

**Watts Healthcare Corporation**

**Financial Statements and Independent Auditor's  
Report, Schedule of Expenditures of Federal Awards  
and Independent Auditor's Reports Required by the  
Uniform Guidance**

**December 31, 2019**

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# Watts Healthcare Corporation

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## Independent Auditor's Report

The Honorable Members of the Board of Directors  
Watts Healthcare Corporation

### *Report on the Financial Statements*

We have audited the accompanying financial statements of Watts Healthcare Corporation (the "Corporation"), which comprise the statement of financial position as of December 31, 2019, and the related statements of activities and changes in net assets, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

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

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

### *Auditor's Responsibility*

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

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2019, 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.

## Other Matters

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated July 27, 2020, on our consideration of the Corporation'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Corporation's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control over financial reporting and compliance.



Los Angeles, California  
July 27, 2020

**Watts Healthcare Corporation**

**Statement of Financial Position  
December 31, 2019**

Assets

Current assets	
Cash	\$ 4,819,973
Patient accounts receivable, net of allowance for doubtful accounts of \$76,000	6,251,114
Grants and contracts receivable	3,081,032
Prepaid expenses and other current assets	<u>157,051</u>
Total current assets	14,309,170
Property and equipment, net	10,243,218
Other assets	<u>357,015</u>
Total assets	<u>\$ 24,909,403</u>

Liabilities and Net Assets

Current liabilities	
Accounts payable	\$ 618,019
Accrued expenses	1,169,509
Accrued salaries	637,002
Accrued vacation and sick leave	1,971,041
Claims payable	393,104
Note payable, current portion	<u>116,499</u>
Total current liabilities	4,905,174
Note payable, net of current portion	<u>3,635,141</u>
Total liabilities	<u>8,540,315</u>
Commitments and contingencies	
Net assets	
Without donor restrictions	14,369,088
Without donor restrictions - board-designated	<u>2,000,000</u>
Total net assets	<u>16,369,088</u>
Total liabilities and net assets	<u>\$ 24,909,403</u>

See Notes to Financial Statements.

**Watts Healthcare Corporation**

**Statement of Activities and Changes in Net Assets  
Year Ended December 31, 2019**

Revenue	
Net patient service revenue	\$ 24,605,555
Grants and contracts	13,693,348
Contributions	857,669
Other revenue	<u>148,451</u>
Total revenue	<u>39,305,023</u>
Expenses	
Operating expenses	
Primary care	13,224,712
Specialty care	6,997,098
Ancillary care	3,454,401
Clinical support	4,251,052
Substance abuse	2,926,324
WIC program	3,113,679
Other programs	<u>940,073</u>
Total operating expenses	<u>34,907,339</u>
Supporting services	
General and administrative expenses	5,494,712
Fundraising	<u>76,692</u>
Total supporting expenses	<u>5,571,404</u>
Total expenses	<u>40,478,743</u>
Change in net assets	(1,173,720)
Net assets without donor restrictions, beginning	<u>17,542,808</u>
Net assets without donor restrictions, end	<u>\$ 16,369,088</u>

See Notes to Financial Statements.

**Watts Healthcare Corporation**  
**Statement of Functional Expenses**  
**Year Ended December 31, 2019**

	Operating expenses							Supporting services					Total expenses	
	Primary care services	Specialty care services	Ancillary care services	Clinical support services	Substance abuse programs	WIC program services	Other programs	Total	Less: General and administrative expenses	Total program expenses	General and administrative expenses	Fundraising		Total
Salaries and wages	\$ 9,481,838	\$ 3,803,365	\$ 2,251,379	\$ 1,347,115	\$ 1,725,827	\$ 1,928,570	\$ 620,027	\$ 21,158,121	\$ (2,557,067)	\$ 18,601,054	\$ 2,557,067	\$ -	\$ 2,557,067	\$ 21,158,121
Fringe benefits	3,113,397	1,248,849	739,249	536,834	566,682	633,253	203,588	7,041,852	(910,868)	6,130,984	910,868	-	910,868	7,041,852
Total salaries and fringe benefits	<u>12,595,235</u>	<u>5,052,214</u>	<u>2,990,628</u>	<u>1,883,949</u>	<u>2,292,509</u>	<u>2,561,823</u>	<u>823,615</u>	<u>28,199,973</u>	<u>(3,467,935)</u>	<u>24,732,038</u>	<u>3,467,935</u>	<u>-</u>	<u>3,467,935</u>	<u>28,199,973</u>
Other operating expenses														
Consulting and contracted services	770,466	710,159	236,295	579,410	128,557	96,490	81,286	2,602,663	(728,459)	1,874,204	728,459	76,692	805,151	2,679,355
Space costs	765,655	30,073	-	1,230,081	217,493	626,895	-	2,870,197	(52,644)	2,817,553	52,644	-	52,644	2,870,197
Supplies	667,424	665,250	318,179	130,954	303,282	103,502	36,823	2,225,414	(197,366)	2,028,048	197,366	-	197,366	2,225,414
Healthcare claims	-	680,360	-	-	-	-	-	680,360	-	680,360	-	-	-	680,360
Equipment rentals and leases	187,248	214,682	102,408	151,294	109,050	84,928	5,954	855,564	(127,711)	727,853	127,711	-	127,711	855,564
Data processing	6,421	244,278	33,635	187,523	2,788	5,387	520	480,552	(195,091)	285,461	195,091	-	195,091	480,552
Travel, conferences and training	102,467	78,871	56,867	30,466	48,981	69,001	70,084	456,737	(286,403)	170,334	286,403	-	286,403	456,737
Interest expense	23	6	46	192,578	-	-	-	192,653	(1,991)	190,662	1,991	-	1,991	192,653
Telephone	81,038	49,485	4,398	207,326	42,793	41,812	1,368	428,220	(27,952)	400,268	27,952	-	27,952	428,220
Dues and subscriptions	29,244	58,554	40,541	58,059	40,980	12,448	7,915	247,741	(137,121)	110,620	137,121	-	137,121	247,741
Insurance	7,018	67,035	-	99,909	37,863	3,252	3,252	218,329	(66,854)	151,475	66,854	-	66,854	218,329
Recruitment	-	-	4,774	7,655	43,396	20,830	2,170	78,825	(69,743)	9,082	69,743	-	69,743	78,825
Printing, postage and publication	42,723	20,479	14,852	62,303	11,624	4,706	6,044	162,731	(59,581)	103,150	59,581	-	59,581	162,731
Total other operating expenses before depreciation	<u>2,659,727</u>	<u>2,819,232</u>	<u>811,995</u>	<u>2,937,558</u>	<u>986,807</u>	<u>1,069,251</u>	<u>215,416</u>	<u>11,499,986</u>	<u>(1,950,916)</u>	<u>9,549,070</u>	<u>1,950,916</u>	<u>76,692</u>	<u>2,027,608</u>	<u>11,576,678</u>
Depreciation	134,863	161,240	158,165	128,276	96,665	8,276	14,607	702,092	(75,861)	626,231	75,861	-	75,861	702,092
Total expenses	<u>15,389,825</u>	<u>8,032,686</u>	<u>3,960,788</u>	<u>4,949,783</u>	<u>3,375,981</u>	<u>3,639,350</u>	<u>1,053,638</u>	<u>40,402,051</u>	<u>(5,494,712)</u>	<u>34,907,339</u>	<u>\$ 5,494,712</u>	<u>\$ 76,692</u>	<u>\$ 5,571,404</u>	<u>\$ 40,478,743</u>
Total general and administrative expenses	<u>(2,165,113)</u>	<u>(1,035,588)</u>	<u>(506,387)</u>	<u>(698,731)</u>	<u>(449,657)</u>	<u>(525,671)</u>	<u>(113,565)</u>	<u>(5,494,712)</u>	<u>5,494,712</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total program expenses	<u>\$ 13,224,712</u>	<u>\$ 6,997,098</u>	<u>\$ 3,454,401</u>	<u>\$ 4,251,052</u>	<u>\$ 2,926,324</u>	<u>\$ 3,113,679</u>	<u>\$ 940,073</u>	<u>\$ 34,907,339</u>	<u>\$ -</u>	<u>\$ 34,907,339</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

See Notes to Financial Statements.

**Watts Healthcare Corporation**

**Statement of Cash Flows  
Year Ended December 31, 2019**

Cash flows from operating activities	
Change in net assets	\$ (1,173,720)
Adjustments to reconcile change in net assets to net cash provided by operating activities	
Depreciation	702,092
Changes in operating assets and liabilities	
Patient accounts receivable	1,388,606
Grants and contracts receivable	(680,477)
Prepaid expenses and other current assets	(19,513)
Other assets	(274,022)
Accounts payable	21,727
Accrued expenses	(27,135)
Accrued salaries	101,558
Accrued vacation and sick leave	143,727
Claims payable	267,845
Deferred revenue	<u>(23,169)</u>
Net cash provided by operating activities	<u>427,519</u>
Cash flows from investing activities	
Acquisition of property and equipment	<u>(1,075,706)</u>
Net cash used in investing activities	<u>(1,075,706)</u>
Cash flows from financing activities	
Loan payments	<u>(103,208)</u>
Net cash used in financing activities	<u>(103,208)</u>
Net decrease in cash	(751,395)
Cash, beginning	<u>5,571,368</u>
Cash, end	<u><u>\$ 4,819,973</u></u>
Supplemental disclosure of cash flow information	
Interest paid during the year	<u><u>\$ 189,008</u></u>

See Notes to Financial Statements.

**Watts Healthcare Corporation**

**Notes to Financial Statements  
December 31, 2019**

**Note 1 - Organization and summary of significant accounting policies**

**Organization**

Watts Healthcare Corporation ("WHCC") is a non-profit corporation supported by federal, state, and local grants, private foundation grants, and revenues from operations. WHCC is a Federally Qualified Health Center whose organizational activities consist of providing high quality clinical, preventive, behavioral and restorative services to the low-income population of South Central Los Angeles. WHCC operates three primary health care facilities; two are located in the Watts district and one is located in the Crenshaw district of the City of Los Angeles. WHCC provides service delivery sites for substance abuse treatment, HIV, and women, infants and children (WIC) nutrition at nine additional locations throughout South Los Angeles County. In addition, WHCC provides mobile dental services as well as mobile services for women throughout South Los Angeles. The Board of Directors governs all of the operations and programs of WHCC through the management team led by the Chief Executive Officer. The underlying philosophy and objective of WHCC is to provide high quality comprehensive health services to the communities it serves, regardless of the patient's ability to pay.

During the year ended December 31, 2019, WHCC received the following mix of revenues from grantors, patients and third-party payors:

Patient fees (primarily Medi-Cal and Medicare)	49%
Managed care contracts	13%
Grants and other contracts	35%
Other revenues	<u>3%</u>
Total	<u><u>100%</u></u>

The U.S. Department of Health and Human Services (the "DHHS") provides substantial support to WHCC. WHCC is obligated under the terms of the DHHS grants to comply with specified conditions and program requirements set forth by the grantor.

**Basis of accounting**

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

**Financial statement presentation**

WHCC reports information regarding its financial position and activities according to two classes of net assets: without donor restrictions and with donor restrictions. They are described as follows:

- *Net Assets Without Donor Restrictions - Undesignated* - Net assets that are not subject to explicit donor-imposed stipulations. Net assets may be designated for specific purposes by action of the Board.
- *Net Assets Without Donor Restrictions - Board-Designated* - Net assets that are not subject to explicit donor-imposed stipulations but have been designated by the Board for a specific purpose. At December 31, 2019, WHCC's Board designated \$1,000,000 to fund future debt refinancing plan and another \$1,000,000 for major property and equipment purchase and maintenance expenditures.

## Watts Healthcare Corporation

### Notes to Financial Statements December 31, 2019

- *Net Assets With Donor Restrictions* - Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time, purpose, or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature where the donor stipulated that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. At December 31, 2019, there were no net assets with donor restrictions.

#### Property and equipment

Property and equipment are recorded at cost if purchased or, if contributed, at fair value at date of contribution. WHCC capitalizes all expenditures for property and equipment in excess of \$5,000; the fair value of contributed property, plant, and equipment is similarly capitalized.

Provision for depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets, which range from three to 40 years. The American Hospital Association Estimated Useful Lives of Depreciable Hospital Assets is used as the guideline for determining useful lives of assets.

Property acquired with certain federal funds is considered to be owned by WHCC while used in the program for which it was purchased or in other future authorized programs. The disposition, as well as the ownership of any proceeds therefrom, is subject to federal regulations.

WHCC 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 such asset is 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. During the year ended December 31, 2019, there were no events or changes in circumstances indicating that the carrying amount of the property and equipment may not be recoverable.

#### Accrued vacation and sick leave

WHCC employees may accumulate vacation during their employment with the corporation and redeem unused sick and vacation time in cash upon termination of employment subject to certain limitations. The estimated amounts of accrued vacation pay and sick leave at December 31, 2019 are as follows:

Accrued sick leave	\$ 714,879
Accrued vacation leave	<u>1,256,162</u>
Total	<u>\$ 1,971,041</u>

#### Net patient services revenue and net patient receivables

Patient care service revenue is reported at the amount that reflects the consideration to which WHCC expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, WHCC bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

## **Watts Healthcare Corporation**

### **Notes to Financial Statements December 31, 2019**

Performance obligations are determined based on the nature of the services provided by WHCC. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. WHCC believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving services in our outpatient centers. WHCC measures the performance obligation from the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our pharmacy revenue patients and customers and WHCC does not believe it is required to provide additional goods or services related to that sale.

WHCC determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with WHCC's policy, and implicit price concessions provided to uninsured patients. WHCC determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. WHCC determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

Medicare - Outpatient services are paid using prospectively determined rates.

Medicaid - Reimbursements for Medicaid services are generally paid at prospectively determined rates per visit or per covered member.

Other - Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per visit, discounts from established charges, and prospectively determined daily rates.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. WHCC also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. WHCC estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

#### **Charity care and community benefit**

WHCC is open to all patients, regardless of their ability to pay. In the ordinary course of business, WHCC renders services to patients who are financially unable to pay for healthcare. WHCC provides care to these patients who meet certain criteria under its sliding fee discount policy without charge or at amounts less than the established rates. Charity care services are computed using a sliding fee scale based on patient income and family size.

## **Watts Healthcare Corporation**

### **Notes to Financial Statements December 31, 2019**

WHCC maintains records to identify and monitor the level of sliding fee discount it provides. For uninsured self-pay patients that do not qualify for charity care, WHCC recognizes revenue on the basis of its standard rates for services provided or on the basis of discounted rates, if negotiated or provided by policy. On the basis of historical experience, a significant portion of WHCC's uninsured patients will be unable or unwilling to pay for the services provided. Thus, WHCC records an explicit concession to uninsured patients in the period the services are provided based on historical experience.

Community benefit represents the cost of services for Medicaid, Medicare, and other public patients for which WHCC is not reimbursed.

Based on the cost of patient services, charity care and community benefit for the year ended December 31, 2019 was \$2.5 million and \$3.1 million, respectively. Such amounts determined to qualify as charity care are not reported as revenue.

#### **Pharmacy receivable and revenue**

WHCC participates in Section 340B of the Public Health Service Act ("PHS Act"), Limitation on Prices of Drugs Purchased by Covered Entities. Participation in this program allows WHCC to purchase pharmaceuticals at discounted rates for prescriptions to eligible patients. Pharmacy revenue is generated through the pharmacy and 340B program that WHCC operates through its agreement with a third party for the year ended December 31, 2019. Under this program, WHCC uses the third party as its agent for the purpose of operating and managing the pharmacy and providing pharmacy services. WHCC recognized pharmacy revenue of \$254,870, included in net patient service revenue, for the year ended December 31, 2019.

#### **Grants and contracts**

Revenue from grants and contracts with resource providers such as the government and its agencies, other organizations and private foundations are accounted for either as exchange transactions or as contributions. When the resource provider receives commensurate value in return for the resources transferred to WHCC, the revenue from the grant or contract is accounted for as an exchange transaction in accordance with Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*. For purposes of determining whether a transfer of asset is a contribution or an exchange, WHCC deems that the resource provider is not synonymous with the general public, i.e., indirect benefit received by the public as a result of the assets transferred is not deemed equivalent to commensurate value received by the resource provider. Moreover, the execution of a resource provider's mission or the positive sentiment from acting as a donor is not deemed to constitute commensurate value received by a resource provider. Revenue from grants and contracts that are accounted for as exchange transactions is recognized when performance obligations have been satisfied. Grants and contracts awarded for the acquisition of long-lived assets are reported as nonoperating revenue, in the absence of donor stipulations to the contrary, during the fiscal year in which the assets are acquired. Cash received in excess of revenue recognized is recorded as refundable advances.

Grants and contracts require WHCC to complete certain performance obligations during specified periods. If such performance obligations are not provided during the specified periods, the governmental entities are not obligated to expend the funds allotted under the contracts. On the other hand, when the resource provider does not receive commensurate value, the transaction is accounted for as a contribution.

## **Watts Healthcare Corporation**

### **Notes to Financial Statements December 31, 2019**

#### **Contributions**

Transactions where the resource provider often receive value indirectly by providing a societal benefit, although the societal benefit is not considered to be of commensurate value, are deemed to be contributions. Contributions are classified as either conditional or unconditional. A conditional contribution is a transaction where WHCC has to overcome a barrier or hurdle to be entitled to the resource and the resource provider is released from the obligation to fund or has the right of return of any advanced funding if WHCC fails to overcome the barrier. WHCC recognizes the contribution revenue upon overcoming the barrier or hurdle. Any funding received prior to overcoming the barrier is recognized as refundable advance.

Unconditional contributions are recognized as revenue and receivable when the commitment to contribute is received.

Conditional and unconditional contributions are recorded as either with donor restriction or without donor restriction. Contributions are recognized as contributions with donor restrictions if they are received with donor stipulations that limit the use of the donated asset. Contributions received with no donor stipulations are recorded as contributions without donor restrictions. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and are reported in the statements of activities and changes in net assets as net assets released from restriction. Donor-restricted contributions whose restrictions expire during the same fiscal year are recognized as contribution without donor restrictions.

#### **Functional allocation of expenses**

The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities and changes in net assets. Costs that have been incurred by a specific program service or supporting services are charged directly to that service. Other management and general administrative expenses are allocated based on the amount of time personnel spend on each service.

#### **Concentrations of credit risk**

Financial instruments that potentially subject WHCC to concentrations of credit risk consist principally of receivables and cash accounts in financial institutions. The total cash balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per institution. As of December 31, 2019, WHCC's bank deposits exceeded the balance insured by the FDIC by approximately \$4,781,000. WHCC monitors its financial institutions and the concentration of credit risk on a regular basis and does not anticipate nonperformance by the financial institutions.

Patient services receivable credit risk is limited because the receivables are reported at the original charge for the service provided less discounts provided under WHCC's charity care policy, less amounts covered by third-party payors and less an estimated allowance for doubtful receivables. WHCC estimates doubtful accounts based on historical bad debts, factors related to specific payors' ability to pay and current economic trends. WHCC writes off accounts receivable against the allowance when a balance is determined to be uncollectible.

#### **Performance indicator**

The statement of activities and changes in net assets includes change in net assets as the performance indicator.

## Watts Healthcare Corporation

### Notes to Financial Statements December 31, 2019

#### Income taxes

WHCC is a non-profit organization that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the Revenue Taxation Code of California. Accordingly, no provision for income taxes is included in the accompanying financial statements.

WHCC has no unrecognized tax benefits at December 31, 2019. WHCC's federal and state income tax returns prior to fiscal year 2016 are closed. Management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

If applicable, WHCC recognizes interest and penalties associated with tax matters as part of income tax expense and includes accrued interest and penalties with accrued expenses in the statement of financial position.

#### Use of estimates

The preparation of financial statements in conformity with GAAP 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Adoption of new accounting pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, *Revenue from Contracts with Customers ("ASC 606")*. ASC 606 provides new revenue recognition guidance that superseded existing revenue recognition guidance. The update, as amended, requires the recognition of revenue related to the transfer of goods or services to customers which reflects the consideration to which WHCC expects to be entitled in exchange for those goods or services, as well as additional qualitative and quantitative disclosures about revenues. WHCC adopted ASU 2014-09 on January 1, 2019 using the modified retrospective method of transition. WHCC performed an analysis of revenue streams and transactions under ASU 2014-09. In particular, for patient service revenue net of contractual allowances and discounts and for pharmacy revenue, WHCC performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts and group pharmacy contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what was previously classified as provision for bad debts and presented as reduction to patient revenue net of contractual allowances and discounts on the statement of activities and changes in net assets is now treated as a price concession that reduces the transaction price, which is reported as net patient services revenue. The new standard also requires enhanced disclosures related to the disaggregation of revenue and significant judgments made in measurement and recognition. The impact of adopting ASU 2014-09 was not material to total revenue without donor restrictions, increase in net assets without donor restrictions, or total net assets.

WHCC's revenue for reporting periods ended after December 31, 2018 is presented under the new guidance, while financial results for prior periods will continue to be reported in accordance with the prior guidance and WHCC's historical accounting policy. WHCC has not experienced significant changes to the pattern of revenue recognition for its contracts, the identification of contracts and performance obligations or the measurement of variable consideration. The adoption of the new standard did not have a material impact on WHCC's financial position, activities, net assets or cash flows as of the adoption date.

## Watts Healthcare Corporation

### Notes to Financial Statements December 31, 2019

In June 2018, FASB issued ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This standard assists entities in evaluating whether transactions should be accounted for as contributions or exchange transactions and determining whether a contribution is conditional. WHCC implemented the provisions of ASU 2018-08 applicable to both contributions received and to contributions made in the accompanying financial statements under a modified prospective basis. Accordingly, there is no effect on net assets in connection with the implementation of ASU 2018-08.

#### Subsequent events

WHCC has evaluated subsequent events through July 27, 2020, which is the date the financial statements were available to be issued.

#### Note 2 - Liquidity and availability of resources

WHCC regularly monitors liquidity required to meet its operating needs and other contractual commitments. WHCC operates with a balanced operating budget and anticipates collecting sufficient revenue to cover general expenditures.

The following table reflects WHCC's financial assets as of December 31, 2019, reduced by amounts not available for general expenditure within one year because of donor restrictions or contractual obligations. Financial assets are considered unavailable when illiquid or not convertible to cash within one year, or because the governing board has set aside the funds for a specific contingency reserve or a long-term investment.

Financial assets	
Cash	\$ 4,819,973
Patient accounts receivable, net of allowance for doubtful accounts	6,251,114
Grants and contracts receivable	<u>3,081,032</u>
	14,152,119
Less those unavailable for general expenditure within one year due to	
Net assets without donor restrictions - board-designated	<u>2,000,000</u>
Financial assets available to meet cash needs for general expenditures within one year	<u><u>\$ 12,152,119</u></u>

**Watts Healthcare Corporation**

**Notes to Financial Statements  
December 31, 2019**

**Note 3 - Patient accounts receivable**

At December 31, 2019, patient accounts receivable consists of the following:

Medicare	\$ 3,028,943
Medi-Cal/Managed care	54,871,646
FQHC reconciliation/PPS cost report	<u>1,546,213</u>
Subtotal	59,446,802
Less allowance for contractual accounts	<u>(53,119,688)</u>
Patient accounts receivable, net of contractual allowances	6,327,114
Less allowance for uncollectible accounts	<u>(76,000)</u>
Total	<u><u>\$ 6,251,114</u></u>

Patients accounts receivable at December 31, 2018 was \$7,639,720. Patient accounts receivable is reduced by an allowance for doubtful accounts. In evaluating the collectability of patient accounts receivable, WHCC analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, WHCC analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), WHCC records a provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates provided by WHCC's policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for doubtful accounts.

WHCC's allowance for doubtful accounts for self-pay patients was 50 percent of self-pay patient accounts receivable at December 31, 2019. In addition, WHCC's self-pay write-offs were \$5,093 for the year ended December 31, 2019. WHCC has not changed its charity care or uninsured discount policies during year ended December 31, 2019.

**Watts Healthcare Corporation**

**Notes to Financial Statements  
December 31, 2019**

**Note 4 - Property and equipment**

At December 31, 2019, property and equipment consists of the following:

Land	\$ 5,386,653
Building and improvements	3,853,552
Leasehold improvements	37,471
Furniture and equipment	4,063,100
Transportation equipment	806,398
Computer systems	<u>2,294,228</u>
	16,441,402
Less accumulated depreciation	<u>(6,198,184)</u>
Total	<u>\$ 10,243,218</u>

Depreciation expense for the year ended December 31, 2019 was \$702,092. The land and building and improvements were used as collateral to secure the note payable (see Note 5).

**Note 5 - Note payable**

On August 25, 2014, WHCC entered into an agreement with Capital Impact Partners ("CIP") a non-profit corporation under the laws of the District of Columbia, for a note ("Note C") in the amount of \$4,300,000 with an adjustable per annum interest rate of 4.89%. The loan proceeds were used solely to refinance a loan made by NCBDC CDE 22, LLC ("NCBDC"), a Delaware limited liability company, on August 20, 2007, to fund certain capital improvements, and to pay all closing costs, legal fees and other financing costs related to the loan.

The maturity date of the note is August 25, 2024. The note is payable in successive monthly installments of principal and interest on the first day of each and every calendar month until maturity date. The loan is collateralized by WHCC's land and building and improvements.

During the current year, WHCC was able to remain in technical compliance with the financial covenants.

At December 31, 2019, note payable consists of the following:

Note C	\$ 3,751,640
Less current portion	<u>116,499</u>
Note payable, net of current portion	<u>\$ 3,635,141</u>

**Watts Healthcare Corporation**

**Notes to Financial Statements  
December 31, 2019**

Schedule of repayments on the note is as follows:

2020	\$	116,499
2021		122,935
2022		129,170
2023		135,722
2024		<u>3,247,314</u>
	\$	<u><u>3,751,640</u></u>

**Note 6 - Grants services and other grants revenue**

For the year ended December 31, 2019, WHCC recognized revenue from DHHS, which is included in grants and contracts on the accompanying statement of activities and changes in net assets, as follows:

<u>Grant number</u>	<u>Grant period</u>	<u>Total grant</u>	<u>Operating revenue</u>
H80CS00850	01/01/19 - 12/31/19	\$ 7,262,767	\$ 7,262,767
H76HA00832	01/01/19 - 12/31/19	275,727	275,727
5H79T102448-05	09/30/18 - 09/29/19	538,723	538,723
C8DCS29799	05/02/16 - 04/30/19	<u>880,479</u>	<u>331,519</u>
Total		<u>\$ 8,957,696</u>	<u>\$ 8,408,736</u>

**Note 7 - Patient service revenue, net**

WHCC recognizes patient services revenue associated with services provided to patients who have Medi-Cal, Medicare, Third Party Payor and Managed Care plans coverage on the basis of contractual rates for services rendered. For uninsured self-pay patients that do not qualify for charity care, WHCC recognizes revenue on the basis of its standard rates for services provided or on the basis of discounted rates if negotiated or provided by WHCC's policy. Charity care services are computed using a sliding fee scale based on patient income and family size. On the basis of historical experience, a significant portion of WHCC's uninsured patients will be unable or unwilling to pay for the services provided. Thus, WHCC records a provision for bad debts related to uninsured patients in the period the services are provided.

Patient service revenue, net of contractual allowances and discounts recognized in the period from these major payor sources is as follows:

Medi-Cal fee for service	\$	5,178,041
Medi-Cal managed care wrap		9,124,221
Medi-Cal managed care		4,485,855
Medicare/dual eligible		1,332,733
Self-pay		423,401
Other		<u>4,061,304</u>
Total	\$	<u><u>24,605,555</u></u>

**Watts Healthcare Corporation**

**Notes to Financial Statements  
December 31, 2019**

Medi-Cal and Medicare revenue is reimbursed to WHCC at the net reimbursement rates as determined by each program. Reimbursement rates are subject to revisions under the provisions of reimbursement regulations. Adjustments for such revisions are recognized in the fiscal year incurred.

**Note 8 - Net assets without donor restrictions - board-designated**

In December 2010, the Board of Directors set aside \$1,000,000 to fund future debt refinancing plans and another \$1,000,000 for major property and equipment purchase and maintenance expenditures.

**Note 9 - Retirement plan**

WHCC maintains a defined contribution pension plan covering substantially all full-time employees who meet certain eligibility requirements. WHCC contributes 5-8% of eligible employees' gross salaries to the plan. After one year of employment, eligible employees who have worked 1,000 hours are enrolled and are 20% vested for their first year of participation. Thereafter they are 20% vested for each subsequent year until they are 100% vested at the fifth year of participation. WHCC's contributions amounted to \$867,725 for the year ended December 31, 2019, which is included in fringe benefits in the statement of functional expenses.

**Note 10 - Commitments and contingencies**

**Operating leases**

WHCC occupies certain facilities under both month-to-month and long-term lease agreements expiring through September 2023. Future minimum rental payments under these noncancelable lease terms in excess of one year at December 31, 2019 are as follows:

2020	\$	977,887
2021		839,773
2022		333,995
2023		<u>26,404</u>
	\$	<u><u>2,178,059</u></u>

Total rent expense amounted to \$1,175,929 for the year ended December 31, 2019, under such operating leases, which is included in space costs in the statement of functional expenses.

**Federal and state grants**

Continuing program funding from federal and state sources is contingent upon availability of funds and project performance. The funds are awarded on a yearly basis upon receipt and approval of program applications. In addition, expenses made under federal and state grants are subject to review and audit by the grantor agencies.

**Medicare/Medi-Cal cost report**

WHCC is reimbursed at prospectively determined rates which are unique to each clinical location for all types of services within each location on an encounter reporting basis. Final settlement is determined after submission of the annual Medicare/Medi-Cal Reconciliation Request Form to the California Department of Health Care Services (the "Department") for purposes of determining whether it was paid appropriately for certain Medicare/Medi-Cal visits. These annual reconciliations result in the determination of any underpayment or overpayment by the Medicare/Medi-Cal program

## **Watts Healthcare Corporation**

### **Notes to Financial Statements December 31, 2019**

for the affected visits. WHCC has recorded a receivable for estimated settlements expected to be received for Medicare/Medi-Cal Reconciliation Request Forms for the years ended December 31, 2014 through 2019. Following submission of the Medicare/Medi-Cal Reconciliation Request Form, WHCC will generally receive a tentative settlement from the Medicare/Medi-Cal program with a final settlement generally made within three years of the date of submission. Department audits for years 2015 and prior have been completed and final settlements were received as of December 31, 2019. WHCC recognized income of \$42,644 for the year ended December 31, 2019 related to changes in estimates on prior year settlements.

#### **Contingencies**

WHCC is subject to certain claims that arise out of the normal course of operations. In the opinion of management, WHCC has sufficient liability insurance to cover any such claims, and these matters will not have a material effect on the financial position of WHCC if disposed of unfavorably.

#### **Malpractice coverage**

WHCC maintains its medical malpractice coverage under the Federal Tort Claims Act ("FTCA"). FTCA provides malpractice coverage to eligible United States Public Health Service supported programs and applies to WHCC and its employees while providing services within the scope of employment included under grant-related activities. The Attorney General, through the U.S. Department of Justice, has the responsibility for the defense of the individual and/or grantee for malpractice cases approved for FTCA coverage. WHCC maintains gap insurance for claims that are not covered by FTCA.

#### **Note 11 - Claims payable**

Operating expenses incurred in the provision of health services are accrued in the period in which services are provided to patients based in part on estimates, including accrual for medical services provided but not yet reported to WHCC. Incurred but not reported ("IBNR") costs are costs associated with health care services incurred during a financial reporting period but not reported to the health care WHCC until after the financial reporting date. WHCC's estimated IBNR claims are determined based on claim lag studies that track and measure date of service against date of payment. The claim lag reports are also adjusted to reflect the current month because these reports are mathematically sensitive to prior history. Estimated IBNR of \$393,104 is presented as claims payable as of December 31, 2019.

#### **Note 12 - Subsequent events**

In December 2019 and early 2020, the coronavirus that causes COVID-19 was reported to have surfaced in China. The spread of this virus globally including in early 2020 has caused business disruption domestically in the United States, the area in which WHCC primarily operates. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration of this uncertainty. Therefore, while WHCC expects this matter to negatively impact WHCC's financial condition, results of operations, or cash flows, the extent of the financial impact and duration cannot be reasonably estimated at this time.

On May 1, 2020, WHCC obtained a loan under the Small Business Administration's Paycheck Protection Program for a total of \$5,182,635. The note has an interest rate of 1.00% per annum and is due on May 1, 2022. Per the terms of the Paycheck Protection Program a portion of the loan's principal may be forgiven depending on how WHCC uses the funds.

**Watts Healthcare Corporation**

**Schedule of Expenditures of Federal Awards  
Year Ended December 31, 2019**

Federal grantor/pass-through grantor/program or cluster title	Federal CFDA number	Pass-through grantor's number	Passed through to subrecipients	Total expenditures
<u>U.S. Department of Health and Human Services</u>				
Direct Programs				
Health Center Program Cluster				
Health Center Program	93.224	H80CS00850	\$ -	\$ 2,443,028
Grants for New and Expanded Services under the Health Center Program	93.527	H80CS00850	-	4,784,119
Total Health Center Program Cluster			-	7,227,147
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	H76HA00832	-	275,727
Substance Abuse and Mental Health Services Projects of Regional and National Significance	93.243	1H79TI080721-01	-	540,451
Total direct programs			-	8,043,325
Passed through the County of Los Angeles				
HIV Emergency Relief Project Grants				
AIDS Outpatient	93.914	PH 003773	-	70,656
HIV/AIDS Medical Care Coordination	93.914	PH 003774	-	195,953
HIV/AIDS Dental Health	93.914	PH 003810	-	298,777
HIV/AIDS Residential Rehab	93.914	H701059	-	73,217
Total 93.914			-	638,603
Block Grants for Prevention and Treatment of Substance Abuse				
Drug Medi-Cal	93.959	PH 003882	-	2,807,806
Perinatal	93.959	PH 003882	-	60,167
Capacity Building	93.959	PH-033156	-	93,939
Alcohol & Drug Prevention	93.959	PH-002785	-	330,734
Total 93.959			-	3,292,646
Passed through the California Family Health Council				
Family Planning Services	93.217	5000 5320 71209 19 20	-	166,417
Total U.S. Department of Health and Human Services			-	12,140,991
<u>Department of Agriculture</u>				
Passed through the State of California				
WIC Special Supplemental Nutrition Program for Women, Infants and Children	10.557	19-10208	-	3,667,707
Total expenditures of federal awards			\$ -	\$ 15,808,698

See Notes to Schedule of Expenditures of Federal Awards.

## Watts Healthcare Corporation

### Notes to Schedule of Expenditures of Federal Awards December 31, 2019

#### **Note 1 - Basis of presentation**

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal award activity of Watts Healthcare Corporation (the "Corporation") under programs of the federal government for the year ended December 31, 2019. The information in the Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"). Because the Schedule presents only a selected portion of the operations of the Corporation, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Corporation.

#### **Note 2 - Summary of significant accounting policies**

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. The Corporation has not elected to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance.

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*

The Honorable Members of the Board of Directors  
Watts Healthcare Corporation

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 Watts Healthcare Corporation (the "Corporation"), which comprise the statement of financial position as of December 31, 2019, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 27, 2020.

*Internal Control over Financial Reporting*

In planning and performing our audit of the financial statements, we considered the Corporation'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 Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control.

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

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

*Compliance and Other Matters*

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

*Purpose of this Report*

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

*CohnReznick LLP*

Los Angeles, California  
July 27, 2020

Independent Auditor's Report on Compliance for Each Major Federal Program and Report on  
Internal Control over Compliance Required by the Uniform Guidance

The Honorable Members of the Board of Directors  
Watts Healthcare Corporation

*Report on Compliance for Each Major Federal Program*

We have audited Watts Healthcare Corporation's (the "Corporation") compliance with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Compliance Supplement* that could have a direct and material effect on each of the Corporation's major federal programs for the year ended December 31, 2019. The Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

*Management's Responsibility*

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

*Auditor's Responsibility*

Our responsibility is to express an opinion on compliance for each of the Corporation's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Corporation's compliance.

*Opinion on Each Major Federal Program*

In our opinion, the Corporation complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2019.

*Report on Internal Control over Compliance*

Management of the Corporation is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Corporation's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over compliance.

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

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

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

A handwritten signature in black ink that reads "CohnReznick LLP".

Los Angeles, California  
July 27, 2020

**Watts Healthcare Corporation**

**Schedule of Findings and Questioned Costs  
Year Ended December 31, 2019**

Section I - Summary of Auditor's Results

Financial Statements

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

Federal Awards

Internal control over major programs:	
• Material weakness(es) identified?	No
• Significant deficiency(ies) identified?	None reported
Type of auditor's report issued on compliance for major federal programs:	<u>Unmodified opinion</u>
Any audit findings disclosed that are required to be reported in accordance with 2 CFR Section 200.516(a)?	No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
93.959	United States Department of Health and Human Services: Block Grants for Prevention and Treatment of Substance Abuse
10.557	United States Department of Agriculture WIC Special Supplemental Nutrition Program for Women, Infants, and Children

Dollar threshold used to distinguish between type A and type B programs:	\$750,000
Auditee qualified as low-risk auditee?	No

Section II - Financial Statement Findings

No matters were reported.

**Watts Healthcare Corporation**  
**Schedule of Findings and Questioned Costs**  
**Year Ended December 31, 2019**

Section III - Federal Award Findings and Questioned Costs

No matters were reported.



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