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ABILITYWORKS, INC.  
MADISON, MISSISSIPPI  
FINANCIAL REPORT  
JUNE 30, 2014

HARPER, RAINS, KNIGHT & COMPANY, P.A.  
CERTIFIED PUBLIC ACCOUNTANTS  
RIDGELAND, MISSISSIPPI

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## HARPER, RAINS, KNIGHT & COMPANY

The Board of Directors  
AbilityWorks, Inc.  
Madison, Mississippi

### Independent Auditors' Report

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of AbilityWorks, Inc., a component unit of the State of Mississippi, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

#### **Management's Responsibility for the Financial Statements**

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

#### **Auditors' Responsibility**

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

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

**Auditors' Responsibility - continued**

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

**Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AbilityWorks, Inc., a component unit of the State of Mississippi, as of June 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matters**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5-11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise AbilityWorks, Inc.'s, a component unit of the State of Mississippi, basic financial statements. The supplementary information included in the accompanying schedules of cost of production, general and administrative expenses, and statistical analysis of operations are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The schedules of cost of production, general and administrative expenses, and statistical analysis of operations are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The Board of Directors  
AbilityWorks, Inc. - Continued

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2014 on our consideration of AbilityWorks, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 audits.

Heuper, Raum, Knight & Company, P.A.

October 17, 2014

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion and analysis of the AbilityWorks, Inc. ("AbilityWorks") financial performance, providing an overview of the activities for the fiscal year ended June 30, 2014.

Since the Management's Discussion and Analysis is designed to focus on the current year's activities, resulting changes and currently known facts, please read it in conjunction with AbilityWorks, Inc.'s basic financial statements.

Highlights

- Total net position for AbilityWorks at year end were reported at \$21,706,859 which was an increase of \$138,771 or less than 1% from the prior fiscal year.
- Revenues for fiscal year 2014 increased \$532,085, or 5.0% from fiscal year 2013. The change in Revenue from 2013 to 2014 included an increase in "production revenue" of \$512,914 and in "other operating revenue" of \$21,031 and a decrease in "nonoperating revenue" of \$1,860.
- Total expenses decreased less than 1%, or \$105,231 which included an increase in the "cost of production" of \$471,308, and decreases in "general and administrative expenses" of \$85,920 and "capital asset purchases" of \$490,619 were noted.
- Operating Transfers-in decreased \$4,895,920, or 45.5%.

Overview of the Financial Statements

Under GASB 34, the applicable accounting standard for governmental financial statements, there are three components to the basic financial statements: 1) the government-wide financial statements, 2) the fund financial statements and 3) the notes to the financial statements.

Government-wide Statements

AbilityWorks is classified as an enterprise fund and therefore utilizes the accrual method as its basis of accounting, which is the same as a private sector business. By utilizing the accrual method of accounting, the presentation of financial information in the government-wide statements and the fund financial statements would contain no differences. However, due to the fact that AbilityWorks is a component unit of the State of Mississippi, government-wide statements are not included herein but will instead be included in the State of Mississippi's basic financial statements. AbilityWorks' financial statements will be presented in the State of Mississippi's government-wide statements under the "business type activities".

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

Fund Financial Statements

The financial statements for AbilityWorks report the financial activity for all seventeen locations making up AbilityWorks. As an enterprise fund, these facilities charge customers for services provided, whether to outside customers or to other agencies within the State. The method of accounting used by AbilityWorks is the accrual method of accounting, which is the same used by private sector businesses, in that revenues are recognized when earned and expenses are recognized when incurred. Included in the fund financial statements are the statements of net position, the statements of revenues, expenses, and changes in net position, and the statements of cash flows using the direct method. No other "required supplementary information" is presented. In addition, supplementary information is presented regarding cost of production, general and administrative expenses and certain statistical information.

Financial Analysis

AbilityWorks' increase in net position increased \$138,771, over the course of this fiscal year's operations.

Table 1  
Balance Sheets  
June 30, 2014 and 2013

	Governmental Activities	
	2014	2013
Current and other assets	\$ 24,799,502	\$ 24,651,037
Current and other liabilities	3,092,643	3,082,949
Net position:		
Unrestricted	\$ 21,706,859	\$ 21,568,088

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- "Current and other assets" increased \$148,465 or less than 1%. Of this amount:
  - "Cash" increased \$160,786 and "Investments" increased \$432.
  - The "Accounts receivables, net" account decreased \$190,661. The fact that "Revenue from Production" increased over \$500,000 while the "Accounts receivables, net" had an immaterial decrease of \$190,661 is a sign that Facility Managers throughout the state as well as the centralized accounting staff are monitoring the receivable balances and ensuring customers are remitting payments in a timely manner.
  - The "Unbilled receivables" account, which involved the Medicaid Waiver for payroll processing services, increased \$82,411. The amount represents the payroll generated for those hours earned by personal care attendants prior to June 30<sup>th</sup>, however, the services were not invoiced to the parent agency by the June 30<sup>th</sup> cutoff. The increase in this account is the reflection of the growth that continues to be experienced in this program as well as our strengthening of review procedures regarding the invoicing process.
  - The "Interfund receivables" account increased by \$195,903. The majority of the Interfund receivables account relates to the Medicaid Waiver, which represents payroll items which have been generated for hourly wages earned by personal care attendants and subsequently invoiced by the parent agency before June 30<sup>th</sup> but were not paid by the parent agency by June 30<sup>th</sup>. The increase in this account is due to the growth experienced with the Medicaid Waiver programs as well as the parent agency having to implement a cutoff date in mid-June for payments made in the last month of the fiscal year, due to the implementation of a new accounting system to the State of Mississippi, known as MAGIC.
  - The "Inventories" account did not significantly change from 2013 to 2014, therefore no explanation is noted.
  - The "Prepaid Expenses" account decreased \$106,117 which was attributable to the balance related to our debit card program for the Medicaid Waiver Payroll. In fiscal year 2013, AbilityWorks contracted with a company to pay personal care attendants through debit cards as opposed to checks. Funding is wired to a company account in order to fund debit card transactions. The balance in this account represents the book balance at year end related to this account.

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- "Current liabilities" increased \$9,694. Of this amount:
  - The "accounts payable" account decreased \$14,780. Under our centralized system, all invoices are submitted to the centralized office for processing. Due to the timing for which invoices were received and subsequently processed at the close of the fiscal year, AbilityWorks noted an immaterial increase in this account.
  - The "accrued expenses" account increased \$24,474. The balance in this account represents the hours earned by the personal care attendants from the period June 16 - 30, 2014 and subsequently paid in July 2014. The increase in this account is the reflection of the growth that continues to be experienced in this program.

Table 2  
Statement of Revenue,  
Expenditures and Changes in Fund Balance  
For the Years Ended June 30, 2014 and 2013

	<u>Governmental Activities</u>	
	<u>2014</u>	<u>2013</u>
Revenues		
Operating revenues		
Revenue from production, net	\$ 10,162,511	\$ 9,649,597
Other operating income, net	909,341	888,310
Nonoperating revenues		
Investment Income	<u>12,051</u>	<u>13,911</u>
Total revenues	11,083,903	10,551,818
Expenditures		
Cost of production	8,787,690	8,316,382
General and administrative	7,862,600	7,948,520
Capital asset purchases	<u>157,442</u>	<u>648,061</u>
Total expenditures	16,807,732	16,912,963
Transfers		
Transfers-in	<u>5,862,600</u>	<u>10,758,520</u>
Total transfers (net)	5,862,600	10,758,520
Increase in net position	138,771	4,397,375
Net assets - beginning of year	<u>21,568,088</u>	<u>17,170,713</u>
Net assets - ending	<u>\$ 21,706,859</u>	<u>\$ 21,568,088</u>

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- AbilityWorks consists of community rehabilitation programs in seventeen separate locations which provide a fee for service to production and manufacturing industries within each workshop's area. Seven of the seventeen locations represented over 85% of the production revenue recorded in 2013. These facilities were: Greenwood, Harrison County, Jackson, Meridian, Monroe County, Oxford, and Washington County. The increase in production revenue was due to increased contract work experienced by some of the facilities throughout the state as well as the various facilities utilizing the LINC'S Program (Linking Innovative Networks of Community Services).
- The increase in the "cost of production" is in correlation to the increase in the "revenue from production". As production revenue increases, the cost of production increases. The increases in the "cost of production" and "revenue from production" were along the same lines in which both increased close to 5.6% each. Through gaining experience and attending team building trainings with their PEERS, Facility Managers gain valuable knowledge in ensuring that supplies and services are purchased closer to the time of need as opposed to stocking items. This practice has led to more efficient purchasing which in turn has helped keep costs down. Additionally, various branches maintain contracts with vendors in which the vendor provides all production supplies, with the exception of labor costs for which AbilityWorks expense.
- The majority of the "other operating income" account is reported by our Medicaid Waiver payroll processing services. The increase reported in this revenue account was \$21,031. The main reasons for fluctuations in this revenue account deal with changes in worker's compensation premiums and the increases in the numbers served in the Home and Community Based Waiver programs.
- The "general and administrative expenses" represent those costs associated with office personnel of the AbilityWorks system, including facility managers, office managers, production managers, evaluators, instructors and administrative assistants as well as reimbursements to the facilities for client transportation and community based services. In fiscal year 2014, we noted an approximate 1% decrease in this category. The majority of general and administrative expenses represent salaries and wages (over 70%). Although only an immaterial decrease was noted, the majority of fluctuation in this category is attributable to salaries and related expenses.

ABILITYWORKS, INC.  
FINANCIAL REPORT  
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- "Capital asset purchases" account in 2014 was \$157,442, which was a decrease of \$490,619. The reason for the decrease was due to a large amount of purchases made in 2013 that were not required in 2014. For FY2014, purchases included two 20 ton straight cool units at Columbus (\$55,779), a Foampak bagflo machine in Gulfport (\$21,069), a Clamco motorized machine at Oxford (\$15,500), a fence for Oxford (\$11,620) and a tank mount for Meridian (\$9,321).
- The transfers-in account is mainly attributable to the parent agency supporting AbilityWorks through funding the administrative costs of each of the seventeen facilities. However, in fiscal year 2013, funding was transferred from the parent agency to the Medicaid Waiver payroll processing to provide adequate funding in their payroll account to account for the cost associated with the increased number of clients being served. Additionally, funding was needed in this bank account to provide an adequate balance to support payrolls as a result of our strengthening of internal controls over the reconciliation and invoicing processes which has delayed the time in which the Medicaid Waiver bank account is replenished after payrolls are generated.

Economic Factors

Mississippi has experienced a steady decrease in the number of jobs in the manufacturing sector over the last decade. While some manufacturing job gains have occurred, statewide manufacturing jobs continues to be stagnant. The loss of manufacturing jobs is a direct reflection of the number of manufacturing businesses that closed down their operations in Mississippi. The production income generated by each AbilityWorks' facility is tied to the availability of subcontract work obtained from manufacturing businesses in the local community. Since manufacturing contracts have been declining in recent years, the AbilityWorks' system has been intentionally expanding production income from service sector contracts. These service contracts include janitorial, housekeeping, and ground maintenance.

Additionally, OVR leadership has incorporated a community based program within the AbilityWorks system. This program, LINC'S (Linking Innovative Networks of Community Services), provides vocational evaluation and job readiness opportunities outside the boundaries of the facility and places clients directly in local businesses. Once the clients' vocational interests are obtained, the facility staff seeks businesses that offer those specific skill opportunities and contracts with them directly to help train our clients. This is a winning scenario for businesses, clients and AbilityWorks.

ABILITYWORKS, INC.  
FINANCIAL REPORT  
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

The AbilityWorks, Inc. system anticipates additional capital asset purchases in fiscal year 2015 in the following area:

- To ensure the viability of the AbilityWorks, Inc. system, we continue to work with local businesses to develop additional contract work. In order to add new contracts throughout the state, we anticipate purchases of new or additional production related equipment, such as fork-lifts, diesel trucks, clean room equipment, etc.
- The purchase of additional fixed assets will be required in the AbilityWorks of Harrison County as a result of the growth in sales related to the producing of crab traps.
- A new air conditioning system for the AbilityWorks of Starkville location.

Lastly, under the requirements of the Affordable Care Act, AbilityWorks Inc. will be required to offer health insurance to all nonclients working 30+ hours per week, effective January 1, 2015. The offering of health insurance to nonclients will include those nonclients working at one of our seventeen facility locations and those personal care attendants employed through one of our two Home and Community Based Waiver Programs. AbilityWorks Inc, has contracted with a third party insurance consultant to provide guidance as to ensure we comply with all applicable requirements as set forth in the Act.

Financial Contact

AbilityWorks' financial statements are designed to present users with a general overview of AbilityWorks' finances and to demonstrate its accountability. If you have any questions about the report or need additional information, contact the Deputy Director, Finance, at the Mississippi Department of Rehabilitation Services, 1281 Highway 51 North, Madison, Mississippi 39110.

ABILITYWORKS, INC.

STATEMENTS OF NET POSITION

June 30, 2014 and 2013

ASSETS

	<u>2014</u>	<u>2013</u>
Current assets		
Cash	\$ 9,309,730	\$ 9,148,944
Investments	165,970	165,538
Accounts receivable, net	1,143,737	1,334,398
Unbilled receivables	2,322,893	2,240,482
Interfund receivable	11,402,370	11,206,467
Inventories	172,552	166,841
Prepaid expenses and other	<u>282,250</u>	<u>388,367</u>
 Total assets	 <u>\$ 24,799,502</u>	 <u>\$ 24,651,037</u>

LIABILITIES AND NET POSITION

Current liabilities		
Accounts payable	\$ 218,577	\$ 233,357
Accrued expenses	<u>2,874,066</u>	<u>2,849,592</u>
Total current liabilities	3,092,643	3,082,949
 Net position - unrestricted	 <u>21,706,859</u>	 <u>21,568,088</u>
 Total liabilities and net position	 <u>\$ 24,799,502</u>	 <u>\$ 24,651,037</u>

The Notes to Financial Statements are an integral part of these statements.

ABILITYWORKS, INC.

STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET POSITION  
Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Revenue		
Revenue from production, net	\$ 10,162,511	\$ 9,649,597
Cost of production	<u>8,787,690</u>	<u>8,316,382</u>
Gross profit	1,374,821	1,333,215
Other operating income	909,341	888,310
General and administrative expenses	<u>7,862,600</u>	<u>7,948,520</u>
Operating loss	(5,578,438)	(5,726,995)
Nonoperating revenue (expenses)		
Investment income	12,051	13,911
Capital asset purchases	<u>(157,442)</u>	<u>(648,061)</u>
Total nonoperating expenses	<u>(145,391)</u>	<u>(634,150)</u>
Loss before transfers	(5,723,829)	(6,361,145)
Transfers-in	<u>5,862,600</u>	<u>10,758,520</u>
Increase in net position	138,771	4,397,375
Net position, beginning of year	<u>21,568,088</u>	<u>17,170,713</u>
Net position, end of year	<u>\$ 21,706,859</u>	<u>\$ 21,568,088</u>

The Notes to Financial Statements are an integral part of these statements.

ABILITYWORKS, INC.

STATEMENTS OF CASH FLOWS  
Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Receipts from customers	\$ 10,331,024	\$ 9,576,640
Receipts from DRS for payroll processing	53,606,004	46,982,482
Other receipts	174,341	167,275
Payments to suppliers	(4,484,789)	(4,327,685)
Payments to employees	(12,022,195)	(11,962,600)
Payments for payroll processing	<u>(53,160,376)</u>	<u>(51,875,246)</u>
Net cash used by operating activities	<u>(5,555,991)</u>	<u>(11,439,134)</u>
Cash flows from noncapital financing activities:		
Transfers-in	<u>5,862,600</u>	<u>10,758,520</u>
Net cash provided by noncapital financing activities	<u>5,862,600</u>	<u>10,758,520</u>
Cash flows from investing activities:		
Investment income	12,051	13,766
Sale and maturity of investments	165,538	164,498
Investment purchases	(165,970)	(165,172)
Capital asset purchases	<u>(157,442)</u>	<u>(648,061)</u>
Net cash used in investing activities	<u>(145,823)</u>	<u>(634,969)</u>
Net increase (decrease) in cash	160,786	(1,315,583)
Cash at beginning of year	<u>9,148,944</u>	<u>10,464,527</u>
Cash at end of year	<u>\$ 9,309,730</u>	<u>\$ 9,148,944</u>

The Notes to Financial Statements are an integral part of these statements.

ABILITYWORKS, INC.

STATEMENTS OF CASH FLOWS - Continued  
 Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (5,578,438)	\$ (5,726,995)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Net effect of changes in assets and liabilities:		
Accounts receivable	190,661	(93,231)
Unbilled receivables	(82,411)	(388,826)
Interfund receivables	(195,903)	(5,254,236)
Inventories	(5,711)	(21,038)
Prepaid expenses and other	106,117	(388,350)
Accounts payable	(14,780)	8,222
Accrued expenses	<u>24,474</u>	<u>425,320</u>
Net cash used by operating activities	<u>\$ (5,555,991)</u>	<u>\$ (11,439,134)</u>

The Notes to Financial Statements are an integral part of these statements.

## NOTES TO FINANCIAL STATEMENTS

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of AbilityWorks, Inc., (hereafter referred to as "AbilityWorks"), a component unit of the State of Mississippi, have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board ("GASB"). The more significant of AbilityWorks' accounting policies follow.

#### Organization and Nature of Operations

AbilityWorks is a non-profit corporation owned and operated by the State of Mississippi, Department of Rehabilitation Services, Office of Vocational Rehabilitation (the "Division"). AbilityWorks was incorporated on July 18, 1969 with the granting of a charter by the State of Mississippi. Legal authority for AbilityWorks is granted under Section 37-33-101 of the Mississippi Code of 1972. AbilityWorks' purpose is to operate a statewide system of community rehabilitation programs through which citizens with disabilities receive work experience to prepare them for employment outside the workshop setting.

Currently, seventeen (17) AbilityWorks facilities are located in communities throughout Mississippi. These facilities provide work settings with realistic job stations where vocational evaluation, work adjustment, counseling, guidance and other services are provided. The Division funds some of the general and administrative expenses, such as staff payroll, rent, utilities, etc. Also, the Division transfers funds to the facilities on a monthly basis for additional expenses incurred as a result of expanded client services, such as maintenance to clients and incentive allowances.

#### Basis of Presentation

During 2013, AbilityWorks adopted Statement No. 63 "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position", which establishes financial reporting standards for state and local governments for periods beginning after December 15, 2011. GASB 63 changes how governments will organize their statements of financial position. Under the new standard, financial statements will include deferred outflows of resources and deferred inflows of resources ("deferrals"), in addition to assets and liabilities, and will report net position instead of net assets. AbilityWorks had no deferred outflows of resources or deferred inflows of resources at June 30, 2014 and 2013.

AbilityWorks presents its financial statements using the financial reporting standards set forth in Statement No. 34 "Basic Financial Statements and Management Discussion and Analysis for State and Local Governments" which sets forth requirements that financial reports include management's discussion and analysis (MD&A), basic financial statements and required supplementary information (RSI).

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Basis of Presentation - continued

Basic financial statements include government wide financial statements, fund financial statements and notes to the financial statements. Since AbilityWorks is a component unit of the State of Mississippi, it only presents fund financial statements. AbilityWorks continues to report as a business-type enterprise fund.

Basis of Accounting

The accounts of AbilityWorks are reported using the accrual basis of accounting and the economic resources measurement focus. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred. Revenue from production and payroll processing income are stated net of provision for bad debt (benefit) expense of \$(2,136) in 2014 and \$10,740 in 2013.

Inventories

Finished goods inventories are stated at the lower of manufacturing cost (first-in, first-out) or market (net realizable value). Purchased raw materials and supplies are stated at the lower of cost (first-in, first-out) or replacement market.

Revenue Recognition

Production revenue is recognized when the goods are shipped or the services performed.

Operating/Nonoperating Income

AbilityWorks has classified its revenue as either operating or nonoperating revenues according to the following criteria:

Operating revenues - Operating revenues generally result from community rehabilitation programs in seventeen separate locations which provide a fee for service to production and manufacturing industries within each workshop's area. Other operating income consists of net payroll income for processing payroll under the Medicaid Waiver program.

Nonoperating revenues - Nonoperating revenues are those revenues that do not meet the definition of operating revenues. Nonoperating revenues include investment income.

Interfund/Intrafund Transactions

Interfund represents transactions with a fund outside of AbilityWorks, while intrafund represents transactions within AbilityWorks. Interfund/intrafund transactions are reflected as either loans, services provided, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon combination. Services provided are treated as revenues and expenditures/expenses.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Interfund/Intrafund Transactions - continued

Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related expense as a reimbursement. All other interfund/intrafund transactions are treated as transfers. Intrafund balances have been eliminated and are not reflected in the basic financial statements.

Capital Asset Purchases

Property and equipment purchased directly by the facilities are the property of the State of Mississippi. These acquisition costs are classified as a nonoperating expense.

Use of Estimates in the Preparation of Financial Statements

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

Income Taxes

AbilityWorks is exempt from federal and state income taxes.

Investments

Investments consist of certificates of deposit which are carried at cost.

Other

AbilityWorks provides transportation and maintenance funds to clients of the Department of Rehabilitation Services based on the orders of client counselors. The clients are not necessarily those employed by AbilityWorks. The amounts provided, \$69,448 in 2014 and \$98,509 in 2013, have been fully reimbursed by the State of Mississippi. The funds provided do not represent income or expenses of AbilityWorks and have not been recorded in the financial statements.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash includes all checking and savings accounts. AbilityWorks has no cash equivalents.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Employee Benefits

Employees of AbilityWorks, who are eligible for employee benefits, are considered employees of and are provided employee benefits through the State of Mississippi. Sufficient details are not provided to AbilityWorks to separately disclose any retirement plan expenses and postemployment benefits. Employee benefit expenses are allocated to AbilityWorks through state paid expenditure transactions and are reported within the general and administrative expenses and cost of production schedules. Disclosures regarding employee benefits are maintained and communicated within the State of Mississippi financial reports.

Subsequent Events

Subsequent events were evaluated by AbilityWorks through October 17, 2014, which is the date the financial statements were available to be issued.

(2) CONCENTRATIONS OF CREDIT AND OTHER RISKS

Financial instruments that potentially subject AbilityWorks to concentrations of credit risk consist of cash and cash equivalents, accounts receivable and loss of financial assistance from the State of Mississippi. AbilityWorks receives substantial support in the form of financial assistance from the State of Mississippi, the loss of which could have a material effect on the continuation of operations. Accounts receivable are due from customers in numerous industries within the State of Mississippi. Each facility monitors the credit worthiness of its customers to limit credit risk.

AbilityWorks maintains cash balances at various financial institutions. Accounts at each institution are insured up to \$250,000 by the Federal Deposit Insurance Corporation ("FDIC"). Amounts in excess of \$250,000 are collateralized by certain assets pledged by the financial institution's trust department in AbilityWorks' name. In addition, AbilityWorks has minimized credit risk by depositing cash and cash equivalents in banks with a high credit standing. AbilityWorks has not experienced any losses of such funds and management believes exposure to significant credit risk on cash and cash equivalents is minimal.

(3) INVESTMENTS

Investments at June 30, 2014, consist of a certificate of deposit totaling \$165,970 which matured in February 2014. Investments at June 30, 2013, consist of a certificate of deposit totaling \$165,538 which matured in February 2013. Interest earned on investments and cash balances for the years ended June 30, 2014 and 2013 was \$12,051 and \$13,911, respectively.

(4) ACCOUNTS RECEIVABLE

A summary of accounts receivable follows:

	<u>2014</u>	<u>2013</u>
Trade receivable	\$ 1,143,737	\$ 1,346,460
Less allowance for doubtful accounts	<u>-</u>	<u>(12,062)</u>
Accounts receivable, net	<u>\$ 1,143,737</u>	<u>\$ 1,334,398</u>

(5) UNBILLED RECEIVABLES

Unbilled receivables are the total amount for payroll processing services rendered but not yet invoiced, related to the Medicaid Waiver program. Unbilled receivables totaled \$2,322,893 in 2014 and \$2,240,482 in 2013.

(6) INTERFUND RECEIVABLES

Interfund receivables/payables related to payroll processing and other services provided to the agencies of the State of Mississippi consist of the following:

	<u>2014</u>	<u>2013</u>
Interfund receivables:		
Office of Special Disability Programs	\$ 7,835,818	\$ 7,181,017
Spinal Cord Trauma Brain Injury	3,406,618	3,888,399
Office of Vocational Rehabilitation	142,673	135,771
Office of Employment Security	101	82
Office of Vocational Rehabilitation for the Blind	8,619	-
University of Southern Mississippi	8,541	-
Mississippi Department of Transportation	-	730
University of Mississippi Medical Center	<u>-</u>	<u>468</u>
	<u>\$11,402,370</u>	<u>\$11,206,467</u>

(7) INVENTORIES

A summary of inventories follows:

	<u>2014</u>	<u>2013</u>
Finished goods	\$ 73,558	\$ 66,885
Raw materials and supplies	<u>98,994</u>	<u>99,956</u>
Total inventories	<u>\$ 172,552</u>	<u>\$ 166,841</u>

(8) OTHER OPERATING INCOME, NET

A summary of other operating income, net follows:

	<u>2014</u>	<u>2013</u>
Payroll processing income, net	\$ 53,862,169	\$ 52,645,818
Payroll processing expense	(53,127,169)	(51,924,783)
Other income	<u>174,341</u>	<u>167,275</u>
Other operating income, net	<u>\$ 909,341</u>	<u>\$ 888,310</u>

(9) RELATED PARTY TRANSACTIONS

Net transfers-in of \$5,862,600 in 2014 and \$10,758,520 in 2013 represent general and administrative expenses paid on behalf of the AbilityWorks' facilities by the State of Mississippi Department of Rehabilitation Services. Transfers-in are from sources as follows:

	<u>2014</u>	<u>2013</u>
MDRS - general and administrative expenses	\$ 7,862,600	\$ 7,948,520
MDRS - payroll processing	<u>(2,000,000)</u>	<u>2,810,000</u>
Total operating transfers	<u>\$ 5,862,600</u>	<u>\$10,758,520</u>

(10) FACILITIES

Production facilities utilized by six AbilityWorks locations are provided without rent by the counties in which the facilities are located. The other eleven facilities reported rent expense of \$415,263 in 2014 and \$421,006 in 2013 under cancellable operating leases. During fiscal years 2014 and 2013, AbilityWorks offset a portion of the rent expense by charging state agencies which occupied space in the facilities an allocated portion of the related rent expense. The amount charged and offset against rent expense was \$209,514 and \$210,882 for 2014 and 2013, respectively.

ABILITYWORKS, INC.

SCHEDULES OF COST OF PRODUCTION

Years Ended June 30, 2014 and 2013

	2014	2013
Bank charges	\$ 16,690	\$ 14,522
Commissions	165,433	162,365
Employee benefits	947,148	939,434
Equipment rent and maintenance	266,251	260,806
Facility repairs and maintenance	128,635	104,218
General shop and tools	77,374	74,637
Marketing	58,389	53,075
Miscellaneous	55,301	64,396
Opportunity wages production	2,228,433	2,065,114
Other administrative expenses	44,325	92,665
Professional fees	247,454	217,005
Rent	205,749	210,124
Salaries, non-client employees	2,786,540	2,601,237
Supplies	1,336,592	1,264,591
Uniforms	39,263	27,019
Vehicle expense	184,113	165,174
	<u>8,787,690</u>	<u>8,316,382</u>
Total cost of production	<u>\$ 8,787,690</u>	<u>\$ 8,316,382</u>

See Independent Auditors' Report.

ABILITYWORKS, INC.

SCHEDULES OF GENERAL AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Client transportation	\$ 628,382	\$ 666,267
Commodities	51,288	51,594
Community based	884,246	710,426
Contractual services	534,404	581,875
Equipment	8,199	-
Salaries and related expenses	5,648,064	5,810,994
Subsidy - opportunity wages	107,420	127,364
Travel	<u>597</u>	<u>-</u>
 Total general and administrative expenses	 <u>\$ 7,862,600</u>	 <u>\$ 7,948,520</u>

See Independent Auditors' Report.

ABILITYWORKS, INC.

SCHEDULE OF STATISTICAL ANALYSIS OF OPERATIONS  
 Year Ended June 30, 2014  
 (Unaudited)

	Total per the Statement of Revenues, Expenses and Changes in Net Assets	Total Cost of Operations for Year in Relation to		
		Clients Served	Client Days	Clients Closed/ Rehabilitated
Cost of production	\$ 8,787,690	\$ 3,189	\$ 83	\$ 9,689
General and administrative expenses	7,862,600	2,853	74	8,669
Total operating cost	16,650,290	6,042	157	18,358
Less revenue and other operating income	10,336,852	3,751	98	11,397
Total operating cost, net of revenue and other operating revenue	6,313,438	2,291	59	6,961
Nonoperating (revenue) expense	145,391	53	-	160
Total operating cost after nonoperating (revenue) expense	\$ 6,458,829	\$ 2,344	\$ 59	\$ 7,121
Totals for the year ended June 30, 2014:				
Clients served	2,756			
Client days	105,634			
Clients closed/rehabilitated	907			
Average daily attendance	435			
Average length of stay per client in days	<u>Client days</u> <u>Clients served</u>	38		

\* Total operating cost after nonoperating expense does not include payroll processing income and payroll processing expenses. These items are not related to clients served and employed data and are appropriately not included in the above analysis.

See Independent Auditors' Report.



HARPER, RAINS, KNIGHT  
& COMPANY

The Board of Directors  
AbilityWorks, Inc.  
Madison, Mississippi

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*

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the basic financial statements of AbilityWorks, Inc., a component unit of the State of Mississippi, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise AbilityWorks, Inc.'s, a component unit of the State of Mississippi, basic financial statements, and have issued our report thereon dated October 17, 2014.

**Internal Control Over Financial Reporting**

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

**Internal Control Over Financial Reporting - continued**

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether AbilityWorks, Inc.'s, a component unit of the State of Mississippi, basic 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*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and is not to provide an opinion on the effectiveness of internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering AbilityWorks, Inc.'s, a component unit of the State of Mississippi, internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Haiper Zeems-Knight & Company, P.A.

October 17, 2014