available for similar financing arrangements.

Functional expenses: Operating expenses directly identified with a functional area are charged to that area and, where those expenses affect more than one area, they are allocated based on estimates made by management.

For grant reporting purposes, the Agency reflects property and equipment purchases as expenses. However, the Agency records these capital expenditures as additions to property and equipment, in accordance with generally accepted accounting principles for financial statement reporting purposes.

Income taxes: The accounting standard on accounting for uncertainty in income taxes addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Agency may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Agency, and various positions related to the potential sources of unrelated business taxable income. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. Management has determined that there are no uncertain tax positions during the reporting periods covered by these financial statements.

The Agency's tax filings are generally no longer subject to examination by the Internal Revenue Service for tax years before 2009.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Use of estimates: The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues, expenses, gains, losses, and other changes in net assets during the reporting period. Actual results could differ from those estimates.

New accounting guidance: During the year ended June 30, 2012, HHO adopted the disclosure guidance contained in the Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) No. 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure - a consensus of the FASB Emerging Issues Task Force*. This ASU requires that the measurement of charity care by a health care entity for disclosure purposes be based on the direct and indirect costs of providing the charity care and that HHO provide disclosure regarding the method used to identify or determine such costs. The measurement and disclosure requirements in this guidance were required to be applied to all periods presented in the financial statements.

Pending pronouncements: In July 2011, the FASB issued ASU 2011-07, *Health Care Entities (Topic 954) – Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-07 requires health care entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay, to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, ASU 2011-07 requires those health care entities to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts, disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts.

For nonpublic entities such as HHO, the provisions of ASU 2011-07 are effective for the first annual period ending after December 15, 2012, and interim and annual periods thereafter. HHO is assessing the impact of the implementation of ASU 2011-07 on its financial statements.

Note 2. Investments

Investments consisted of the following at June 30, 2012:

Certificates of deposit	$ 449,880
Mutual funds:	
Domestic bond	2,756,670
International bond	443,752
Domestic equity	2,233,082
International equity	886,477
	6,769,861
Cash and equivalents	981,206
	$ 7,751,067

A portion of the investment balance totaling $253,756 is reserved for the Agency's deferred compensation plan.

For the year ended June 30, 2012, interest and dividends totaled $321,460, unrealized gains were $110,268 and investment management fees totaled $34,913. Interest and investment income as reflected on the statement of activities also includes amounts from other sources, including notes receivable.

Note 3. Fair Value Measurements

The Agency records its investments at fair value. Fair value is 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. The Agency utilizes valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs. Assets and liabilities recorded at fair value are categorized within the fair value hierarchy based upon the level of judgment associated with the inputs used to measure their value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy are described below:

Level 1. Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Agency has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2. Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3. Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Agency's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

The Agency assesses the levels of the investments at each measurement date. Transfers between levels are required to be recognized on the actual date of the event or change in circumstances that caused the transfer. For the year ended June 30, 2012, there were no such transfers.

The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risks associated with investing in those instruments. Investments are exposed to various risks such as interest rate, market and credit risks. It is reasonably possible that changes in values of investments will occur in the near term and that such changes could materially affect the amounts reported. Investments received as contributions are recorded at fair value, based upon quoted market prices.

At June 30, 2012, the Agency's investments are comprised primarily of mutual funds listed on a national securities exchange and stated at the last reported sales price on the day of valuation. These financial investments are classified as Level 1 in the fair value hierarchy.

Note 4. Pledges Receivable

Pledges receivable are as follows at June 30, 2012:

Expected collections in less than one year	$ 2,941,449
Expected collections in one to five years	891,500
	3,832,949
Less discount to present value	(31,929)
	$ 3,801,020

Note 5. Escrow and Reserve Accounts

In connection with the development of their properties, certain Agency affiliates are required to maintain various escrow and reserve accounts. Balances and activity in these accounts were as follows for June 30, 2012:

	July 1, 2011	Deposits (including interest income)	Withdrawals	June 30, 2012
Argyle				
Reserve for replacements	$ 100,872	$ 4,998	$ 20,551	$ 85,319
Diversey				
Reserve for replacements	109,799	14,700	13,808	110,691
Real estate tax and insurance escrow	41,898	39,815	35,660	46,053
Ellis				
Reserve for replacements	121,487	22,000	49,500	93,987
Mayfield LP				
Reserve for replacements	143,244	6,363	146,877	2,730
Real estate tax and insurance escrow	21,739	16,378	-	38,117
Reserve for operating deficit	456,835	-	-	456,835
Hollywood LP				
Construction escrows	1,604,545	150,868	454,478	1,300,935
Reserve for replacements	1,054,077	149,163	101,500	1,101,740
Real estate tax and insurance escrow	507,979	302,950	52,342	758,587
Negative arbitrage reserve	-	669,834	-	669,834
Prairie				
Real estate tax and insurance escrow	32,000	-	-	32,000
Reserve for operating deficit	141,800	7,635	9,000	140,435
Fond du Lac				
Reserve for replacements	-	29,671	20,000	9,671
Leland LP				
Reserve for replacements	471,813	80,552	69,027	483,338
Real estate tax and insurance escrow	28,393	73,137	84,527	17,003
North Avenue LP				
Reserve for replacements	121,682	34,316	18,648	137,350
Real estate tax and insurance escrow	423,660	402,621	366,353	459,928
Drexel LP				
Reserve for replacements	142,007	68,817	42,906	167,918
Viceroy LP				
Reserve for replacements	-	131,515	-	131,515
	$ 5,523,830	$ 2,205,333	$ 1,485,177	$ 6,243,986

Diversey and Ellis received $153,128 and $308,573, respectively, in rent subsidies during fiscal 2012, from the U.S. Department of Housing and Urban Development (HUD) under the Section 8 Housing Assistance Payments Program, pursuant to contracts with HUD expiring in fiscal 2012, renewed annually.

Note 6. Limited Partnerships and Other Entities

The several HH affiliate corporations hold general partner interests in various limited partnerships and member interests in various limited liability companies. The limited partnerships and other entities own and operate residential apartment buildings which qualify for low income housing tax credits. This is summarized as follows:

HH Affiliate Corporations	GP or Member Interest	Limited Partnerships and Other Entities	Year Formed	Number of Units
Drexel	0.01%	Drexel LP	2002	39
Hollywood	0.01%	Hollywood LP	2008	197
Leland	0.01%	Leland LP	2004	137
Mayfield	1.00%	Mayfield LP	1997	39
North Avenue	0.01%	North Avenue LP	2000	62
Sutherland	See below	Sutherland LP		
ABLA	0.0025%	Roosevelt Square I LP	2004	184
ABLA II	0.0025%	Rosevelt Square II LP	2008	177
HH Highland	0.007%	Highland MM, LLC	2008	197
1218 W. Highland	0.01%	Prairie LLC	2008	24
Fond du Lac MM	0.01%	Fond du Lac Apartments, LLC	2009	38

The Agency's consolidated financial statements include the balances and accounts of the entities listed above, including the residential real estate projects owned by the limited partnerships and other entities.

The limited partnerships have received an allocation of low income housing tax credits from a state or federal agency to assist in developing, operating, and managing affordable housing developments. Each property from these developments has qualified for and has been allocated low income housing tax credits pursuant to Internal Revenue Code Section 42, which regulates the use of the development as to occupant eligibility and unit gross rent, among other requirements. Each property development must meet the provisions of these regulations during each of the first 15 years in order to remain qualified to receive the credits. If the development remains in compliance, the credits will be allocated over a 10-year period. The properties for several of these real estate projects are also subject to various other contractual limitations.

After the 15-year tax credit compliance periods lapse, the Agency generally has options to acquire the non-controlling interests in the real estate projects, at prices to be negotiated with the non-controlling interests, which should result in the Agency acquiring those interests without a material expenditure.

As to Leland, Mayfield, North Avenue, Drexel, HH Highland, and Hollywood, an HH entity is the sole general partner. Highland MM, LLC is jointly owned by HH Highland (70%) and an unrelated entity, Guest House Highland, LLC (30%).

In a prior year, HH acquired the remaining unrelated third party general and limited partner interests of Sutherland LP, effectively terminating the limited partnership.

The limited partnership and operating agreements include provisions which may result in annual income and loss allocations different from the ownership percentages presented above. In addition, the respective partnership agreements provide for various obligations of the general partners, including their obligation to provide funds for any development and operating deficits.

HH and Leland have provided a guarantee for Leland LP's repayment of a $700,000 junior mortgage loan which matures in 2026.

ABLA and ABLA II do not hold controlling interests in Roosevelt Square I LP and Roosevelt Square II LP (RS II), which are Illinois limited partnerships. Therefore, their ownership interests are included in investments in limited partnerships, as reflected on the consolidated statement of financial position.

Note 6. Limited Partnerships and Other Entities (Continued)

Residual interest

In July 2007, HH entered into a subordinate note receivable due from RS II in the amount of $6,068,116. The note provides for interest at 5.15 percent compounded annually, and matures in July 2047. No principal or interest payments are due before maturity. At June 30, 2011, the Agency reported an outstanding balance for the note of $7,375,779 including accrued interest of $1,307,663.

The note was issued by RS II in exchange for a 99-year lease (the land leasehold) to certain land parcels, which lease had been donated to HH by the Chicago Housing Authority, and which HH then assigned to RS II. The donation was recorded as contribution revenue by HH in 2007 at its $6,068,116 estimated fair value on the contribution date.

In fiscal year 2012, the Agency determined that no interest should have been accrued on the note in previous years due to uncertainty about the collectability of that interest. Any interest or principal that HH might collect on the note will be recorded as income if and when collected in the future. Accumulated but unrecorded interest income on the note through June 30, 2012 totals $1,724,784, including $417,121 for fiscal year 2012.

Further, the asset reported by HH is described as a “residual interest”. Management expects that, at the conclusion of the 15-year housing credit compliance period for RS II, (a) HH will become the owner of the RS II property subject to then-existing obligations to lenders; (b) the note receivable with HH will be eliminated since it would then be both the debtor and the lender; and (c) RS II will continue to benefit from the land leasehold for its remaining term. Accordingly, HH’s actual asset is the residual interest in the note collateral (the land leasehold).

The Agency has restated and reclassified its notes receivable balance at July 1, 2011 to reverse accrued interest and to reflect its asset as a residual interest (Note 18).

Receivables due from limited partnerships

Two other subordinated notes due from RS II in the aggregate amount of $516,239 are included in the financial statements as receivables due from limited partnerships. These notes are reported net of an interest rate discount that was imputed when the loans were funded in 2007. HH is not presently accruing interest on the notes, since no present payments are required and they do not mature until 2047. At June 30, 2012, RS II has approximately $31,000,000 of mortgage debt outstanding, including $3,154,223 face amount of the two notes described above.

Other limited partnership matters

In fiscal 2012, HH received from the City of Chicago and recorded as in-kind revenue donated land and building with an estimated fair value of $2,458,000. This property is the site for a new development, Viceroy LP’s 89-unit permanent supportive housing project for single adults. Viceroy, which holds a general partner interest in Viceroy LP, is co-owned with an unrelated entity, First Baptist Congregational Church. The project is being developed for an estimated total cost of $22,300,000, including a $13,300,000 construction contract; financing sources include low income housing tax credits from Illinois Housing Development Authority (IHDA), Illinois affordable housing tax credits and tax increment financing. The donated land and building, the fair value of which has been recorded on the financial statements as unrestricted in-kind revenue, are subject to various contractual limitations.

HH is required through the tax credit, development, and operating agreements to provide a guarantee that ensures the project stays in compliance with the regulatory agency, construction of the project is completed, and the project operates within investor projections and continues to be financially sustainable over the course of the compliance period. Except for North Avenue LP and Leland LP, HH could be called upon to fund these guarantees in the future. The operating guarantee is calculated by making adjustments to changes in net assets for depreciation, accruals and reserves withdrawals.

Note 7. Notes Receivable

Notes receivable at June 30, 2012 are as follows:

Tax Increment Financing (TIF) note due from City of Chicago to Hollywood LP, in annual payments on March 1 of $575,824, including interest at a rate of 7.09 percent, through 2028.	$	5,651,348
Junior mortgage note due from Monteclare Senior Residences of Avalon Park Phase I, LLC to HHCS, bearing interest at 4.32 percent per annum; principal and any accrued unpaid interest are due in 2046; interest is payable beginning in 2030 from net cash flow in a manner set forth in LLC's operating agreement.		1,530,000
Accrued interest		257,002
Junior mortgage note due from Monteclare Senior Residences of Avalon Park Phase I, LLC to HHCS, bearing interest at 2.50 percent per annum; principal and interest are due in 2046.		688,431
Accrued interest		65,290
Unsecured promissory note due from Heartland International Health Center (an affiliated entity - Note 15) to Heartland Alliance, due in monthly installments of $4,932 including interest at a rate of 2.28 percent, through June 2013.		58,080
Related amount due from Heartland International Health Center to Heartland Alliance.		28,000
	$	8,278,151

A TIF note for $5,900,000 from the City of Chicago was issued December 18, 2008 and accrues interest annually effective April 1, 2011. Payments are made to the extent the tax increment is available from property taxes paid in the local real estate tax district as long as the developer is in compliance with the terms of the redevelopment agreement. The initial payment on March 1, 2011 was $287,912. If the tax increment is insufficient for the City to pay the debt service on the note, Hollywood LP established a tax increment deficiency fund in the amount of $1,229,552 to service Hollywood's obligation to the City of Chicago (Note 9). Due to the uncertainty of collection, Hollywood LP has recorded the TIF note as notes receivable with an offset account in deferred revenue. Interest and TIF revenue is recognized as TIF payments are received. The TIF note is closed to prepayment until March 1, 2018.

Scheduled future maturities of the TIF note are as follows:

2013	$	181,032
2014		194,290
2015		208,518
2016		223,789
2017		240,178
Thereafter		4,603,541
	$	5,651,348

Note 7. Notes Receivable (Continued)

As part of its expansion into supportive housing and social services to seniors, HHCS entered into a transaction with an unrelated real estate developer to assist in the acquisition of a property in the Woodlawn neighborhood of Chicago in return for a long-term service contract at the facility called Monteclare Senior Residences of Avalon Park Phase I, LLC (Monteclare). In October 2008, the City of Chicago deeded land in the Woodlawn neighborhood to HHCS with an appraised value of $1,530,000. The land was immediately transferred to Monteclare in exchange for a junior mortgage in the same amount. At the same time, the City of Chicago also transferred to HHCS a Donation Tax Credit in the amount of $688,431, which was sold to Bank of America. The proceeds from this sale were lent to Monteclare in return for a note receivable secured by a junior mortgage on the facility.

In July 2010, HHO received a program related investment (PRI) from the Washington Square Health Foundation (Foundation) in amounts totaling $100,000 in support of the Alliance of Chicago Community Health Services (the Alliance; an affiliated, equity-method investee; Note 1). The PRI includes HHO's obligation under promissory notes payable to the Foundation, secured by the assets of the Alliance. HHO then entered into a reciprocal agreement with the Alliance, which includes notes receivable from the Alliance with similar terms. HHO is a pass-through organization for the PRI to the Alliance due to its tax-exempt status. The purpose of the PRI was to support the Alliance's Health Information Technology Enhancement Project. HHO has recorded in its accounting records notes payable and notes receivable, respectively, but has netted their balances for financial reporting purposes. The respective notes are payable in annual installments of $23,097, including interest at a 5.0 percent annual rate, through October 2015, and the outstanding balance of each note was $80,000 at June 30, 2012.

Note 8. Property and Equipment

Property and equipment consisted of the following at June 30, 2012:

Land	$ 3,265,414
Building and improvements	78,904,872
Furniture, equipment and vehicles	5,630,276
Leasehold improvements	3,832,412
Construction in progress	7,230,551
	98,863,525
Less accumulated depreciation and amortization	23,139,029
	$ 75,724,496

The majority of property and equipment consists of HH rental properties, totaling $69,535,331 (net of accumulated depreciation) at June 30, 2012. Construction in progress consists primarily of $6,879,743 for building renovation costs incurred on the Viceroy LP development.

Depreciation and amortization expense on property and equipment was $4,184,878 for the year ended June 30, 2012.

Note 9. Debt Obligations

Notes payable, many of which are subject to certain requirements, including financial covenants, consisted of:

Heartland Alliance		
Note payable to the Ford Foundation for use by HH for the Roosevelt Square project; total available under the arrangement is $1,500,000, of which $500,000 was funded in June 2008 (subsequent fundings are subject to program performance). Annual interest is 1.00 percent and maturity is June 5, 2016.	$	500,000
Unsecured line of credit through Bank of America for general operations. Credit availability under the line is $3,000,000 and the related interest rate is either the Bank of America prime rate plus 1.00 percent or LIBOR plus 1.25 percent. A non-use fee of 0.20 percent is applicable. The line of credit expires on January 31, 2013.		507,375
HHCS		
Note payable to Citibank issued to refinance the 1620-24 W. Chase building. Payments are due in monthly installments of $10,867, including interest at 6.81 percent, maturing on November 26, 2016.		485,532
Non-interest bearing note payable to City of Chicago Department of Housing with principal due in 2036.		645,028
First mortgage loan payable to IFF (a nonprofit community development financial institution). Payments are due in monthly installments of $2,835, including interest of 4.17 percent. The loan matures in November 2019, when all unpaid principal and accrued interest becomes due.		216,704
Mortgage loan payable to IFF. Payments are due in monthly installments of $8,110, including interest of 6.00 percent, maturing on January 1, 2017.		386,242
Certain of the Agency's assets are pledged to secure these notes.		
HHO		
Five-year note payable to IFF with interest payable monthly at 5.00 percent and secured by certain property and equipment. The note payable matures on February 1, 2015.		315,982
HH		
Third mortgage loan payable to the City of Milwaukee. The proceeds come from the portion of federal stimulus Neighborhood Stabilization Program (NSP). Upon receipt of certain grant proceeds from the U.S. Department of Housing and Urban Development, HH is required to pay the capital portion of the proceeds ($400,000) as a mandatory prepayment of the NSP loan. The note will mature on August 19, 2030, at which time all remaining principal will become due. The note is secured by a mortgage on the property and an assignments of rents and leases.		441,188
Non-interest bearing note payable to Local Initiatives Support Corporation, due February 1, 2013. The proceeds from this loan were used for predevelopment expenses relating to a low income housing development project in Milwaukee, Wisconsin.		45,956
Note payable to Bank of America Community Development Corp. Interest payments are due monthly at a rate of 30-day LIBOR plus 2.25 percent and $1,800 of principal is paid monthly. Final payment is due May 31, 2015.		217,694

Note 9. Debt Obligations (Continued)

Argyle		
First mortgage loan payable to Community Investment Corporation, (a nonprofit mortgage lender) in the amount of $333,000, due in monthly installments of $2,120, including interest at 5.875 percent through January 1, 2030, at which time any unpaid principal and interest is due. The interest rate is adjusted every five years until the maturity date.	$	318,727
Non-interest bearing second mortgage loan payable to the City of Chicago Department of Housing in the amount of $2,162,013 due in monthly principal installments of $2,083 through June 14, 2033, at which time all principal comes due.		2,012,461
Non-interest bearing third mortgage loan payable to IHDA in the amount of $350,000, due in annual principal payments in the amount of $2,400 until June 14, 2033, at which time the remaining principal comes due.		326,483
Certain Argyle assets are pledged to secure the mortgage loans payable.		
Diversey		
First mortgage loan payable to U.S. Bank payable over 15 years in monthly installments of $7,578, including interest, through April 1, 2013, at which time the remaining principal and accrued interest come due. Payments on the loan, which bears interest (at 9.00 percent), are calculated on a 17 ½ year amortization schedule.		254,422
Junior mortgage loan payable to the City of Chicago Department of Housing. Interest accrues annually at 3.0 percent. The entire principal balance plus accrued interest is due on June 23, 2013 or upon repayment of the first mortgage, if earlier.		1,073,955
Non-interest bearing third mortgage loan payable to IHDA, due 2026.		494,483
Certain Diversey assets are pledged to secure the mortgage loans payable.		
Ellis		
Non-interest bearing first mortgage loan payable to the City of Chicago Department of Housing. Payable in monthly principal installments of $305 through 2036, at which time the remaining principal is due.		2,035,632
Non-interest bearing second mortgage loan payable to IHDA maturing in 2035, payable annually in amounts equivalent to 10 percent of annual surplus cash, as defined.		213,991
Certain Ellis assets are pledged to secure the mortgage loans payable.		
Mayfield LP		
Non-interest bearing mortgage note payable to IHDA in monthly installments of $500 through January 1, 2028, at which time the remaining unpaid balance is due. The note is collateralized by real estate held for lease and an assignment of rents and leases.		1,541,094

Note 9. Debt Obligations (Continued)

Hollywood LP		
First mortgage note insured by HUD is collateralized by a deed of trust on the rental property, and funded from proceeds of the City of Chicago Multi-Family Housing Revenue Bonds (Hollywood House Apartments), Series 2008A at a rate of 6.44 percent per annum. Monthly payments of principal and interest of $78,400 are due through December 2028. From January 2029 until August 2050, monthly payments of principal and interest are due in the amount of $32,627, at which time the remaining principal is due.	$	11,106,239
Mortgage note payable to the City of Chicago, Department of Finance. Principal and interest at 1.00 percent is due and payable in August 2050.		4,873,741
Mortgage note is held by IHDA, in the original amount of $1,250,000. The note is non-interest bearing. Principal payments are due annually, commencing after the 17-month construction period. Principal payments are equal to 9 percent of net cash, as defined in the loan agreement, and available surplus as defined by HUD. Any unpaid principal is due and payable on August 1, 2050.		1,250,000
Mortgage note is held by IHDA, in the original amount of $750,000. The note is non-interest bearing. Principal payments are due anually, commencing after the 17-month construction period. Principal payments are equal to 9 percent of net cash, as defined in the loan agreement, and available surplus as defined by HUD. Any unpaid principal is due and payable on August 1, 2050.		750,000
Certain Hollywood LP assets, namely real estate assignment of rents and leases, fixture filing, interest in building, and improvements thereof are pledged to secure the mortgage loans payable.		
Fond du Lac Apartments, LLC		
First construction loan payable to Citibank, N.A., in the original amount of $2,800,000. The note bears interest at an adjustable interest rate of one month LIBOR plus a 4.0 percent margin using a floor of 5.50 percent. Interest only payments are made through proceeds from the construction loan. The note matured and all remaining principal and interest due was paid in full on September 4, 2012.		2,349,840
Second mortgage loan payable to Wisconsin Housing Economic Development Authority Tax Credit Assistance Program (WHEDA TCAP), non-interest bearing. Commencing on the 16th anniversary of the mortgage loan date, principal is due based on 25 percent of the surplus cash flow for the previous 12 months. The note matures on August 19, 2030, at which time any remaining principal will become due.		1,700,000
Certain Fond du Lac Apartments, LLC assets, namely real estate assignment of rents and leases, fixture filing, interest in building, and improvements thereof are pledged to secure the construction and mortgage loans payable.		

Note 9. Debt Obligations (Continued)

North Avenue LP		
First mortgage loan payable to IHDA in the original amount of $2,300,000. The note is non-interest bearing. Monthly installments of principal only are due in the amount of $417. The note matures on May 1, 2023, at which time any remaining principal is due.	$	2,254,166
Second mortgage loan payable to Illinois Development Housing Authority in the original amount of $750,000. The note is non-interest bearing. Monthly installments of principal only are due in the amount of $100. The note matures on May 1, 2023, at which time any remaining principal is due.		738,800
Certain North Avenue LP assets, namely real estate assignment of rents and leases, fixture filing, interest in building, and improvements thereof are pledged to secure the mortgage loans payable.		
Leland LP		
First mortgage note payable to Bridgeview Bank Group in the original amount of $2,282,840. Monthly installments of $15,949 for principal and interest are due based on a 30-year amortization that began June 2006. The note matures May 2, 2026, at which time any remaining unpaid principal and interest is due.		2,094,945
Second mortgage note payable to the City of Chicago, Department of Housing in the original amount of $1,632,500. The note is interest free and matures on June 1, 2026, at which time the entire outstanding principal is due. The note is guaranteed by an affiliate of the general partner.		1,632,500
Third mortgage, non-interest bearing note payable to IHDA in the amount of $750,000. Commencing July 1, 2006, monthly installments of principal are payable in the amount of $100. The note matures on June 1, 2026, at which time the entire balance is due.		742,700
Fourth mortgage note payable to City of Chicago, LIHTF (low income housing trust fund) in the original amount of $700,000. The note bears no interest and matures on June 1, 2026 at which time the entire balance is due.		700,000
Certain Leland LP assets, namely real estate assignment of rents and leases, fixture filing, interest in building, and improvements thereof are pledged to secure the mortgage loans payable.		
Drexel LP		
First mortgage, non-interest bearing note payable to Chicago Housing Authority in the amount of $3,373,651, maturing on March 6, 2046, at which time the principal is due.		3,373,651
Second mortgage, non-interest bearing note payable to IHDA in the amount of $750,000. Monthly installments of principal only are due in the amount of $100. The loan matures on March 6, 2046, at which time the entire principal is due.		743,000
Third mortgage note payable to the City of Chicago, Department of Housing in the original amount of $558,188. The note bears interest at 5.36 percent per annum. The entire principal and accrued interest are payable at maturity, which is August 1, 2044.		588,188
Certain Drexel LP assets, namely real estate assignment of rents and leases, fixture filing, interest in building, and improvements thereof are pledged to secure the mortgage loans payable.		
	$	46,930,719

Note 9. Debt Obligations (Continued)

Future annual principal payments required under the above obligations are as follows:

2013	$	2,590,301
2014		733,055
2015		868,897
2016		715,538
2017		530,157
Thereafter		41,492,771
	$	46,930,719

Description of Series A Tax-Exempt Bonds

Included in long-term debt is $11,510,000 of Multi-Family Housing Revenue Bonds Series 2008A issued on December 18, 2008 and maturing serially from February 20, 2012 to August 20, 2050, backed by the full faith and credit of the United States of America through GNMA certificates. The bonds were issued pursuant to an ordinance adopted by the City of Chicago Council on September 10, 2008. The proceeds of the bonds were used to: (a) finance a portion of the costs of the acquisition, construction, rehabilitation and equipping of a multi-family mixed income rental development (Hollywood House), (b) establish a bond reserve and project fund in accordance with the trust agreement, and (c) pay costs incurred to issue the bonds. The coupon rates for the bonds range from 3.30 percent to 6.50 percent and interest is payable in February and August each year, starting August 2009. The bonds were discounted by $260,200 to the market interest rate when issued.

Certain bonds which total $7,260,000 are subject to mandatory redemption prior to maturity by lot at par. The bonds may be redeemed starting February 20, 2024 through August 20, 2050 through sinking fund installments. After December 2017, all bonds are optionally redeemable at 102 percent through December 2018, 101 percent from December 2018 to December 2019 and at par thereafter.

The proceeds of the bonds were used to purchase GNMA Securities from PNC Bank (the GNMA Issuer) which enabled the Bank to make the mortgage loan to HHLP. At June 30, 2012, the amount of the mortgage loan outstanding was $11,870,006 and the GNMA Securities purchased by the bond trustee were $11,870,006. These amounts are netted in long-term debt in the consolidated statement of financial position. The mortgage note bears interest at 6.44 percent and the GNMA Securities bear interest at 6.19 percent. Interest expense relating to the mortgage debt used to renovate and construct the building was capitalized during the construction period. Interest on the bonds is expensed net of the interest income relating to the Guaranteed Investment Contract (GIC) purchased with excess bond proceeds and the GNMA Securities.

The Bonds are secured by the GNMA Securities, the GIC investments and the TIF note in the current amount of $5,651,348, which is recorded as notes receivable on the Consolidated Statements of Financial Position (see Note 7). All payments scheduled to be made to PNC Bank under the Mortgage Note will be assigned to the bonds. No partner of HHLP has any personal liability with respect to the bonds.

Note 10. Operating Leases

The Agency occupies its headquarters under an amended lease agreement through 2017. The lease is a net lease which provides for monthly base rentals in amounts up to $24,000, plus the Agency's proportionate share of building expenses and real estate taxes. At June 30, 2012, a deferred rent liability of $226,668 represents the cumulative excess of rental expense recognized on a straight-line basis over the term of the lease and the actual cash outlay for base rentals.

Approximate future minimum rental payments at June 30, 2012 under the office and various other noncancelable leases are as follows:

2013	$ 3,513,000
2014	2,589,000
2015	1,690,000
2016	1,426,000
2017	1,254,000
Thereafter	2,301,000
	$ 12,773,000

Note 11. Changes in Consolidated Unrestricted Net Assets Attributable to Controlling Financial Interests and to Non-Controlling Interests

Changes in the Agency's controlling interests and the non-controlling interests attributable to its investments in consolidated limited partnerships and other entities are as follows:

	Total	Controlling Interest	Noncontrolling Interest
Balance, July 1, 2011, as previously reported	$ 49,684,744	$ 42,689,527	$ 6,995,217
Prior period adjustment	(953,190)	(3,900,189)	2,946,999
Balance, July 1, 2011, as restated	48,731,554	38,789,338	9,942,216
Change in net assets	793,701	3,904,833	(3,111,132)
Capital contributed by non-controlling interests	2,559,886	-	2,559,886
Balance, June 30, 2012	$ 52,085,141	$ 42,694,171	$ 9,390,970

Capital contributed by non-controlling interests represents member or limited partner cash investments received during fiscal year 2012 in certain real estate projects: Fond du Lac Apartments LLC, $303,847; and Viceroy Hotel Limited Partnership, $2,256,039. At June 30, 2012, an aggregate $16,510,760 is scheduled to be collected in the future from non-controlling interests, based on their unpaid capital commitments to the real estate projects.

Note 12. Temporarily Restricted Net Assets

Temporarily restricted net assets were available for the following purposes:

Care Coordinated Entity (CCE) Development	$	3,500
Chicago community oral health forum		61,803
Employment and economic advancement		176,037
GISHR		371,614
Heartland Center for System Change		45,000
IMPACT		500,889
International programs		1,937,612
Kovler Center		835,951
Mental health services		326,671
National Immigrant Justice Center		4,638,709
Primary health care services		311,266
Research and policy		650,923
Supportive housing and economic protection		525,585
Vital Bridges		9,500
Wellness and prevention		207,353
Youth Residential Services		1,378
Other		575,139
	$	11,178,930

Temporarily restricted net assets were released from restrictions for the following purposes:

Care Coordinated Entity (CCE) Development	$	241,500
Chicago community oral health forum		196,440
Employment and economic advancement		144,709
GISHR		288,386
Heartland Center for System Change		60,000
IMPACT		488,758
International programs		1,005,522
Mental health services		184,600
National Immigrant Justice Center		2,234,992
Primary health care services		47,237
Research and policy		481,983
Supportive housing and economic protection		327,485
Vital Bridges		111,865
Wellness and prevention		270,537
Youth Residential Services		48,622
Other		85,000
	$	6,217,636

Note 13. Acquisition of Vital Bridges NFP, Inc.

Pursuant to a June 22, 2011 agreement and plan of merger, Vital Bridges NFP, Inc., an Illinois not-for-profit corporation, merged with and into HHO effective July 1, 2011, principally for the purpose of establishing the "Vital Bridges Center on Chronic Care," operated as an unincorporated division of HHO (the separate existence of Vital Bridges ceased). Vital Bridges is an organization formed for the purpose of helping people impacted by HIV and AIDS to improve their health and build self-sufficiency by providing food, nutrition, housing, case management, and prevention services.

All assets and liabilities of Vital Bridges at the time of the merger were transferred to HHO and were recorded at their fair values, including estimated fair values for land and building based on appraisals. The excess of assets over liabilities of $1,547,118 is reflected on the Agency's consolidated statement of activities as a non-cash contribution revenue and results in an increase to unrestricted net assets. HHO provided no cash or equity consideration in the transaction.

The agreement and plan of merger includes various covenants, including one requiring HHO to provide the Vital Bridges services through fiscal year 2014.

Note 14. Employee 401(k) Plan

The Agency sponsors the Heartland Alliance 401(k) Plan, which is a defined contribution plan that provides retirement, disability or death benefits to eligible employees of the Agency. All money contributed to the 401(k) plan is held in a trust fund maintained by MG Trust, with a separate account maintained for each participant. Employees are eligible to participate in the 401(k) plan after completing six months of service with the Agency. The 401(k) plan is subject to the provisions of the Employee Retirement income Security Act of 1974 (ERISA), as amended.

The 401(k) plan is designed as a qualified cash deferral arrangement pursuant to the Internal Revenue Code and provides for both employee-directed and employer contributions. Employee-directed contributions are made by the Agency at the direction of the employee and deducted from the employee's direct compensation. The aggregate annual amount of each individual employee-directed contribution is limited to federal dollar limits. The Agency contributes a discretionary percentage of each participant's base compensation as specified in the 401(k) plan agreement. Participants must be 21 years of age and have one year of service to receive employer contributions. Participants are immediately vested in their employee-directed contributions and related earnings thereon. Employer contributions are vested 100 percent only after completion of three years of service. The Agency has the right to discontinue its contributions at any time and to terminate the 401(k) plan, subject to the provisions of ERISA. Agency discretionary contributions to the Plan for fiscal year 2012 totaled $742,792.

The Agency also maintains a deferred compensation plan for certain of its executives. Total expense relating to this plan in fiscal year 2012 was $41,000. The liability for deferred compensation at June 30, 2012 was $253,756.

Note 15. Transactions with Affiliates

The Agency has entered into an agreement with Heartland International Health Center (Health Center), an affiliated human services agency, to provide management and administrative services to the Health Center. These management and administrative services consist of fiscal management, accounting, human resources support, fund development, and insurance and facilities management. In addition, the Health Center's employees are eligible to participate in the Agency's 401(k) plan. The agreement with the Health Center is in effect through November 2013. Revenue recognized by the Agency under this agreement amounted to $526,373 for the year ended June 30, 2012.

The Health Center has also entered into an agreement with HHO which provides clinical management and administrative services to the Health Center. Although the agreement with HHO is in effect through November 2013, there are very little clinical or administrative services occurring between the two entities as the Health Center has moved towards providing its own staffing solution to its patients in recent years. The Health Center shares one clinical provider with HHO; the value of that service to the Health Center, paid to HHO, was $101,533 during fiscal year 2012.

As of June 30, 2012, the Health Center owed the Agency $69,645.

Note 15. Transactions with Affiliates (Continued)

During fiscal 2008, the Health Center and the Agency entered into an agreement that resulted in a reassessment of previous years' management and general expense charges and a forgiveness of certain other management and general expense charges. At the time of the agreement, $279,357 owed to the Agency by the Heath Center was converted into an unsecured promissory note. The note is payable in monthly installments of $4,931, including interest at a rate of 2.28 percent. The note is due in June 2013. At June 30, 2012, the outstanding balance on the note was $58,080. The agreement also includes a provision whereby $140,000 of the original amount owed will be reduced by $28,000 per year, over a five-year period, provided all management, general and administrative payments are made on time. The balance on this amount is $28,000 at June 30, 2012 and is included in notes receivable on the consolidated statement of financial position.

Note 16. Contingencies

In April 2010, HHCS negotiated and signed a fee for service contract with the State of Illinois, and the Illinois Department of Human Services (IDHS) to provide trainee workers with temporary employment during the contract period (April 2010 through September 2010). HHCS successfully employed approximately 27,000 workers during the contract period. The contract stipulated a fee-for-service arrangement and was billed by HHCS and paid by IDHS accordingly. Subsequently, IDHS asserted that, pursuant to the terms of an underlying federal grant, all fees paid by IDHS to HHCS under this contract are required to be matched to actual costs, the fee-for-service terms notwithstanding. HHCS has been cooperating with IDHS in this regard. Net revenues earned as a result of the fee-for-service contract was $10,800,000 and was available for tail costs and other administrative and related program costs.

The Agency does not believe that HHCS has a liability or obligation to return to IDHS any net revenues earned under the IDHS contract. State and federal grants received by the Agency, including the IDHS contract, are subject to audit, and the Agency could become liable for any expenditure or earned amount disallowed upon audit. Management believes, however, that such disallowance, if any, would not be material to the financial statements.

From time to time, the Agency is subject to claims that arise in the ordinary course of conducting its activities. In management’s opinion, the resolution of these matters would not have a material effect on the financial position of the Agency.

Note 17. Subsequent Events

The Agency has evaluated subsequent events through January 17, 2013, the date on which the financial statements were available to be issued.

In fiscal 2013, the Agency formed a new entity called Heartland Alliance International (HAI), a single member limited liability company, to conduct business under some of the existing international contracts previously performed under the contractual obligations of the Agency. HAI was funded by transferring assets held by Heartland Alliance to HAI in connection with the execution of the above referenced contracts.

HHO has partnered with more than 30 Chicago-area service providers, hospitals, other health care organizations and social service providers to form a new entity called Together4Health, LLC (T4H). T4H was formed as a result of a pilot program administered by the Illinois Department of Healthcare and Family Services (IDHFS) to coordinate a new system to improve the health and well-being of Chicago seniors and adults with disabilities on Medicaid. HHO was selected to be the managing member of the new organization and is expected to be the majority member of T4H because of its initial investment already contributed towards the formation of T4H.

The Agency has signed a new 15-year lease for its Chicago office space with its current landlord. Build-out of the new office space is expected to occur in fiscal 2013. Funding for the build-out will be made in part with a tenant allowance from the landlord and a new term loan from Bank of America. As of January 17, 2013, $1,300,000 has been borrowed under the term loan.

Note 18. Prior Period Adjustments

Developer fee: Prior to fiscal year 2012, HH had collected $3,356,485 in fees from the consolidated project partnerships, for the development of apartment rental units. These fees had been recorded as (a) income by HH as they were collected and (b) as depreciable rental property assets by the project partnerships. In fiscal year 2012, the Agency determined that these transactions should have been eliminated in the consolidation of HH and the project partnerships. Accordingly, a prior period adjustment of $2,352,457 was recorded in fiscal year 2012 to eliminate the non-depreciated portion of the fees previously recognized as consolidated income. The remaining non-depreciated portion of the fees at June 30, 2012 is $2,522,395

Consolidating entities: HH holds controlling interests in Drexel LP, Leland LP, and North Avenue LP. In fiscal 2012, the Agency determined that these limited partnerships should have been consolidated within the Agency's financial statements in past years.

Roosevelt Square II: As described in Note 6, in fiscal year 2012 the Agency determined that no interest should have been accrued on the note receivable due to uncertainty about its collectability.

The correction of the accounting for this transaction will have a negative non-cash impact on the results of the Agency going forward since no accrued interest income will be recorded.

The note principal sum of $6,068,116 has been reclassified as a residual interest asset.

A summary of the July 1, 2011 statement of financial position balances impacted by these adjustments for:
(1) developer fees to be eliminated; (2) consolidation of controlled project partnerships; and (3) land leasehold note and accrued interest, is as follows:

	Amount as Previously Reported	Prior Period Adjustments			Amount as Restated
	June 30, 2011	(1)	(2)	(3)	July 1, 2011
Assets					
Cash	$ 9,061,980	$ -	$ 34,921	$ -	$ 9,096,901
Accounts receivable other	1,127,252	-	221,469	-	1,348,721
Escrow and reserve accounts	4,336,275	-	1,187,555	-	5,523,830
Investment in limited partnerships	693,504	-	(637,956)	-	55,548
Notes receivable	8,441,357	-	-	(7,375,779)	1,065,578
Receivables due from limited partnership	12,459,851	-	(1,582,510)	-	10,877,341
Property and equipment, net	48,004,702	-	20,473,736	-	68,478,438
Deferred financing fees	892,805	-	282,979	-	1,175,784
Residual interest	-	-	-	6,068,116	6,068,116
Liabilities and Net Assets					
Accounts payable and accrued expenses	8,602,582	-	841,207	240,069	9,683,858
Deferred revenue	6,168,561	2,352,457	4,736	-	8,525,754
Debt obligations	14,771,143	-	16,187,252	-	30,958,395
Net assets-undesignated and controlling interests	41,476,948	(2,352,457)	-	(1,547,732)	37,576,759
Net assets-non-controlling interests	6,995,217	-	2,946,999	-	9,942,216

Heartland Alliance for Human Needs & Human Rights

Single Audit Act
Supplementary Financial and Compliance Report
June 30, 2012

Contents

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*

To the Board of Directors
Heartland Alliance for Human Needs & Human Rights
Chicago, Illinois

We have audited the consolidated financial statements of Heartland Alliance for Human Needs & Human Rights (the Agency) as of and for the year ended June 30, 2012, and have issued our report thereon dated January 17, 2013. 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.

<u>Internal Control Over Financial Reporting</u>

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

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. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item FS 12-01 to be a material weakness.

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. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item FS 12-02 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency'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 that are required to be reported under *Government Auditing Standards*. However, the results of our tests disclosed an other matter which is required to be reported under *Government Auditing Statements* and which is described in the accompanying schedule of findings and questioned costs as item FS 12-03.

We noted certain matters that we reported to management of the Agency in a separate letter dated January 17, 2013.

The Agency's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Agency's response and, accordingly, we express no opinion on it.

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

McGladrey LLP

Chicago, Illinois
January 17, 2013

McGladrey

Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

To the Board of Directors
Heartland Alliance for Human Needs & Human Rights
Chicago, Illinois

Compliance

We have audited the compliance of Heartland Alliance for Human Needs & Human Rights (the Agency) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133*, Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. The Agency's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency's compliance based on our audit.

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

As described in item SA 12-01 in the accompanying schedule of findings and questioned costs, the Agency did not comply with requirements regarding activities allowed or unallowed, allowable costs/cost principles, cash management, equipment and real property management, period of availability of federal funds, and reporting that are applicable to its Unaccompanied Alien Children program. Compliance with such requirements is necessary, in our opinion, for the Agency to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Agency complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. The results of our auditing procedures also disclosed another instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item SA 12-02.

Internal Control over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item SA 12-01 to be a material weakness.

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. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item SA 12-02 to be a significant deficiency.

Schedule of Expenditures of Federal Awards

We have audited the consolidated financial statements of Heartland Alliance for Human Rights & Human Needs as of June 30, 2012, and have issued our report thereon dated January 17, 2013, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic 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 audits 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.

The Agency's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Agency's response and, accordingly, we express no opinion on it.

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

McGladrey LLP

Chicago, Illinois
January 17, 2013

Heartland Alliance for Human Needs & Human Rights

Schedule of Expenditures of Federal Awards
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Federal Project or Pass-Through Grantor's Number	Total Expenditures	Expenditures by Entity: Heartland Alliance	Heartland Human Care Services	Heartland Health Outreach	Heartland Housing
CDBG Entitlement Grants Cluster							
U.S. Department of Housing and Urban Development							
Community Development Block Grants/Entitlement Grants							
HHCS - Pass through Chicago Department of Family and Support Services							
Youth Services Counseling	14.218	25601-2	$ 14,559	$ -	$ 14,559	$ -	$ -
Youth Services Counseling	14.218	23175-3	28,366	-	28,366	-	-
Seniors in Crisis	14.218	23175-1 / 25564-3	14,704	-	14,704	-	-
Psych Youth Services	14.218	23175-2 / 25601-1	37,136	-	37,136	-	-
Parent Skills Training	14.218	25340-1 / 23643-1	24,611	-	24,611	-	-
Survivors Domestic Violence	14.218	23175-4 / 25564-1	29,396	-	29,396	-	-
HHCS - Pass-through City of Chicago Department of Public Health							
HIV - Aids Housing	14.218	25356	22,483	-	22,483	-	-
HHO - Pass-through Cook County							
Food & Nutrition	14.218	10-102/11-096	24,618	-	-	24,618	-
HHO - Pass-through Village of Oak Park							
Food Services	14.218	B11/24 / B12-04	6,690	-	-	6,690	-
ARRA - Community Development Block Grant ARRA Entitlement Grants (CDBG-R)							
HHCS - Pass-through City of Chicago Department of Environment							
Community Green Jobs	14.253	22285	122,557	-	122,557	-	-
Total Community Development Block Grants Cluster			325,120	-	293,812	31,308	-
Health Centers Cluster							
U.S. Department of Health and Human Services							
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)							
HHO - Health Care for the Homeless/McKinney	93.224	H80CS00111C0	4,140,709	-	-	4,140,709	-
Affordable Care Act (ACA) Grants for New and Expanded Services Under the Health Centers Program							
HHO - Health Care for the Homeless - Person Centered Medical Home Development	93.527	H80CS00111C0	35,000	-	-	35,000	-
HHO - Health Care for the Homeless/McKinney	93.527	H80CS00111C0	202,236	-	-	202,236	-
Total Health Centers Cluster			4,377,945	-	-	4,377,945	-

Heartland Alliance for Human Needs & Human Rights

Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Federal Project or Pass-Through Grantor's Number	Total Expenditures	Expenditures by Entity: Heartland Alliance	Heartland Human Care Services	Heartland Health Outreach	Heartland Housing
Other Programs							
U.S. Department of Agriculture							
HHCS - Passed-through Illinois State Board of Education							
Illinois Free, Food Donation	10.550	64-108-8430-53	$ 236,620	$ -	$ 236,620	$ -	$ -
			236,620	-	236,620	-	-
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program							
HHCS - Passed-through Illinois State Board of Education							
Food Stamp, Employment, and Training	10.561	81XQ943FP1	70,602	-	70,602	-	-
			70,602	-	70,602	-	-
Total U.S. Department of Agriculture			307,222	-	307,222	-	-
U.S. Department of Housing and Urban Development							
Emergency Solutions Grant Program							
HHO - Pass-through Cook County							
Emergency Shelter Grants Program	14.231	E10-19 / E11-20	5,883	-	-	5,883	-
HHO - Pass-through Village of Oak Park							
Emergency Shelter Grants Program	14.231	S10-08 / E11-02	10,413	-	-	10,413	-
			16,296	-	-	16,296	-
Supportive Housing Program							
HHCS - Supportive Housing Program I	14.235	IL0174B5T101003	575,988	-	575,988	-	-
HHCS - Supportive Housing Program II	14.235	IL0173B5T101003	342,099	-	342,099	-	-
HHCS - Transitional Housing II	14.235	IL0209B5T101003	1,515,966	-	1,515,966	-	-
HHCS - Families Building Community Expansion	14.235	IL0119B5T101003	1,162,457	-	1,162,457	-	-
HHO - REN - Antonia Safe Haven	14.235	IL0096B5T101003 / IL0096B5T101104	329,515	-	-	329,515	-
HHO - REN - Pathways Home Outpatient	14.235	IL0178B5T101003 / IL0178B5T101104	346,804	-	-	346,804	-
HHO - REN - Pathways Home Safe Haven	14.235	IL0180B5T101003 / IL0180B5T101104	964,076	-	-	964,076	-
HHO - REN - Pathways Home Permanent Housing	14.235	IL0179B5T101003 / IL0179B5T101104	417,093	-	-	417,093	-
HHCS - Neon Dorms - Supportive Housing	14.235	IL0167B5T101003	233,352	-	233,352	-	-
HHCS - ISH - Medicaid SHP Project	14.235		25,007	-	25,007	-	-
HHO - REN - Bridges to Home	14.235	IL0099B5T101003 / IL0099B5T101104	134,070	-	-	134,070	-
HHO - REN - Supportive Permanent Housing	14.235	IL0216B5T101003 / IL0216B5T101104	263,012	-	-	263,012	-
HHO - REN - Assisted Permanent Housing	14.235	IL0097B5T101003 / IL0097B5T101104	115,054	-	-	115,054	-
HHO - REN - Low Income Housing Trust Fund Chronic Homeless Initiative	14.235	IL0393B5T101002 / IL0393B5T101103	89,524	-	-	89,524	-
HH - Heartland Housing - HUD Grant	14.235		10,417	-	-	-	10,417
HHCS- Pass-through AIDS Foundation - Chicago							
CHHP Homeless Services	14.235		307,830	-	307,830	-	-
Samaritan Bonus Project	14.235		131,361	-	131,361	-	-
HHO - Pass-through AIDS Foundation - Chicago							
Medicaid Supported Housing Pilot	14.235	IL0460B5T101000	43,568	-	-	43,568	-
HH - Pass-through Department of Commerce and Economic Opportunity							
HH - DCEO Grant	14.235		182,157	-	-	-	182,157

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Other Programs (Continued)							
U.S. Department of Housing and Urban Development (Continued)							
Supportive Housing Program (Continued)							
HH - Pass-through City of Milwaukee Housing Authority							
HH - 1218 West Highland Ave, LLC - Section 8	14.235		$ 59,008	$ -	$ -	$ -	$ 59,008
HH - Pass-through Milwaukee County Housing							
HH - Fond du Lac Apartments, LLC - Section 8	14.235		82,417	-	-	-	82,417
HHO - Pass-through Pillars							
REN - West Cook Housing Initicative	14.235	IL0264B5T111003 / IL0264B5T111104	52,082	-	-	52,082	-
REN - West Cook Housing Action Network Choice Endeavors	14.235	IL0427B5T110900	11,245	-	-	11,245	-
HH - Pass-through Chicago Housing Authority							
Argyle Neighborhood Development Corp. - Rental Assistance	14.235		165,226	-	-	-	165,226
Ellis Neighborhood Development Corp. - Rental Assistance	14.235		308,573	-	-	-	308,573
Hollywood House - LLP - Rental Assistance	14.235		521,732	-	-	-	521,732
Mayfield LP - Section 8 - Housing Assistance Program	14.235		196,907	-	-	-	196,907
Drexel Jazz LP	14.235		9,336	-	-	-	9,336
North Ave LLP - Rental Assistance	14.235		231,120	-	-	-	231,120
Leland Limited Partnership - Rental Assistance	14.235		259,678	-	-	-	259,678
HH - Pass-through Illinois Housing Development Authority							
Diversy Neighborhood Corp. - Section 8 Housing	14.235		192,619	-	-	-	192,619
			9,279,293	-	4,294,060	2,766,043	2,219,190
Shelter Plus Care							
HHCS - Pass through Chicago Department of Family and Support Services							
Prevention Information	14.238	18850-5 & 8	64,462	-	64,462	-	-
Shelter Plus Care III	14.238	24431	602,277	-	602,277	-	-
Family Shelter Plus Care	14.238	24430	93,319	-	93,319	-	
HHO - Pass through Chicago Department of Family and Support Services							
Shelter Plus Care II	14.238	PO 24429-1	145,017	-	-	145,017	-
Northside Shelter Plus Care	14.238	PO 24428-1	161,765	-	-	161,765	-
HHO - Pass-through Cook County							
Shelter Plus Care - Permanent Housing	14.238	IL0270C5T111003	144,802	-	-	144,802	-
HH - Pass-through City of Milwaukee Housing Authority							
HH - 1218 West Highland Ave, LLC - Shelter Plus Care	14.238		26,400	-	-	-	26,400
HH - Pass-through Milwaukee County Housing							
HH - Fond du Lac Apartments, LLC - Shelter Plus Care	14.238		68,200	-	-	-	68,200
			1,306,242	-	760,058	451,584	94,600
Housing Opportunities for Persons with AIDS							
HHCS - First Step	14.241	ILH080022	223,500	-	223,500	-	-
HHCS - Pass-through City of Chicago Department of Public Health							
TLC - HOPWA	14.241	21227-2 & 3	324,323	-	324,323	-	-
Housing - Epoch	14.241	21228-2 & 3	112,061	-	112,061	-	-
HHCS - Pass-through AIDS Foundation - Chicago							
HOPWA Track 1 Housing Assistance	14.241		128,447	-	128,447	-	-
CHHP	14.241		62,789	-	62,789	-	-
HHCS - Domestic Violence Homeless Project	14.241	IL0233B5T101003	42,470	-	42,470	-	-
HHO - Pass-through City of Chicago Department of Public Health							
Transitional Housing Opportunities - HOPWA	14.241	PO 21072 - 3/4	326,200	-	-	326,200	-
HHO - Pass-through AIDS Foundation - Chicago							
Housing Advocacy Services - HOPWA	14.241	21097	142,579	-	-	142,579	-
CHHP-SPNS - Housing & Support Services	14.241	8458	95,723	-	-	95,723	-
CHHP-SPNS - Housing & Support Services	14.241	8459	8,546	-	-	8,546	-
HHCS - Pass-through Chicago House							
Prevention with Positive Patterns	14.241		3,000	-	3,000	-	-
			1,469,638	-	896,590	573,048	-

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Other Programs (Continued)							
U.S. Department of Housing and Urban Development (Continued)							
ARRA - Homelessness Prevention and Rapid Re-Housing Program							
HHCS - Pass through Chicago Department of Family and Support Services							
Homeless Prevention & Rapid Re-Housing	14.257	20324-3 & 5	$ 713,044	$ -	$ 713,044	$ -	$ -
Housing Locator and Inspection Program	14.257	20324-4 & 6	311,017	-	311,017	-	-
			1,024,061	-	1,024,061	-	-
Public and Indian Housing							
HHCS - Pass-through Chicago Housing Authority							
Family Works	14.850	9122	2,945,248	-	2,945,248	-	-
Family Works - Clinical Outreach	14.850	9122	727,176	-	727,176	-	-
Family Works	14.850	9122	277,856	-	277,856	-	-
			3,950,280	-	3,950,280	-	-
Resident Opportunity and Supportive Services - Service Coordinators							
HHCS - Pass-through Chicago Housing Authority							
Transitional Jobs	14.870	9037	302,731	-	302,731	-	-
HHCS - Pass-through HH							
HH - Ross Service Coordinator	14.870		10,515	-	-	-	10,515
			313,246	-	302,731	-	10,515
Section 8 Housing Choice Vouchers							
HHCS - Pass-through Chicago Housing Authority							
ABLA Case Management	14.871	663	383,722	-	383,722	-	-
			383,722	-	383,722	-	-
Total U.S. Department of Housing and Urban Development			17,742,778	-	11,611,502	3,806,971	2,324,305
U.S. Department of Justice							
Services to Advocate for and Respond to Youth							
HHCS - VRS Youth Services	16.018	2010-WY-AX-K026	104,250	-	104,250	-	-
			104,250	-	104,250	-	-
Services for Trafficking Victims							
HA - U.S. Dept. of Justice Office of Justice Programs (OJP)	16.320	2003-VT-BX-K003	153,093	153,093	-	-	-
			153,093	153,093	-	-	-
Second Chance Act Prisoner Reentry Initiative							
HHCS - Second Chance Mentoring	16.812	2009-JU-FX-0059	214,252	-	214,252	-	-
			214,252	-	214,252	-	-
Total U.S. Department of Justice			471,595	153,093	318,502	-	-

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Other Programs (Continued)							
U.S. Department of Labor							
WIA Adult Program							
HHCS - Pass-through Michigan Works							
Get Set	17.258	0701-05100	$ 457,564	$ -	$ 457,564	$ -	$ -
HHCS - Pass - through Cook County Works							
Cook County Works	17.258	GJ-20024-10-60-A-25	58,353	-	58,353	-	-
			515,917	-	515,917	-	-
ARRA - Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors							
HHCS - Pass - through Jobs for the Future							
Pathways Out of Poverty	17.275	GJ-20024-10-60-A-25	246,119	-	246,119	-	-
			246,119	-	246,119	-	-
Total U.S. Department of Labor			762,036	-	762,036	-	-
U.S. Department of State							
International Programs to Combat Human Trafficking							
HA - Protecting Iraqi Victims of Trafficking through Direct Service, Documentation and Legislative Advocacy	19.019	S-SGTIP-09-GR-0095	245,134	245,134	-	-	-
HA - Great Lakes Regional Anti-Trafficking Partnership (GRAAP)	19.019	S-SGTIP-09-GR-0115	343,176	343,176	-	-	-
HA - Child Protection and trafficking Prevention	19.019	S-SGTIP-10-GR-0037	69,842	69,842	-	-	-
HA - Haiti - CREATE - G/TIP	19.019	S-SGTIP-11-GR-0004	186,197	186,197	-	-	-
			844,349	844,349	-	-	-
International Programs to Support Democracy, Human Rights, and Labor							
HA - Enhancing Livelihood Opportunities for Former Child Soldiers in Sri Lanka	19.345	S-LMAQM-09-GR-573	181,793	181,793	-	-	-
HA - Iraq Radio and New Media Production in Support of Ethnic and Secterian Tolerance	19.345	S-LMAQM-10-GR-507	416,530	416,530	-	-	-
HA - Global LGBT Human Rights Defenders Fund	19.345	S-LMAQM-10-GR-568	192,603	192,603	-	-	-
HA - Advancing Human Rights Protections for Victims of Violence	19.345	S-LMAQM-10-GR-643	320,803	320,803	-	-	-
HA - RITEWORK	19.345	S-LMAQM-11-GR-1076	186,094	186,094	-	-	-
			1,297,823	1,297,823	-	-	-
Overseas Refugee Assistance Program for Near East and South Asia							
HA - Iraq - Gender Based Violence (GIWI)	19.519	S-LMAQM-08-GR-548	12,551	12,551	-	-	-
HA - Iraq - Institutionalized Persons - DRL	19.519	S-LMAQM-08-GR-564	439,115	439,115	-	-	-
HA - Iraq - Protection for Torture Survivors & Children in the Criminal Justice System	19.519	S-LMAQM-08-GR-637	83,317	83,317	-	-	-
HA - ATG Combat Human Trafficking	19.519	S-SGTIP-09-GR-0044	1,907	1,907	-	-	-
HA - Lebanon - Protection/MHS for High Risk Refugees	19.519	SPRMC010CA131	381,138	381,138	-	-	-
			918,028	918,028	-	-	-
U.S. Refugee Admissions Program							
HHCS - Pass-through United States Committee on Refugees & Immigration							
Reception and Placement	19.510		269,616	-	269,616	-	-
			269,616	-	269,616	-	-
Total U.S. Department of State			3,329,816	3,060,200	269,616	-	-

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Other Programs (Continued)							
U.S. Department of Education							
Adult Education - Basic Grants to States							
HHCS - Pass-through Illinois Community College Board							
Adult Education & Family Literacy Basic	84.002	508AS	$ 115,081	$ -	$ 115,081	$ -	$ -
HHCS - Pass-through Workforce Investment Act	84.002		71,355	-	71,355	-	-
			186,436	-	186,436	-	-
Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)							
HHCS - Pass - through Northeastern Illinois University	84.334	P334A100031	8,750	-	8,750	-	-
			8,750	-	8,750	-	-
Total U.S. Department of Education			195,186	-	195,186	-	-
U.S. Department of Health and Human Services							
Global AIDS							
HA - Dominican Republic MSM HIV Intervention and Prevention	93.067	1U2GPS003001-01	370,777	370,777	-	-	-
HA - Impact CI-Improving Prevention and Access to Care Cote d'Ivoire	93.067	1U2GPS002833-01	1,408,776	1,408,776	-	-	-
HA - DR Integrated MSM HIV Intervention and Prevention Program	93.067	3U2GPS003001-02W1	21,258	21,258	-	-	-
			1,800,811	1,800,811	-	-	-
Project Grants and Cooperative Agreements for Tuberculosis Control Programs							
HHO - Pass-through Chicago Department of Public Health							
Homeless TB Program	93.116	PO 19946	68,577	-	-	68,577	-
			68,577	-	-	68,577	-
AIDS Education and Training Centers							
HHO - Pass-through UIC - Board of Trustees							
Midwest AIDS Training & Education Center - MATEC	93.145	E45302 490050	23,000	-	-	23,000	-
HHO - Ryan White Part C Ask-Screen-Intervene (93.145)	93.145	6 H76HA00113-20-03	86,410	-	-	86,410	-
			109,410	-	-	109,410	-
Projects for Assistance in Transition from Homelessness (PATH)							
HHO - Pass-through Illinois Department of Human Services - DMH							
Southside Linkage Project - PATH	93.150	45CQ601113	87,029	-	-	87,029	-
			87,029	-	-	87,029	-
Coordinated Services and Access to Research for Women, Infants, Children, and Youth							
HHO - Pass-through Access Community Health Network							
Nutritional Assessments	93.153	H12HA23013	7,106	-	-	7,106	-
			7,106	-	-	7,106	-

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Other Programs (Continued)							
U.S. Department of Health and Human Services (Continued)							
National Research Service Awards - Health Services Research Training							
HHO - Pass-through Northwestern University							
NU Center for Advancing Equity in Clinical Preventive Services	93.226	60030159 HHO	$ 12,286	$ -	$ -	$ 12,286	$ -
			12,286	-	-	12,286	-
Mental Health Research Grants							
HHO - Pass-through Illinois Institute of Technology							
Adherence & Empowerment: Service Participation & Meaniful Outcomes	93.242	1P20MH085981-01 / SA421-0301-6157	32,968	-	-	32,968	-
			32,968	-	-	32,968	-
Substance Abuse and Mental Health Services - Projects of Regional and National Significance							
HHCS - Pass-through AIDS Foundation of Chicago							
Access to Wellness	93.243		21,701	-	21,701	-	-
HHO - Pass-through AIDS Foundation - Chicago							
SAMHSA - CSAT Healthy Connections Contract	93.243	1H79TI021710-02-03	142,655	-	-	142,655	-
SAMHSA - Access to Wellness Program	93.243	1UD1T1023567-01	47,299	-	-	47,299	-
HHO - SAMHSA - National Child Traumatic Stress Network	93.243	5U79SM059457-02 & 03	445,336	-	-	445,336	-
HHO -SAMHSA - Earmarks	93.243	1H79SM059992-01	129,569	-	-	129,569	-
			786,560	-	21,701	764,859	-
ARRA - Community Health Applied Research Network							
HHO - Pass-through Alliance of Chicago Community Health Centers							
Community Health Applied Research Network	93.420	1UB2HA20234	36,666	-	-	36,666	-
			36,666	-	-	36,666	-
Centers for Disease Control and Prevention - Affordable Care Act (ACA) - Communities Putting Prevention to Work							
HHCS - Pass-through Children's Memorial Hospital							
Healthy Places - Consortium to Lower Obesity in Chi Children	93.520		59,832	-	59,832	-	-
			59,832	-	59,832	-	-
Temporary Assistance for Needy Families							
HA - Pass-through Jewish Federation - Chicago							
RICI	93.558		73,970	73,970	-	-	-
HHCS - Pass-through Illinois Department of Human Services							
IDHS TANF Job Placement	93.558	81XQ943000	84,585	-	84,585	-	-
			158,555	73,970	84,585	-	-

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Other Programs (Continued)							
U.S. Department of Health and Human Services (Continued)							
Refugee and Entrant Assistance - State Administered Programs							
HHCS - Pass-through Jewish Federation of Metropolitan Chicago							
Medical Case Management	93.566		$ 81,896	$ -	$ 81,896	$ -	$ -
RSS Early Employment	93.566		69,677	-	69,677	-	-
RSS Cultural Adjustment	93.566		99,070	-	99,070	-	-
HHO - Pass-through Jewish Federation of Metropolitan Chicago							
Refugee Mental Health Services	93.566	81XQ36100	208,219	-	-	208,219	-
HHO - Pass-through Illinois Department of Public Health							
Refugee Health Program	93.566	20180046	215,609	-	-	215,609	-
			674,471	-	250,643	423,828	-
Refugee and Entrant Assistance - Voluntary Agency Programs							
HHCS - Pass-through United States Committee on Refugee and Immigration							
Reception & Placement Matching Grant	93.567	90RV005901	164,137	-	164,137	-	-
			164,137	-	164,137	-	-
Community Services Block Grant							
HHO - Pass-through AIDS Foundation - Chicago							
ARRA - CDBG - 100K Homes Outreach	93.569	23776	35,516	-	-	35,516	-
HHCS - Pass-through Chicago Department of Family and Support Services							
Family Violence Prevention Initiative	93.569		13,969	-	13,969	-	-
Family Violence Prevention Initiative	93.569		18,865	-	18,865	-	-
			68,350	-	32,834	35,516	-
Refugee and Entrant Assistance - Discretionary Grants							
HHCS - Pass-through Jewish Federation of Metropolitan Chicago							
RSS Senior Services	93.576		40,558	-	40,558	-	-
RSS K-12 Services	93.576		71,129	-	71,129	-	-
HHCS - Pass-through Illinois Department of Human Services							
Vocational English Hospitality Training	93.576	81XQ364000	71,211	-	71,211	-	-
HHO - Pass-through Illinois Department of Public Health							
Refugee Nutrition	93.576	20180046	45,000	-	-	45,000	-
HHO - Pass-through Coalition of Limited English Speaking Elderly							
Refugee Agricultural Partnership Program	93.576	90ZR0024	37,271	-	-	37,271	-
HA -LGBT Refugees and Asylees	93.576	90XR0017/01	231,783	231,783	-	-	-
			496,952	231,783	182,898	82,271	-

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Other Programs (Continued)							
U.S. Department of Health and Human Service (Continued)							
Refugee and Entrant Assistance - Targeted Assistance Grants							
HHCS - Pass-through Jewish Federation of Metropolitan Chicago							
TAG Mandatory	93.584		$ 109,590	$ -	$ 109,590	$ -	$ -
			109,590	-	109,590	-	-
Services to Victims of a Severe Form of Trafficking							
HHCS - ORR - Northern Tier Anti-Trafficking Consortium	93.598		367,518	-	367,518	-	-
HHCS - ORR - Northern Tier Anti-Trafficking Consortium (Client Support)	93.598		111,403	-	111,403	-	-
			478,921	-	478,921	-	-
Assistance for Torture Victims							
HA - Services for Survivors of Torture	93.604	90ZT0088	418,086	418,086	-	-	-
			418,086	418,086	-	-	-
Social Services Block Grant							
HHCS - Pass-through Illinois Department of Human Services							
Employment Based English Program	93.667	81XQ085000	58,752	-	58,752	-	-
			58,752	-	58,752	-	-
Unaccompanied Alien Children Program							
HHCS -ORR - Unaccompanied Alien Children / Tender Age	93.676	90ZU0047	11,207,039	-	11,207,039	-	-
HA - Pass-through The VERA Institute of Justice							
VERA	93.676		267,530	267,530	-	-	-
			11,474,569	267,530	11,207,039	-	-
ARRA - Grants to Health Centers Programs							
HHO - ARRA - Capital Improvement Program	93.703	C81CS13539-01-03	117,995	-	-	117,995	-
			117,995	-	-	117,995	-
ARRA - Prevention and Wellness - Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)							
HHCS - Pass-through Respiratory Health Association of Metro Chicago							
Tobacco Cessation	93.724		38,293	-	38,293	-	-
			38,293	-	38,293	-	-
Medical Library Assistance							
HHO - Pass-through UIC - National Library of Medicine							
Medical Library Assistance	93.879	HHSN276201100005C	13,287	-	-	13,287	-
			13,287	-	-	13,287	-

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Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Federal Project or Pass-Through Grantor's Number	Total Expenditures	Expenditures by Entity: Heartland Alliance	Heartland Human Care Services	Heartland Health Outreach	Heartland Housing
Other Programs (Continued)							
U.S. Department of Health and Human Services (Continued)							
HIV Emergency Relief Project Grants							
HHCS - Pass-through AIDS Foundation of Chicago							
ORS Case Management	93.914		$ 38,113	$ -	$ 38,113	$ -	$ -
Title I Ryan White Case Management	93.914		65,781	-	65,781	-	-
HHO - Pass-through Chicago Department of Public Health							
HIV/Aids Ryan White - Part A - Case Management	93.914	PO 23776	122,544	-	-	122,544	-
HIV/Aids Ryan White - Part A - Food	93.914	PO 23762-1/2	1,066,573	-	-	1,066,573	-
HIV/Aids Ryan White - Part A - Ambulatory	93.914	PO 23792-1/2	158,923	-	-	158,923	-
HIV/Aids Ryan White - Part A - Oral	93.914	PO 23792-1/2	354,995	-	-	354,995	-
HIV/Aids Ryan White - Part A - Admin	93.914	PO 23792-1/2	51,488	-	-	51,488	-
			1,858,417	-	103,894	1,754,523	-
HIV Care Formula Grants							
HHCS - Pass-through AIDS Foundation of Chicago							
Title II Ryan White Case Management	93.917		65,099	-	65,099	-	-
HHO - Pass-through AIDS Foundation - Chicago							
Ryan White - Part B	93.917	25780055	223,932	-	-	223,932	-
			289,031	-	65,099	223,932	-
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease							
HHO - Pass-through Access Community Health Network							
Ryan White Part C EIS	93.918	H12HA23013	13,732	-	-	13,732	-
HHO - Pass-through Erie Family Health Centers							
HIV Early Intervention with Respect to HIV Disease	93.918		2,047	-	-	2,047	-
HHO - Ryan White Part C Outpatient EIS Program	93.918	4 H76HA00113-20-02	609,336	-	-	609,336	-
HHO - Ryan White Part C Outpatient EIS Program	93.918	2H76HA00113-21-00	409,038	-	-	409,038	-
			1,034,153	-	-	1,034,153	-
Ryan White HIV/AIDS Dental Reimbursement and Community Based Dental Partnership Grants							
HHO - Pass-through UIC - Board of Trustees							
Chicago AIDS Network for Dental Outreach - CANDO	93.924	2H65HA00016-07-00	145,381	-	-	145,381	-
			145,381	-	-	145,381	-
HIV Prevention Activities - Non-Governmental Organization Based							
HHCS - HIV Prevention	93.939		228,941	-	228,941	-	-
			228,941	-	228,941	-	-
HIV Prevention Activities - Health Department Based							
HHO - Pass-through Chicago Department of Public Health							
Prevention Case Management	93.940	17154-4	31,947	-	-	31,947	-
			31,947	-	-	31,947	-
Block Grants for Community Mental Health Services							
HHO - Pass-through Illinois Department of Human Services - DMH							
Community Mental Health Block Grant	93.958	45CQ021113	3,900	-	-	3,900	-
			3,900	-	-	3,900	-

Heartland Alliance for Human Needs & Human Rights

Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Federal Project or Pass-Through Grantor's Number	Total Expenditures	Expenditures by Entity: Heartland Alliance	Heartland Human Care Services	Heartland Health Outreach	Heartland Housing
Other Programs (Continued)							
U.S. Department of Health and Human Services (Continued)							
Block Grants for Prevention and Treatment of Substance Abuse							
HHCS - Pass-through Illinois Department of Human Services							
ATOD Innovative Prevention Program	93.959	11GQ02052	$ 87,583	$ -	$ 87,583	$ -	$ -
HHO - Pass-through Illinois Department of Human Services - DASA							
Substance Abuse Prevention & Treatment Block Grant Fund - Global	93.959	43CQ0A1113	44,209	-	-	44,209	-
Substance Abuse Prevention & Treatment Block Grant Fund - ARCH	93.959	43CQ0K1113	31,168	-	-	31,168	-
Substance Abuse Prevention & Treatment Block Grant Fund - ICOCE	93.959	43CQ0H1113	65,758	-	-	65,758	-
			228,718	-	87,583	141,135	-
Total U.S. Department of Health and Human Services			21,093,691	2,792,180	13,174,742	5,126,769	-
Corporation for National & Community Service							
Social Innovation Fund							
HHO - Pass-through AIDS Foundation - Chicago							
Connect 2 Care	94.019	1OSIHDC001	56,068	-	-	56,068	-
			56,068	-	-	56,068	-
Total Corporation - National & Community Service			56,068	-	-	56,068	-
U.S. Department of Homeland Security							
Emergency Food and Shelter National Board Program							
HHCS - Pass-through United Way of America							
Emergency Food and Shelter	97.024		18,447	-	18,447	-	-
FEMA	97.024		40,500	-	40,500	-	-
			58,947	-	58,947	-	-
Total U.S. Department of Homeland Security			58,947	-	58,947	-	-
Agency for International Development							
USAID Foreign Assistance for Programs Overseas							
HA - Women of Ethiopia-Community Advancement for Recovery & Empowerment	98.001	663-A-00-09-00424-00	173,914	173,914	-	-	-
HA - Integrated MSM HIV/AIDS Prevention Program (Nigeria)	98.001	620-A-00-09-0015-00	1,637,582	1,637,582	-	-	-
HA - HIV/AIDS Prevention Activities in Ghana	98.001	641-G-00-10-00069-00	151,355	151,355	-	-	-
HA - Colombia Victims of Torture Treatment Program	98.001	AID-OAA-A-10-00046	678,967	678,967	-	-	-
HA - Haiti WE-LEAD Gender Advocacy Program	98.001	AID-OAA-A-10-00049	705,403	705,403	-	-	-
HA - Improving Effectiveness of Torture Treatment	98.001		188,285	188,285	-	-	-
			3,535,506	3,535,506	-	-	-
Total Agency for International Development			3,535,506	3,535,506	-	-	-
Total Expenditures of Federal Awards			$ 52,255,910	$ 9,540,979	$ 26,991,565	$ 13,399,061	$ 2,324,305

Note 1. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

Note 2. Basis of Presentation

The Schedule of Expenditures of Federal Awards includes the federal grant activity of Heartland Alliance for Human Needs & Human Rights (the Agency) and its consolidated affiliates, which expended federal awards during the year ended June 30, 2012, including Heartland Human Care Services, Inc. (HHCS), Heartland Health Outreach, Inc. (HHO), and Heartland Housing, Inc. (HH) and its consolidated affiliates, Diversey Neighborhood Development Corporation, Ellis Neighborhood Development Corporation, Argyle Neighborhood Development Corporation, Mayfield Limited Partnership, and Hollywood House Limited Partnership.

The Schedule of Expenditures of Federal Awards for the Agency and its consolidated entities includes multiple columns for the purposes of presenting the amount of expenditures by entity.

Note 3. Summary of Subrecipient Payments

The Agency provided federal awards to subrecipients as follows:

Program Title	CFDA Number	Amount
U.S. Department of Health and Human Services		
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)	93.224	$ 711,172
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	137,363
Services to Victims of a Severe Form of Trafficking	93.598	290,563
Global AIDS	93.067	814,369
Refugee and Entrant Assistance - Discretionary Grants	93.576	60,000
U.S. Department of Housing and Urban Development		
Shelter Plus Care	14.238	142,462
U.S. Department of Justice		
Services to Advocate for and Respond to Youth	16.018	29,105
U.S. Department of State		
International Programs to Combat Human Trafficking	19.019	45,808
International Programs to Support Democracy, Human Rights, and Labor	19.345	382,217
Overseas Refugee Assistance Program for Near East and South Asia	19.519	318,463
U.S. Agency for International Development		
USAID Foreign Assistance for Programs Overseas	98.001	805,710
Total Awards to Subrecipients		$ 3,737,232

Note 4. Non-Cash Assistance

The Agency received non-cash assistance of $236,620 during the year ended June 30, 2012. The Agency did not receive any other non-cash assistance during the year ended June 30, 2012.

Heartland Alliance for Human Needs & Human Rights

Schedule of Findings and Questioned Costs
Year Ended June 30, 2012

Section I - Summary of Auditor's Results

Financial Statements:
Type of auditor's report issued: unqualified

Internal control over financial reporting:

Material weakness(es) identified?	X	Yes	___	No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	X	Yes	___	None Reported
Noncompliance material to financial statements noted?	___	Yes	X	No

Federal Awards:
Internal control over major programs:

Material weakness(es) identified?	X	Yes	___	No
Significant deficiency(ies) identified that are not considered to be material weakness(es)	X	Yes	___	None Reported

Type of auditor's report issued on compliance for major programs:
Qualified:
Unaccompanied Alien Children Program

The opinions for all other major programs are unqualified.

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	X	Yes	___	No

Identification of major programs:

Tested as a major program:

CFDA Number	Name of Federal Program or Cluster
14.235	Supportive Housing Program
14.241	Housing Opportunities for Persons with AIDS
14.850	Public and Indian Housing
17.275	ARRA – Program of Competitive Grants For Worker Training and Placement in High Growth and Emerging Industry Sectors
93.067	Global AIDS
93.224 / 93.527	Health Centers Cluster
93.604	Assistance for Torture Victims
93.676	Unaccompanied Alien Children Program
93.914	HIV Emergency Relief Project Grants
98.001	USAID Foreign Assistance for Programs Overseas

Dollar threshold used to distinguish between type A and type B programs: $1,567,677

Auditee qualified as low-risk auditee?	___	Yes	X	No

Section II – Financial Statement Findings

FS 12-01: Financial Reporting

We were required to record several adjustments to the consolidated financial statements resulting from audit differences which we detected, and many adjustments prepared by the Agency's Financial Accountability Services (FAS) staff resulting from their analyses of account balances performed at the time of audit fieldwork.

In addition, this year's adjustments included prior period adjustments to correct errors in the application of accounting principles; the Agency was required to restate its opening net assets as of July 1, 2011 for its accounting for (a) the Roosevelt Square II land leasehold, (b) the consolidation of three controlled partnership investments and (c) the elimination of development fees paid by controlled partnerships and recorded as income by the Agency.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-205-45 requires that a complete and accurate set of financial statements be prepared as of the end of the reporting period.

We understand that there was unplanned turnover around year-end in the controller position for the Heartland Alliance entity. Additionally, the previous accounting methodology had been in place for several years and was subject to annual audits.

Adjustments occurring during the course of the audit process result in delays to the audit and to the issuance of the financial statements. Errors in monthly financial statements could affect their reliability.

Recommendation

Recording adjustments during the course of the year, instead of at (or after) year-end, would improve the accuracy of the accounting records and monthly financial statements, reduce instances of reporting differences between the audited financial statements and any financial results previously communicated, and facilitate the audit process. Accounting tasks such as monthly reconciliations play a key role in proving the accuracy of accounting data and information included in interim financial statements. Therefore, in order to provide more accurate and timely accounting information, we strongly recommend that the Agency develop more effective review and reconciliation policies and procedures as a routine part of the accounting process. This would involve monthly analyses and reconciliations of all accounts, making adjustments throughout the year that have typically been made only at year-end, and performing more frequent reviews of the general ledger throughout the year, including making any necessary adjustments.

We recommend that the Agency evaluate the material complex transactions it engages in, and that it document the planned accounting for those transactions, especially as to transactions it engages in with controlled entities.

Section II – Financial Statement Findings

Views of responsible officials:

Action Plan:

Management is in agreement with this finding and the accompanying recommendation.

Management notes that in 2012 the Agency selected McGladrey LLP to perform auditing services, and that was in keeping with our rotation cycle for outside auditors. As a result of a more comprehensive review of our housing division our current auditors suggested numerous prior period adjustments that yielded a significant number of adjusting entries during the course of their fieldwork. A number of the transactions went back to the beginning of our investment in the numerous properties on our books—as far back as the 1990s. Management agrees with its current auditor’s interpretation of those accounting principles.

Management also notes that a number of adjustments made during the fieldwork were a result of the departure of a key accounting staff that occurred at the beginning of the audit.

Responsibility: CFO.

FS 12-02: Inadequate Internal Control Over Compliance and Instances of Noncompliance with Requirements of a Major Federal Program

See Section III, Findings and Questioned Costs for Federal Awards, Finding SA 12-01.

FS 12-03: Other Matters

In April 2010, HHCS negotiated and signed a fee for service contract with the State of Illinois, and the Illinois Department of Human Services (IDHS) to provide trainee workers with temporary employment during the contract period (April 2010 through September 2010). HHCS successfully employed approximately 27,000 workers during the contract period. The contract stipulated a fee-for-service arrangement and was billed by HHCS and paid by IDHS accordingly. Subsequently, IDHS asserted that, pursuant to the terms of an underlying federal grant, all fees paid by IDHS to HHCS under this contract are required to be matched to actual costs, the fee-for-service terms notwithstanding. The Agency has been cooperating with IDHS in this regard. Net revenues earned as a result of the fee-for-service contract were $10,800,000 and was available for tail costs and other administrative and related program costs.

This program was completed in fiscal year 2011 and no longer existed in fiscal year 2012. However, the Agency has reported this as a contingent matter in its fiscal 2012 financial statements.

Recommendation:

We recommend that the Agency continue to work with IDHS and resolve this matter.

Views of responsible officials:

Action Plan:

Management agrees with this recommendation and has consistently worked with the Illinois Department of Human Services to find a possible solution. These efforts will continue.

Responsibility:

The Executive Director of Heartland Human Care Services is responsible for working with IDHS on this matter.

Section III – Findings and Questioned Costs for Federal Awards

Finding SA 12-01: Inadequate Internal Control Over Compliance and Instances of Noncompliance with Requirements of the Major Federal Program

Questioned Costs: Cannot be determined

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

Federal Program Title; Pass-Through Entity (if applicable); CFDA Number; Award Number; Award Year(s):

Unaccompanied Alien Children Program; CFDA No. 93.676; 90ZU0047; October 1, 2010 through September 30, 2011, October 1, 2011 through September 30, 2012

Criteria: The A-102 Common Rule and OMB Circular A-110 (2 CFR part 215) require that non-Federal entities receiving Federal awards (i.e., Agency management) establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.

The objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs), as found in §____.105 of OMB Circular A-133, are as follows:

(1) Transactions are properly recorded and accounted for to:
  (i) Permit the preparation of reliable financial statements and Federal reports;
  (ii) Maintain accountability over assets; and
  (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:
  (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
  (ii) Any other laws and regulations that are identified in the compliance supplements; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Condition: There were lapses in the application of established internal controls which reduce and or/minimize the risk of fraud and ensure compliance with applicable compliance requirements for the program. This resulted in the Agency failing to comply with allowable activities, allowable costs, cash management, equipment and real property management, period of availability and reporting requirements. During the course of our audit, we noted the following:

a. Allowable Activities/Allowable Costs

- Program Director was the sole reviewer and approver of all program activities and expenditures.
- Insufficient controls over program expenditures.

Finding SA 12-01: Inadequate Internal Control Over Compliance and Instances of Noncompliance with Requirements of the Major Federal Program (Continued)

b. <u>Cash Management</u>

- Program director developed, managed and oversaw an independent cash management process through Western Union (unknown to FAS) program spreadsheets, and Ticket Tracker (not reported).
- Cash handling protocols not established; large amount of cash kept on site, multitude of staff handling cash.

c. <u>Equipment and Real Property Management</u>

- No inventory or accounting of equipment purchased with federal funds related to this program.

d. <u>Period of Availability</u>

- Purchase of an airline gift card in one grant year for use in a future grant year.

e. <u>Reporting</u>

- Financial reporting system for the client sponsor funds, which pertain to the Family Reunification Program (a component of the grant program) was independent of FAS and had inadequate financial controls and accounting practices.

Cause and effect: The Agency did not establish effective internal control over the program.

Not establishing and maintaining internal controls designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements can lead to noncompliance with applicable compliance requirements as listed above.

Recommendation: We recommend that the Agency continue to follow the new program controls, which will allow it to establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements as required under the A-102 Common Rule and OMB Circular A-110 (2 CFR part 215).

Views of responsible officials:

Action Plan:

On June 11, 2012 senior management at the Agency, including the CEO, CFO and the Chief Corporate Compliance Officer were made aware of possible internal control weaknesses at one of the Agency's divisions. As is customary for any such allegations, the office of the Chief Corporate Compliance Officer immediately initiated an internal investigation.

Finding SA 12-01: Inadequate Internal Control Over Compliance and Instances of Noncompliance with Requirements of the Major Federal Program (Continued)

Relatively quickly, our internal control investigation concluded that the process used by the program for managing funds related to the family reunification portion of the program needed to be strengthened. A series of corrective actions were immediately identified by our compliance team, and corrective steps were taken by senior management. At no time did our internal investigation reveal any misappropriation of sponsor's funds by staff. Corrective actions, inclusive of a policy review for managing reunification funds, have now been fully implemented and are being tested on a priority basis by our Internal Auditor, reporting to our Risk Policy Committee of the Board and the Chief Corporate Compliance Officer. A weekly reconciliation is performed by the Finance & Accountability Services for any refunds that are due back to sponsor families.

Responsibility:
CFO and Chief Corporate Compliance Officer

Finding SA 12-02: Equipment and Real Property Management

Questioned Costs: None

Federal Agency: U.S. Agency for International Development

Federal Program Title; Pass-Through Entity (if applicable); CFDA Number; Award Number(s); Award Year(s):

USAID Foreign Assistance for Programs Overseas; CFDA No. 98.001; 663-A-00-09-00424-00, 620-A-00-09-0015-00, 641-G-00-10-00069-00, AID-OAA-A-10-00046, AID-OAA-A-10-00049; September 14, 2009 through May 31, 2012; October 20, 2009 through October 19, 2014; August 26, 2010 through August 25, 2013; October 1, 2010 through September 30, 2013; and September 30, 2010 through September 29, 2013

Criteria: The OMB Circular A-133 requires nonprofit organizations to follow the provisions of OMB Circular A-110 for equipment and real property management. Per OMB Circular A-110:

a. Equipment records shall be maintained.
b. A physical inventory of equipment shall be taken at least once every two years and reconciled to the equipment records.
c. An appropriate control system shall be used to safeguard equipment, and equipment shall be adequately maintained.

Condition: The Agency did not perform a physical inventory of equipment and did not establish an appropriate control system to safeguard equipment as required.

Context: Equipment purchased under these grants has not been tagged. A physical inventory of this equipment has not been performed.

Cause and effect: Lack of funding to support the need for administrative resources, a decentralized procurement system serving more than 100 locations nationally, plus a requirement to operate at a moment's notice in the international arena contributed to this finding.

Not establishing adequate control system to safeguard equipments and not performing required physical inventory at least once every two years can lead to misappropriation of these assets.

Finding SA 12-02: Equipment and Real Property Management (Continued)

Recommendation: We recommend that the Agency establish policies and procedures for equipment management to comply with the requirements set forth in the Circular A-110. We also recommend that the Agency perform physical inspections and tag all equipment.

Views of responsible officials:

Action Plan:

The Agency acknowledges this finding as a deficiency that needs to be addressed. Senior management is currently discussing this issue and possible solutions. Senior Management is aware of the significant cost involved to fully comply with Circular A-110.

Responsibility:

Executive management

Consolidated Financial Statement Findings

Identifying number: 2011-1 – Participant Payroll

Corrective action has been taken.

Identifying number: 2011-2 – Non-payroll Costs

Corrective action has been taken.

Identifying number: 2011-3 – Subrecipient Monitoring

Corrective action has been taken.

Federal Award Findings and Questioned Costs

Identifying number: 2011-1 – Participant Payroll

Corrective action has been taken.

Identifying number: 2011-2 – Non-payroll Costs

Corrective action has been taken.

Identifying number: 2011-3 – Subrecipient Monitoring

Corrective action has been taken.

HEARTLAND
ALLIANCE
ENDING POVERTY

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January 25, 2013

U.S. Department of Health and Human Services
Administration for Children and Families
Audit Resolution Director
370 L'Enfant Promenade, S.W.
Sixth Floor East
Washington, D.C. 20447

Department of Health and Human Services:

Heartland Alliance for Human Needs and Human Rights respectfully submits our corrective action plan for the year ended June 30, 2012. The name and address of the independent public accounting firm that conducted our audit this year is McGladrey LLP, One South Wacker Drive, Suite 800, Chicago, Illinois 60606.

The findings from the June 30, 2012 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

Financial Statement Findings

FS 12-01: Financial Reporting

Recommendation:

Recording adjustments during the course of the year, instead of at (or after) year-end, would improve the accuracy of the accounting records and monthly financial statements, reduce instances of reporting differences between the audited financial statements and any financial results previously communicated, and facilitate the audit process. Accounting tasks such as monthly reconciliations play a key role in proving the accuracy of accounting data and information included in interim financial statements. Therefore, in order to provide more accurate and timely accounting information, we strongly recommend that the Agency develop more effective review and reconciliation policies and procedures as a routine part of the accounting process. This would involve monthly analyses and reconciliations of all accounts, making adjustments throughout the year that have typically been made only at year-end and performing more frequent reviews of the general ledger throughout the year, including making any necessary adjustments.

We recommend that the Agency evaluate the material complex transactions it engages in, and that it document the planned accounting for those transactions, especially as to transactions it engages in with controlled entities.

Action Plan:

Management is in agreement with this finding and the accompanying recommendation. Management notes that this finding came about as a result of several factors that the agency experienced during the fiscal year. Regarding the adjustments made during the field visit, management acknowledges that it experienced the departure of a key accounting staff at the beginning of the audit and therefore a number of the year end adjusting entries had to be performed during the fieldwork. Management also notes that it significantly changed the auditing process during the audit period and agreed with our auditors to perform the audit on a consolidated method. This process was significantly different than in the prior four years and as such the accounting staff was not fully prepared to handle the scope of this revised engagement. Management has discussed going back to the previously successful method with our current auditors.

Management agrees that it will better plan and evaluate the complexities of its transactions especially related to its housing development arm. Management also notes that our current auditing firm's application of accounting principles especially around housing development was different than that of prior auditors. Management agrees with its current auditor's interpretation of those accounting principles.

Responsibility: CFO.

FS 12-02: Inadequate Internal Control Over Compliance and Instances of Noncompliance with Requirements of a major Federal Program:

Responsibility:

See management response to "Finding SA 12-01: Equipment and Real Property Management" below.

FS 12-03: Other Matters

Recommendation:

We recommend that the Agency continue to work with IDHS and resolve this matter.

Action Plan:

Management agrees with this recommendation and has all along worked with the Illinois Department of Human Services to find a possible solution.

Responsibility:

Executive Director of Heartland Human Care Services is responsible for working with IDHS on this matter.

Single Audit Findings:

Finding SA 12-01: Inadequate Internal Control over Compliance and Instances of Noncompliance with Requirements of the Major Federal Program

Criteria:
The A-102 Common Rule and OMB Circular A-110 (2 CFR part 215) require that non-Federal entities receiving Federal awards (i.e., Agency management) establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.

The objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs), as found in §____.105 of OMB Circular A-133, are as follows:

(1) Transactions are properly recorded and accounted for to:
- (i) Permit the preparation of reliable financial statements and Federal reports;
- (ii) Maintain accountability over assets; and
- (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:
- (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
- (ii) Any other laws and regulations that are identified in the compliance supplements; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Condition:
There were lapses in the application of established internal controls which reduce and or/minimize the risk of fraud and ensure compliance with applicable compliance requirements for the program. This resulted in the Agency failing to comply with allowable activities, allowable costs, cash management, equipment and real property management, period of availability and reporting requirements.

Recommendation:
We recommend that the Agency establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements as required under the A-102 Common Rule and OMB Circular A-110 (2 CFR part 215).

Action Plan:
On June 11, 2012 senior management at the agency, including the CEO, CFO and the Chief Corporate Compliance Officer were made aware of possible internal control weaknesses at one of the agency's divisions. As is customary for any such allegations, the office of the Chief Corporate Compliance Officer immediately initiated an internal investigation.

Relatively quickly, our internal control investigation concluded that the process used by the program for managing funds related to the family reunification portion of the program needed to be strengthened. A series of corrective actions were immediately identified by our compliance team, and corrective steps were taken by senior management. At no time did our internal investigation reveal any misappropriation of sponsor's funds by staff. Corrective actions, inclusive of a policy review for managing reunification funds, have now been fully implemented and are being tested on a priority basis by our Internal Auditor, reporting to our Risk Policy Committee of the Board and the Chief Corporate Compliance Officer. A weekly reconciliation is performed by the Finance & Accountability Services for any refunds that are due back to sponsor families.

Relative to the equipment and inventory issue, some 2 years ago management began a process of addressing this issue by beginning a process in tagging, documenting and inventorying its equipment at its various sites and locations. As the Agency began this process of documenting its inventory controls we became acutely aware that the desired state of proper inventory controls would not be achieved if additional resources and a degree of consolidated purchasing, warehousing and distribution was not factored into this process. Management is therefore considering the following actions to remedy this finding:

Task	Due Date	Responsible Party
Document all fixed assets on the balance sheet in Financial Edge (by summary purchases)	June 30, 2013	CFO and Controllers
Identify all fixed assets purchased with federal funds	April 30, 2013	Financial Controllers & Program Staff
Inventory at least 50% of equipment where federal funds were used to purchase such equipment.	June 30, 2013	Controllers / Facilities Management / Program staff
Management to determine a need for a more robust FAS tool.	January 31, 2014	CIO / CFO

Management agrees with the period of availability finding. Program staff has been briefed on this compliance issue.

Responsibility:

Executive Director for HHCS, CFO and Chief Corporate Compliance Officer

Finding SA 12-02: Equipment and Real Property Management

Condition:

The Agency did not perform a physical inventory of equipment and did not establish an appropriate control system to safeguard equipment as required.

Context:

Equipment purchased under these grants has not been tagged. A physical inventory of this equipment has not been performed.

Cause and Effect:

Lack of resources and sufficient oversight on the part of the Agency's Management caused the issues listed above.

Recommendation:

We recommend that the Agency establish policies and procedures for equipment management to comply with the requirements set forth in the Circular A-110. We also recommend that the Agency perform physical inspections and tag all equipment.

Action Plan:

Management began a process of addressing this issue by beginning a process in tagging, documenting and inventorying its equipment at its various sites and locations. As the Agency began this process of documenting its inventory controls we became acutely aware that the desired state of proper inventory controls would not be achieved if additional resources and a degree of consolidated purchasing, warehousing and distribution was not factored into this process. Management is therefore considering the following actions to remedy this finding:

Task	Due Date	Responsible Party
Document all fixed assets on the balance sheet in Financial Edge (by summary purchases)	June 30, 2013	CFO and Controllers
Identify all fixed assets purchased with federal funds	April 30, 2013	Financial Controllers & Program Staff
Inventory at least 50% of equipment where federal funds were used to purchase such equipment.	June 30, 2013	Controllers / Facilities Management / Program staff
Management to determine a need for a more robust FAS software and evaluate the need for a central distribution of purchases.	January 31, 2014	CIO / CFO / Executive Management

Responsibility:

Executive Management and CFO

If you have any questions regarding our corrective action plan, please do not hesitate to contact me at 312-660-1401.

Very truly yours,

Brian Registe
Chief Financial Officer
Heartland Alliance