

Terrace Gardens, Inc.

Financial Statements and Supplementary Information

Years Ended December 31, 2014 and 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Terrace Gardens, Inc.
Milpitas, California

We have audited the accompanying 2014 financial statements of Terrace Gardens, Inc., a California nonprofit public benefit corporation, which comprise the statement of financial position as of December 31, 2014, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the 2014 financial statements referred to above present fairly, in all material respects, the financial position of Terrace Gardens, Inc. as of December 31, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements as of and for the year ended December 31, 2013 were audited by Berger Lewis Accountancy Corporation, whose practice became part of Armanino^{LLP} as of January 1, 2015, and whose report dated April 24, 2014, expressed an unmodified opinion on those statements.

Reports Issued in Accordance with *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 23, 2015, on our consideration of Terrace Gardens, 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 audit.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary schedules on pages 12 - 13 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 2014 information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the 2014 information is fairly stated in all material respects in relation to the financial statements taken as a whole.

The 2013 information on pages 12 - 13 was subjected to the auditing procedures applied in the 2013 audit of the basic financial statements by Berger Lewis Accountancy Corporation, whose practice became part of Armanino^{LLP} as of January 1, 2015, and whose report on such information stated that it was fairly stated in all material respects in relation to the 2013 financial statements as a whole.

Armanino LLP

Armanino^{LLP}
San Jose, California

April 23, 2015

TERRACE GARDENS, INC.
Statements of Financial Position
December 31, 2014 and 2013

ASSETS

	<u>2014</u>	<u>2013</u>
Current assets		
Cash	\$ 22,664	\$ 10,000
Tenant accounts receivable	231	4
Other receivables	93	238
Prepaid expenses	<u>35,948</u>	<u>28,227</u>
Total current assets	<u>58,936</u>	<u>38,469</u>
Property and equipment, at cost		
Land	1,565,277	1,565,277
Buildings and improvements	14,009,241	13,964,173
Furnishings and equipment	348,490	335,374
Construction in progress	<u>208,156</u>	<u>46,658</u>
	16,131,164	15,911,482
Accumulated depreciation	<u>(7,057,425)</u>	<u>(6,645,019)</u>
Total property and equipment, net	<u>9,073,739</u>	<u>9,266,463</u>
Tenant security deposits	<u>77,278</u>	<u>77,039</u>
Restricted cash and funded reserves		
Replacement reserves	1,344,689	1,166,942
Restricted cash for Carillon maintenance fund	<u>794</u>	<u>792</u>
Total restricted cash and funded reserves	<u>1,345,483</u>	<u>1,167,734</u>
Total assets	<u>\$ 10,555,436</u>	<u>\$ 10,549,705</u>

LIABILITIES AND NET ASSETS

Current liabilities		
Accounts payable	\$ 117,607	\$ 221,774
Wages payable	12,374	10,583
Accrued vacation	14,190	13,627
Rents received in advance	372	221
Deferred revenue	<u>1,900</u>	<u>3,800</u>
Total current liabilities	<u>146,443</u>	<u>250,005</u>
Tenant security deposits	<u>77,278</u>	<u>77,039</u>
Total liabilities	<u>223,721</u>	<u>327,044</u>
Net assets		
Unrestricted net assets	10,330,921	10,221,869
Temporarily restricted net assets	<u>794</u>	<u>792</u>
Total net assets	<u>10,331,715</u>	<u>10,222,661</u>
Total liabilities and net assets	<u>\$ 10,555,436</u>	<u>\$ 10,549,705</u>

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

TERRACE GARDENS, INC.
Statements of Activities
Years Ended December 31, 2014 and 2013

	2014	2013
Revenue		
Rental program		
Gross residential rent potential	\$ 1,188,003	\$ 1,151,858
Vacancy and collection loss	(8,986)	(4,967)
Net residential rental income	1,179,017	1,146,891
Laundry and vending income	3,694	4,612
Other tenant charges	5,805	6,036
Tenant guest income	6,300	5,900
Rental program revenue	1,194,816	1,163,439
Grant income - CDBG grant	239,232	161,146
Food services	481,456	466,518
Interest income	4,746	2,316
Total revenue	1,920,250	1,793,419
Program expenses		
Rental program		
Administrative	113,406	112,971
Depreciation	412,406	387,735
Personnel and benefits	347,837	353,191
Repairs and maintenance	231,739	246,683
Taxes and insurance	50,466	42,935
Utilities	149,676	152,247
Rental program expenses	1,305,530	1,295,762
Tenant services program		
Food service costs	488,479	473,822
Recreation supplies	6,674	5,121
Tenant services program expenses	495,153	478,943
Total operating program expenses	1,800,683	1,774,705
Other expenses		
Loss on disposal of assets	-	11,249
Total program expenses	1,800,683	1,785,954
Supporting services expense		
Management and general expenses	10,513	10,460
Total expenses	1,811,196	1,796,414
Change in unrestricted net assets	109,054	(2,995)
Change in net assets	109,054	(2,995)
Net assets, beginning of year	10,222,661	10,225,656
Net assets, end of year	\$ 10,331,715	\$ 10,222,661

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

TERRACE GARDENS, INC.
Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	2014	2013
Cash flows from operating activities		
Change in net assets	\$ 109,054	\$ (2,995)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	412,406	387,735
Loss on disposal of assets	-	11,249
Changes in operating assets and liabilities		
Tenant accounts receivable	(227)	863
Other receivables	145	2,891
Prepaid expenses	(7,721)	(825)
Tenant security deposits, net	-	1
Accounts payable	20,046	(7,595)
Wages payable	1,791	1,704
Accrued vacation	563	2,785
Rents received in advance	151	(1,977)
Deferred revenue	(1,900)	(1,900)
Net cash provided by operating activities	534,308	391,936
Cash flows from investing activities		
Funding of replacement reserves	(282,450)	(264,174)
Withdrawal from replacement reserves	104,704	119,460
Acquisition of property and equipment	(343,896)	(263,934)
Changes in other funds held by trustee	(2)	(3)
Net cash used in investing activities	(521,644)	(408,651)
Net increase (decrease) in cash	12,664	(16,715)
Cash, beginning of year	10,000	26,715
Cash, end of year	\$ 22,664	\$ 10,000

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

1. General Information

Organization

Terrace Gardens, Inc. (the "Organization") is a nonprofit public benefit corporation, incorporated in the State of California on September 12, 1986. The Organization was formed to provide low-income persons in the City of Milpitas (the "City") with housing facilities and services. The Organization is governed by a nine member board of directors, one of whom must be the City Manager, or his appointee; one of whom must be a member of the City Council; five of whom must be residents of the City; and the remaining two members may be selected without regard to residence.

The board of directors' governing authority is limited by a Regulatory Agreement, dated November 17, 1987, between the Organization and the City. Significant provisions of this agreement are described in Note 2. The Organization and the City have entered into an amended and restated Regulatory Agreement on December 6, 2006.

Operations

The Organization's purpose is to develop and manage the operations of a residential complex which consists of 148 rental units, 3 guest rooms, and 2 staff units. The complex is located in the City and dedicated to the needs of elderly persons. The City contributed the land for the complex and the value is reported in the financial statements at its estimated fair market value at the date contributed as determined by the County Assessor.

2. Regulatory Agreement

Pursuant to the amended and restated Agreement dated December 6, 2006 with the City, the Organization is:

Prohibited from:

- Using the land contributed by the City for any purpose other than constructing and operating the Terrace Gardens residential project.
- Encumbering the land or project by any security interest, selling, assigning, conveying or otherwise transferring its interest in the project or project site.
- Discriminating in any manner against any person on account of race, marital status, sex, religious creed, ancestry, national origin or physical handicaps in connection with constructing or operating the project.

Required to:

- Maintain adequate insurance coverage, indemnify and hold harmless the City and its officials and employees against any actual or alleged liabilities resulting from any acts or omissions of the Organization or its employees.
- Submit operating budgets on or before the first day of each fiscal year to the City for approval.

2. Regulatory Agreement (continued)

- Establish a reserve account for replacement and other project contingencies which must be funded at the rate of \$4,000 per month (see Note 4 for details on reserves).
- Limit occupancy in the project to persons 62 or more of age (in the case of joint occupancy at least one occupant must meet the age requirement) or 55 or more of age and handicapped.
- Rent dwelling units by giving preference first to elderly residents and to elderly parents of residents of the City, and finally to residents of Santa Clara County.
- At least 25 units shall be rented to extremely low-income senior citizen households with household incomes at or below 30% of median income in Santa Clara County; the remaining rental units shall be rented to very low-income senior citizen households with household incomes at or below 50% of median income in Santa Clara County.
- Limited rent in an amount not to exceed 30% of occupant's income, unless otherwise agreed by both the City and the Organization.
- Establish and maintain a surplus cash account, disbursements from which can only be made with the City's prior written approval and which must be disbursed to the City 30 days after receiving the City's written request for all or a portion of the surplus funds.
- Provide the City with annual financial statements audited by an Independent Certified Public Accountant.

3. Summary of Significant Accounting Policies

Basis of accounting

The Organization recognizes revenue on the accrual basis of accounting. Revenue from program fees is recognized as revenue in the period in which the service is provided. The value of the rent-free employee units is shown as rental income and as an expense of operations.

Basis of presentation

The Organization follows standards of accounting and financial reporting as prescribed by the American Institute of Certified Public Accountants. In accordance with generally accepted accounting principles, the Organization reports its financial position and activities in three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Organization. Under this category, the Organization maintains an operating fund plus any net assets designated by the Board for specific purposes.

Temporarily restricted net assets include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.

3. Summary of Significant Accounting Policies (continued)

Permanently restricted net assets include those assets which are subject to a non-expiring donor restriction, such as endowments. There are currently no permanently restricted net assets.

Use of estimates

The presentation of financial statements in conformity with accounting principle generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Economic concentrations

The future operations of the Organization could be affected by changes in the economic or other conditions in the geographic area of Milpitas or by changes in federal low-income housing subsidies or the demand for such housing.

Cash and cash equivalents

Cash consists of cash on hand and cash in demand deposit accounts. Not included in cash are funds restricted as to their use, regardless of their liquidity, such as security deposits and replacement reserves. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash. There were no cash equivalents as of December 31, 2014 and 2013.

The Organization maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Allowance for doubtful accounts

The Organization uses the specific write-off method to provide for doubtful accounts since past experience and management's estimation indicates an adequate allowance for such accounts is immaterial.

Property and equipment

Property and equipment are stated at cost of acquisition, and recorded at cost or estimated fair value for donated items. Major improvements or replacement over \$10,000 are charged to the property accounts. The cost of repairs and maintenance which do not improve or extend the life of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 5 to 50 years. Depreciation is charged to the activity benefiting from the use of the property or equipment. Depreciation expense for the years ended December 31, 2014 and 2013 was \$412,406 and \$387,735, respectively.

3. Summary of Significant Accounting Policies (continued)

Accounting for impairment of long-lived assets

The Organization reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of the property and equipment may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the asset to future net cash flows, undiscounted and without interest, expected to be generated by the asset. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. As of December 31, 2014 and 2013, there were no events or changes in circumstances indicating that the carrying amount of the property and equipment may not be recoverable.

Tenant security deposits

Tenant security deposits are not available for operating purposes. The Organization is required to maintain funds equal to the related liability and holds the funds in separate, interest bearing accounts in the name of the Organization.

Functional expenses

Directly identifiable expenses are charged to program and supporting services. Management and general expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of the Organization.

Property taxes

The Organization has filed and received an exemption from certain property taxes in accordance with Section 214 of the California Code.

Income taxes

Terrace Gardens, Inc. is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements.

Advertising

The Organization's policy is to expense advertising costs as the costs are incurred. Advertising expense for the years ended December 31, 2014 and 2013 was \$1,168 and \$536, respectively.

Uncertainty in income taxes

Accounting principles generally accepted in the United States of America provide accounting and disclosure guidance about positions taken by an organization in its tax returns that might be uncertain. Management has considered its tax positions and believes that all of the positions taken by the Organization in its federal and state tax returns are more-likely-than-not to be sustained upon examination.

The Organization files information returns in the U.S. federal jurisdiction and state of California. The Organization's federal returns for the tax years 2011 and beyond remain subject to examination by the Internal Revenue Service. The Organization's California returns for the tax years 2010 and beyond remain subject to examination by the Franchise Tax Board.

TERRACE GARDENS, INC.
Notes to Financial Statements
December 31, 2014 and 2013

3. Summary of Significant Accounting Policies (continued)

Subsequent events

Management of the Organization has evaluated events and transactions subsequent to December 31, 2014 for potential recognition or disclosure in the financial statements. The Organization has no subsequent events that required recognition or disclosure in the financial statements for the fiscal year ended December 31, 2014. Subsequent events have been evaluated through the date the financial statements became available to be issued, April 23, 2015.

4. Restricted Cash and Funded Reserves

Replacement reserves

In accordance with the Regulatory Agreement, a replacement reserve account has been established and is to be funded monthly. The annual funding required is \$48,000. Funding was increased from the requirement amount based on the 2010 Reserve Study prepared by Reserve Analysis Consulting, LLC. The annual reserve deposits of 2014 and 2013 were approved by the Board of Directors for \$277,718 and \$261,933, respectively. Interest earned on the replacement reserve is considered to have the same restrictions as the replacement reserve. As of December 31, the activities of replacement reserve are as follows:

	<u>2014</u>	<u>2013</u>
Balance at January 1,	\$ 1,166,942	\$ 1,022,229
Monthly deposits	277,718	261,933
Interest received, net of bank fee	4,693	2,240
Withdrawals	<u>(104,664)</u>	<u>(119,460)</u>
Balance at December 31,	<u>\$ 1,344,689</u>	<u>\$ 1,166,942</u>

Restricted cash

The restricted cash consists of funds in the Carillon Memorial Maintenance Fund, held for the repair or improvement of the Carillon. These funds are restricted in use and may not be used for operations. As of December 31, 2014 and 2013, the funds were \$794 and \$792, respectively.

5. Grant Income

In 2014, the City of Milpitas granted the Organization 2013/2014 and 2014/2015 Community Development Block Grant (CDBG) funds totaling \$239,232 for emergency generator, resident air conditioning units, elevator modernization and cab upgrade. The full amount of \$239,232 was expended in 2014.

In 2013, the City of Milpitas granted the Organization 2012/2013 CDBG funds totaling \$161,146 for replacement of unit kitchen stoves, and community kitchen commercial refrigerator/freezer at Terrace Gardens. The full amount of \$161,146 was expended in 2013.

TERRACE GARDENS, INC.
Notes to Financial Statements
December 31, 2014 and 2013

6. Surplus Cash (Deficiency)

Under Section 23 of the Regulatory Agreement dated November 17, 1987 with the City of Milpitas, the Organization is required to remit surplus cash to the City upon receipt of 30 days written notice. Surplus cash is defined by that agreement as cash remaining after payment of all liabilities less amounts required for reserves. Surplus cash at December 31, 2014, is computed as follows:

<u>Account description</u>	<u>Computation of Surplus Cash</u>	<u>Amount</u>
Cash		\$ 22,664
Total cash		<u>22,664</u>
Accounts payable		(117,607)
Wages payable		(12,374)
Accrued vacation		(14,190)
Rents received in advance		<u>(372)</u>
Total current obligations		<u>(144,543)</u>
Surplus cash (deficiency)		\$ <u>(121,879)</u>

SUPPLEMENTARY INFORMATION

TERRACE GARDENS, INC.
Operating Program Expenses
Years Ended December 31, 2014 and 2013

	<u>2014</u>		<u>2013</u>	
	<u>Amount</u>	<u>Percent of total revenue</u>	<u>Amount</u>	<u>Percent of total revenue</u>
Administrative				
Advertising	\$ 1,168	0.1 %	\$ 536	- %
Bookkeeping	14,688	0.8	14,688	0.8
Computer charges	2,891	0.2	3,023	0.2
Management fees	56,854	3.0	56,854	3.2
Mileage and travel	693	-	587	-
Miscellaneous	1,501	0.1	4,777	0.3
Office administration	15,759	0.8	14,358	0.8
Security	2,097	0.1	1,972	0.1
Telephone	<u>17,755</u>	<u>0.9</u>	<u>16,176</u>	<u>0.9</u>
Total administrative expense	<u>113,406</u>	<u>5.9</u>	<u>112,971</u>	<u>6.3</u>
Depreciation	412,406	21.5	387,735	21.6
Personnel and benefits				
Administrative salaries	120,627	6.3	127,242	7.1
Health insurance	30,663	1.6	33,890	1.9
Janitor salary	45,205	2.4	41,241	2.3
Maintenance salaries	96,550	5.0	93,850	5.2
Manager's rent free unit	14,880	0.8	14,880	0.8
Payroll taxes	24,094	1.3	23,612	1.3
Workers' compensation insurance	12,376	0.6	14,863	0.8
401K matching/EE benefits	<u>3,442</u>	<u>0.2</u>	<u>3,613</u>	<u>0.2</u>
Total personnel and benefits expense	<u>347,837</u>	<u>18.1</u>	<u>353,191</u>	<u>19.7</u>
Repairs and maintenance				
Decorating and painting	5,691	0.3	3,475	0.2
Elevator maintenance	18,928	1.0	15,685	0.9
Exterminating	6,796	0.4	6,433	0.4
Fire alarm expense	5,246	0.3	5,269	0.3
Grounds contract and supplies	25,125	1.3	25,882	1.4
Heating/cooling repairs	23,527	1.2	19,830	1.1
Janitor	7,584	0.4	5,520	0.3
Plumbing maintenance	10,647	0.6	8,459	0.5
Repairs and maintenance contracts-				
miscellaneous	5,397	0.3	3,335	0.2
Repairs contract	30,608	1.6	44,206	2.5
Exterior painting and replacements	47,929	2.5	73,344	4.1
Rubbish removal	38,679	2.0	32,364	1.8
Window and glass repairs	3,025	0.2	896	-
Rehabilitation expenses	<u>2,557</u>	<u>0.1</u>	<u>1,985</u>	<u>0.1</u>
Total repairs and maintenance expense	<u>231,739</u>	<u>12.1</u>	<u>246,683</u>	<u>13.8</u>

TERRACE GARDENS, INC.
Operating Program Expenses
(Continued)
Years Ended December 31, 2014 and 2013

	2014		2013	
	Amount	Percent of total revenue	Amount	Percent of total revenue
Taxes and insurance				
Fidelity bond insurance	\$ 206	- %	\$ 219	- %
Property insurance	37,690	2.0	34,173	1.9
Property taxes	6,590	0.3	6,650	0.4
Other taxes	<u>5,980</u>	<u>0.3</u>	<u>1,893</u>	<u>0.1</u>
Total taxes and insurance expense	<u>50,466</u>	<u>2.6</u>	<u>42,935</u>	<u>2.4</u>
Utilities				
Electricity	65,509	3.4	61,843	3.4
Gas	21,532	1.1	23,712	1.3
Sewer	18,929	1.0	19,663	1.1
Water	<u>43,706</u>	<u>2.3</u>	<u>47,029</u>	<u>2.6</u>
Total utilities expense	<u>149,676</u>	<u>7.8</u>	<u>152,247</u>	<u>8.5</u>
Food service contract				
Food service costs	<u>488,479</u>	<u>25.4</u>	<u>473,822</u>	<u>26.4</u>
Total food service contract expense	<u>488,479</u>	<u>25.4</u>	<u>473,822</u>	<u>26.4</u>
Recreation				
Recreation supplies	<u>6,674</u>	<u>0.3</u>	<u>5,121</u>	<u>0.3</u>
Total recreation expense	<u>6,674</u>	<u>0.3</u>	<u>5,121</u>	<u>0.3</u>
Total operating expenses	<u>\$ 1,800,683</u>	<u>93.6 %</u>	<u>\$ 1,774,705</u>	<u>99.0 %</u>

ADDITIONAL INDEPENDENT AUDITOR'S REPORT

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
Terrace Gardens, Inc.
Milpitas, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Terrace Gardens, Inc., a California nonprofit public benefit corporation, which comprise the statement of financial position as of December 31, 2014 and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 23, 2015.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Terrace Gardens, Inc.'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 material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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



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April 23, 2015