



**Single Audit Report**  
**Watts Healthcare Corporation**  
*Year ended December 31, 2014*  
*with Report of Independent Auditors*

An Independently Owned Member  
**McGLADREY ALLIANCE**



 **Vasquez**  
& Company LLP  
Certified Public Accountants and Business Consultants



**Single Audit Report**  
**Watts Healthcare Corporation**  
***Year ended December 31, 2014***  
***with Report of Independent Auditors***

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**Report of Independent Auditors on Internal Control over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with Government Auditing Standards**

**Board of Directors  
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, 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 June 10, 2015.

**Internal Control over Financial Reporting**

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

*Vasquez + Company LLP*

**Los Angeles, California  
June 10, 2015**

**Report of Independent Auditors on Compliance for Each Major Federal Program,  
on Internal Control over Compliance, and on the Schedule of Expenditures  
of Federal Awards Required by OMB Circular A-133**

**Board of Directors  
Watts Healthcare Corporation**

**Report on Compliance for Each Major Federal Program**

We have audited Watts Healthcare Corporation's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Watts Healthcare Corporation's major federal programs for the year ended December 31, 2014. Watts Healthcare 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 the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for each of Watts Healthcare 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Watts Healthcare 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 Watts Healthcare Corporation's compliance.

***Opinion on Each Major Federal Program***

In our opinion, Watts Healthcare 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, 2014.



### **Other Matters**

The results of our auditing procedures disclosed an instance of noncompliance which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding No. 2014-001. Our opinion on each major federal program is not modified with respect to this matter.

WHCC's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. WHCC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

### **Report on Internal Control over Compliance**

Management of Watts Healthcare 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 Watts Healthcare 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 OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Watts Healthcare 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 preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



## **Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133**

We have audited the financial statements of Watts Healthcare Corporation as of and for the year ended December 31, 2014, and have issued our report thereon dated June 10, 2015, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 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 schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

*Vasquez + Company LLP*

**Los Angeles, California  
June 10, 2015**

**Watts Healthcare Corporation**  
**Schedule of Expenditures of Federal Awards**  
**Year ended December 31, 2014**

Federal Grantor / Pass Through Grantor / Program Title	Pass Through Grantor's Number	CFDA Number	Federal Expenditures
<b>MAJOR PROGRAMS</b>			
<b>Department of Health and Human Services</b>			
Direct Programs:			
Substance Abuse and Mental Health Services Admin - TCEP	5H79TI024448	93.243	\$ 562,427
Passed through the County of Los Angeles			
Block Grants for Prevention and Treatment of Substance Abuse			
General Program Services (GPS), Perinatal & First Five	PH002269	93.959	1,630,035
Alcohol & Drug Prevention	PH002036A	93.959	208,553
		Total 93.959	<u>1,838,588</u>
<b>Department of Agriculture</b>			
Passed through the State of California			
Women, Infants and Children (WIC)	11-10510	10.557	<u>3,761,470</u>
		Total Major Programs	<u>6,162,485</u>
<b>NONMAJOR PROGRAMS</b>			
<b>Department of Health and Human Services</b>			
Direct Programs:			
Community Health Centers	H80CS00850	93.224	5,966,223
Outpatient Early Intervention Services with Respect to HIV Disease	H76HA00832	93.918	436,385
Passed through the County of Los Angeles			
HIV Emergency Relief Project Grant			
AIDS Outpatient	PH-002368	93.914	143,346
AIDS Psychiatry	H209575	93.914	37,412
HIV / AIDS Medical Care Coordination	PH-002376	93.914	96,557
HIV / AIDS Dental Health	PH002155	93.914	241,576
HIV Care Formula Grants			
HIV / AIDS Residential Rehabilitation	H701059	93.914	193,435
HIV Prevention Activities			
HIV / AIDS Prevention Case Management	PH001056	93.914	106,774
		Total 93.914	<u>819,100</u>
Passed through the California Family Health Council			
Title X - Family Planing		93.217	<u>130,844</u>
		Total Nonmajor Programs	<u>7,352,552</u>
		Total Federal Programs \$	<u>13,515,037</u>

*See accompanying Notes to Schedule of Expenditures of Federal Awards and the Report of Independent Auditors on Compliance for Each Major Federal Program, on Internal Control over Compliance, and on the Schedule of Expenditures of Federal Awards Required by OMB Circular A-133.*

**NOTE 1            GENERAL**

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal awards programs of Watts Healthcare Corporation (WHCC). WHCC's organization is defined in Note 1 of the WHCC's financial statements. All federal awards, including federal awards passed through intermediate governmental agencies to WHCC, is included in the accompanying schedule.

**NOTE 2            BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards is presented using the accrual basis of accounting, which is described in Note 2 of the Notes to the Financial Statements of WHCC as of and for the year ended December 31, 2014. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the financial statements

**NOTE 3            RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Amounts reported in the accompanying schedule agree with the amounts reported in the related federal financial reports taken as a whole.

**Watts Healthcare Corporation  
Schedule of Findings and Questioned Costs  
Year ended December 31, 2014**

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**Section I – Summary of Auditors’ Results**

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**Financial Statements**

Type of auditors’ report issued on the financial statements:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	No
• Significant deficiency(ies) identified?	None reported
Noncompliance material to the financial statements noted?	No

**Federal Awards**

Internal control over major programs:	
• Material weakness(es) identified?	No
• Significant deficiency(ies) identified?	None reported
Type of auditors’ report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	Yes (2014-001)

**Identification of Major Programs:**

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
93.243	Substance Abuse and Mental Health Services Administration
93.959	Block Grants for Prevention and Treatment of Substance Abuse
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)

Dollar threshold used to distinguish between Type A and Type B programs:	\$ 405,451
Auditee qualified as a low-risk auditee:	Yes

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**Section II – Financial Statement Findings**

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None reported.

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**Section III – Federal Award Findings**

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**Finding No. 2014-001 – Allowable Costs / Cost Principles**

***Federal Program Information***

<i>Federal Catalog Number:</i>	93.243
<i>Federal Program Name:</i>	Substance Abuse and Mental Health Services Administration (SAMHSA)
<i>Federal Agency:</i>	Department of Health and Human Services (DHHS)
<i>Pass-Through Entity:</i>	N/A

***Criteria***

Funds (including direct costs and indirect costs) may be used for expenses clearly related and necessary to carry out approved activities that will provide immediately useful, practical knowledge that service providers need as they wrestle with the rapidly changing health care environment.

***Condition***

During our test of disbursements, we noted that the fund was charged for proposal development costs for the SAMHSA Minority AIDS Initiative Continuum of Care Pilot Program in the amount of \$3,000. We believe this expense should be classified under the general and administrative expenses of WHCC.

***Questioned costs***

\$6,000 (includes similar expenses totaling \$3,000)

***Possible Asserted Cause and Effect***

There may be an error in the classification of the above expense. WHCC may need to return the above amount to DHHS or adjust the expenses reported to DHHS.

***Recommendation***

We recommend that WHCC return the above funds or amend the reported expenses under the program. WHCC should ensure that expenses are correctly coded to the proper accounts to avoid the above error.

***View of Responsible Officials and Planned Corrective Action***

The invoices for the SAMHSA Minority AIDS Initiative Continuum of Care Pilot Program as well as three other invoices were coded incorrectly. The consultant (grant writer) who is also the program evaluator for the SAMHSA program works on different proposals as needed. To avoid future coding errors, WHCC will develop a form or use existing forms to have program staff complete a requisition for grant writing services and get appropriate approval before engaging the consultant. The requisition will have information of the requesting department, description of the requested services, the cost center or sub-account to be charged, etc. The consultant will be advised to submit invoices with adequate details.

**Watts Healthcare Corporation**  
**Schedule of Findings and Questioned Costs**  
**Year ended December 31, 2014**

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WHCC Finance and program management will contact the Grants Management Officer at SAMHSA to discuss this error and seek guidance on the best way to resolve the questioned costs and/or determine if the Federal Financial Report (FFR) submitted for the 2013/14 grant period can be amended for the \$6,000 in costs.

**Finding No. 2013-001 - Cash Management**

***Federal Program Information***

<i>Federal Catalog Number:</i>	93.501
<i>Federal Program Name:</i>	Affordable Care Act (ACA) Grants for School-Based Health Centers Capital Program
<i>Federal Agency:</i>	Department of Health and Human Services
<i>Pass-Through Entity:</i>	N/A

*Criteria*

Title 2: Grants and Agreements

[PART 200—UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS](#), [Subpart D—Post Federal Award Requirements](#)

Section 200.305 Payment (b) and (b)(1)

For non-Federal entities other than states, payments methods must minimize the time elapsing between the transfer of funds from the United States Treasury or the pass-through entity and the disbursement by the non-Federal entity whether the payment is made by electronic funds transfer, or issuance or redemption of checks, warrants, or payment by other means.

The non-Federal entity must be paid in advance, provided it maintains or demonstrates the willingness to maintain both written procedures that minimize the time elapsing between the transfer of funds and disbursement by the non-Federal entity, and financial management systems that meet the standards for fund control and accountability as established in this part. Advance payments to a non-Federal entity must be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the non-Federal entity in carrying out the purpose of the approved program or project. The timing and amount of advance payments must be as close as is administratively feasible to the actual disbursements by the non-Federal entity for direct program or project costs and the proportionate share of any allowable indirect costs. The non-Federal entity must make timely payment to contractors in accordance with the contract provisions.

*Condition*

During our review of program expenditures and drawdowns, we noted that the amount of drawdown was more than the actual program expenditures by \$118,962.

*Questioned costs*

\$118,962

*Possible Asserted Cause and Effect*

The project term ended on June 30, 2013. However, WHCC was not able to spend all the funds that were drawn as of the end of project since some of the expenditures originally budgeted such as built-in furniture were paid by Los Angeles Unified School District (LAUSD), leaving the funds unobligated. The grantor may request WHCC to return the funds.

*Recommendation*

We recommend that WHCC return the funds to the federal grantor. In addition, WHCC should strengthen controls over cash management to ensure that the time elapsing between the date the fund were drawn and the disbursement for such funds is minimized.

*View of Responsible Officials and Planned Corrective Action*

An initial budget was developed and submitted to HRSA for the equipment that our clinical staff identified as being required to outfit two (2) new school based clinic facilities. The use of the HRSA funds received was restricted to equipment for these two (2) new sites. Funds were drawn down to make the purchases commensurate with the timeline that our local school district (Los Angeles Unified) identified as the dates that these facilities would be completed. Our plan was to make initial equipment orders and then make subsequent orders to outfit these new facilities which required all new equipment both within a relatively short period of time. The timeline for the completion of the facilities was delayed by the school district which delayed the actual disbursement of some of the federal drawdown. WHCC was subsequently able to realize discounted rates on some of the equipment and unanticipated built-ins provided in the two new facilities eliminated the need for some of the planned equipment purchases. Therefore, WHCC was unable to use all of the HRSA funds drawn down for school-based equipment purchases. The Vice President for Finance reported this information to the appropriate HRSA official during the time of the Federal Financial Reporting. WHCC is working with HRSA on how to handle the unexpended funds.

*Status*

The program ended on June 30, 2013. Any unspent amount was forfeited. The unspent cash advance amounting to \$118,962 was returned to the Department of Health and Human Services on April 17, 2015.

**Finding No. 2013-002 - Equipment Management**

***Federal Program Information***

<i>Federal Catalog Number:</i>	93.501
<i>Federal Program Name:</i>	Affordable Care Act (ACA) Grants for School-Based Health Centers Capital Program
<i>Federal Agency:</i>	Department of Health and Human Services
<i>Pass-Through Entity:</i>	N/A

*Criteria*

Title 2: Grants and Agreements

[PART 200—UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS, Subpart D—Post Federal Award Requirements](#)

Section 200.313 Equipment (d)(1) to (2)

*Management requirements.* Procedures for managing equipment (including replacement equipment), whether acquired in whole or in part under a Federal award, until disposition takes place will, as a minimum, meet the following requirements:

- (1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of funding for the property (including the FAIN), who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the project costs for the Federal award under which the property was acquired, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.
- (2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

*Condition*

During our review of the program's compliance with the equipment management requirements, we noted that property records maintained by WHCC did not include the following information: a) serial number or other identification number; b) the source of funding for the property (including the FAIN); c) who holds title; d) percentage of Federal participation in the project costs for the Federal award under which the property was acquired; e) the location; and f) the use and condition of the property. In addition, there was no documentation of the reconciliation of the results of the physical inventory with the general ledger or books. After the inventory taking, the items counted were matched with the property list but there was no documentation of the reconciliation done and whether the reconciliation was reviewed by management or the finance department. Hence, we cannot determine if there were any difference noted between the physical inventory and equipment list and if such differences were resolved.

*Questioned costs*

Not applicable

*Possible Asserted Cause and Effect*

There are no adequate controls in place to ensure that required equipment information are included in the property records and that reconciliation of results of physical inventory and property records are properly documented and reviewed by management or the finance department.

*Recommendation*

We recommend that WHCC should strengthen controls over equipment management to ensure that required equipment information is included in the property records. In addition, reconciliation of the results of the physical inventory and property records should be properly documented and reviewed by management or the finance department.

*View of Responsible Officials and Planned Corrective Action*

(1) Property Records:

- a. For every item that had a Serial Number, the Serial Number was input into the system by Material Management staff. However where items were wall mounted before the inventory. Maintenance staff and Materials Management staff will remove from the wall and record in the asset record.
- b. Source: Every asset has a general subaccount which is part of asset record which signifies location, department, and funding source. The existing software would not allow the system to function properly using the code. A new system will be purchased that will correct this problem by October 1.
- c. Who Holds Title: All fixed asset items WHCC purchases, WHCC holds title to. The company fixed asset tag signifies such
- d. Location: The Departmental location is signified by the general ledger code used to book the purchase and is included in the fixed asset record however starting October 1, 2014 WHCC will enter the building and room where the equipment resides within the computer record.
- e. Condition: No condition description has been entered into the asset computer record. Beginning October 1, 2014 Material Management staff will indicate in the record for moveable equipment either fully usable, partially usable, or non-useable.

(2) Physical Inventory:

The WHCC manager of Materials Management and Senior Accountant will meet after the close of the September 30, 2014 WHCC general ledger. They will review the differences between the computerized listing maintained by Materials Management and a formally documented reconciliation showing fixed asset values and how they are different in either asset number or value between the listing total produced and the general ledger. This reconciliation will be provided to for the Vice President for Finance and Chief Financial Officer (CFO). The report will be co-signed by the manager of Materials Management and the Senior Accountant and include an analysis of each item unaccounted for, if any. Included in this report provided to the Vice President for Finance and CFO will be an explanation of the differences, justifications of proposed appropriate write-offs for the general ledger or a request of further investigation needed.

The same process will be done after the general ledger closing as of December 31, 2014.

*Status*

- (1) WHCC kept a database via electronic spreadsheet in 2014 that comprises our assets while sourcing asset tracking system to purchase in 2015. The spreadsheet includes company asset number, Department name, general ledger code, serial number, make, model, description, vendor, purchase order number, date received, total cost, and notes section (such as grant source). We are also maintaining a spreadsheet for disposals and transfers. Both databases will be subsequently exported to the new tracking system in 2015.

- (2) The physical inventory will be accomplished in August 2015 by Materials Department and reconciled using Materials and general ledger records generated by Senior Accountant and reviewed and approved by financial management administration.

**Finding No. 2013-003 - Level of Effort**

**Federal Program Information**

Federal Catalog Number: 93.914  
 Federal Program Name: HIV Emergency Relief Project Grants  
 Federal Agency: Department of Health and Human Services  
 Pass-Through Entity: County of Los Angeles, California

*Criteria*

Per grant agreements with the County of Los Angeles, WHCC is required to meet certain performance goals to ensure continued funding of the programs.

*Condition*

A comparison of the performance goals and the actual performance (see below) showed that WHCC did not meet the performance goals set by the County of Los Angeles in the grant agreements for the period March 1, 2013 through February 28, 2014.

Description	Oral Health Care (Dental) Services			Substance Abuse, Residential Rehab		
	March 1, 2013 to February 28, 2014			March 1, 2013 to February 28, 2014		
	Performance Goals	Actual per service report	Variance (Over)/Under	Performance Goals	Actual per service report	Variance (Over)/Under
Number of Unduplicated Clients	400	157	243	24	13	11
Number of Diagnostic Procedures	800	173	627			
Number of Prophylactic Dental	800	280	520			
Number of Dental Procedures	800	378	422			
Number of Days				2,624	741	1,883

Description	Mental Health/Psychiatric Treatment			Medical Care Coordination		
	March 1, 2013 to February 28, 2014			March 1, 2013 to February 28, 2014		
	Performance Goals	Actual per service report	Variance (Over)/Under	Performance Goals	Actual per service report	Variance (Over)/Under
Number of Unduplicated Clients	45	34	11	73	30	43
Number of Hours	300	88	212	3,162	343	2,819
% of Referrals Linked				80%	19%	61%

*Questioned costs*

Not applicable

*Possible Asserted Cause and Effect*

Possible cause for not meeting the performance goals was either the goals were too high or efforts exerted by WHCC were not enough to meet the goals. As a result, the County of Los Angeles may discontinue the funding of the programs if WHCC continues not to meet the performance goals.

*Recommendation*

We recommend that WHCC exert extra effort to meet the performance goals to ensure continued funding of the programs. WHCC should also determine if the performance goals are achievable. If not, WHCC should discuss with the County of Los Angeles for a possible reduction of the performance goals to more realistic targets.

*View of Responsible Officials and Planned Corrective Action*

**Substance Abuse HIV/AIDS Contract year 2013**

<p>2013 Contract Goal: 2624 Bed Days</p> <p>Unduplicated Client Goals 24</p>	<p>2013 Actual: 724 Bed Days</p> <p>Actual 13</p>	<p>The lack of achievement of the performance goals for this project was directly related to unanticipated staffing issues. The Outreach Supervisor was the key staff person for this activity and was on extended medical leave for the duration of this contract period. The Program Coordinator who along with other responsibilities had to assume the counseling and recruitment duties normally assigned to the Outreach Supervisor. The required recruitment of clients from outside agencies was significantly reduced due to the staffing shortage. The extended medical leave of the key staff person compromised the achievement of contract performance goals.</p> <p><b>Progress to date:</b></p> <ul style="list-style-type: none"> <li>• All goals since augmentation to contract have increased.</li> <li>• 35 unduplicated clients serviced in 2014-2015</li> <li>• 2 counselors are now servicing contract</li> <li>• New Outreach Supervisor hired June 2014</li> <li>• 1512 bed days had been billed for 2014-2015</li> </ul>
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**Psychiatric Services Contract year 2013**

<p>2013 Contract Goal: 45 unduplicated clients</p>	<p>2013 Actual: 34 unduplicated clients &lt;11&gt;</p>	<p>This contract is to service non-insured clients. In the prior year 2012, we serviced 44 unduplicated clients. However, due to the roll out of the Affordable Care Act in 2013, a significant number of our non-insured clients received insurance which made them ineligible for services under this contract for 2013 and early 2014. This forced an initiative to rebuild this service population.</p>
<p>2013 Contract Goal: 300 service hours</p>	<p>2013 Actual Hours: 88 service hours &lt;213&gt;</p>	<p>The achievement of the service hour goals under this contract was directly related to the hiring of a psychiatrist to provide the necessary hours of service. WHCC was unable to recruit and hire a psychiatrist for this part-time activity that could provide the desired hours of service. WHCC was subsequently forced to contract with a psychiatrist who had only very limited hours available to apply toward this project. However,</p>

**Watts Healthcare Corporation  
Status of Prior Audit Findings  
Year ended December 31, 2014**

		<p>this psychiatrist was unable to make up hours of service time lost to holidays. A total of 24-hours per month of provider time would have been required to achieve the performance goals under this agreement. The psychiatrist that we were able to hire only averaged 8-hours per month of clinic time.</p> <p><b>Progress to date:</b> Due to the reduced demand for psychiatrist services for uninsured HIV-positive clients, Los Angeles County eliminated much of the funding for this program.</p>
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**Medical Care Coordination Contract 2013**

2013 Contract Goal: 73 unduplicated clients	2013 Actual: 30 unduplicated clients <43>	<p>1. The start of activities on this contact was delayed by the funding agency. Although the contract period started on March 1, the County's delay plus the required staff training for this new activity pushed the start date of activities to July 2013. Staff training was provided in the allocated time period prior to the start of project activities.</p> <p>2. After this new project started, recruitment of patients was required. The loss of 4-months of service time was the major factor in not achieving the project goals and was unavoidable in this case.</p>
2013 Contract Goal: 3,162 service hours	2013 Actual Hours: 343 service hours <2,820>	<p><b>Progress to date:</b> In 2014, an additional staff person was hired to assist with administrative tasks thus freeing up the MSW to be able to provide direct face to face service delivery time. As a result, service hours for 2014 improved from 343 hours in 2013 to 928 in 2014. The number of unduplicated clients improved from 30 unduplicated clients in 2013 to 56 unduplicated clients in 2014.</p>

**Oral Health Care (Dental) Services Contract 2013**

2013 Contract Goal:  400 unduplicated clients	2013 Actual:  157 unduplicated clients <243>	<p>The start date for this contract was March 1. However, new dental operatories that were funded under this contract were purchased at the beginning of the contract period but were not installed and fully functional until October 2013. In addition new staff had to be hired for this program that could not go into service until the two new operatories were complete in October 2013. The actual dental care services for HIV-positive clients were therefore only provided for part of the contract period. The number 157 clients actually represent five months of effort rather than 12 months. The 400 unduplicated client goal was not achievable with only five months of services.</p>
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**Watts Healthcare Corporation  
Status of Prior Audit Findings  
Year ended December 31, 2014**

800 Number of prophylactic procedures	280 <520>	This number correlates with the actual number of clients seen at this time and represents five months of work.
800 Number of dental procedures	378 <422>	This number correlates with the actual number of clients seen at this time and represents five months of work.
800 Number of diagnostic procedures	173 <627>	This number correlates with the actual number of clients seen at this time and represents five months of work.

*Status*

WHCC reports that progress has been made toward meeting the performance goals in the Oral Health Care, Substance Abuse Residential Rehab and Medical Care Coordination contracts. Major improvements will be evident in each program from the 2013-14 contracts. The Mental Health Coordination contract was discontinued by the County as part of a reduction in service requirements for uninsured HIV-positive clients. WHCC is using other behavioral health staff to meet the behavioral health needs of HIV-positive clients and referrals are made to specialty providers when psychiatric services are required.





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801 South Grand Avenue, Suite 400 • Los Angeles, California 90017-4646 • Ph. (213) 873-1700 • Fax (213) 873-1777



**Audited Financial Statements**  
**Watts Healthcare Corporation**  
*As of and for the Years ended December 31, 2014 and 2013*  
*With Report of Independent Auditors*

An Independently Owned Member  
**McGLADREY ALLIANCE**



 **Vasquez**  
& Company LLP  
Certified Public Accountants and Business Consultants



**Audited Financial Statements**  
**Watts Healthcare Corporation**  
*As of and for the Years ended December 31, 2014 and 2013*  
*With Report of Independent Auditors*

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## **Report of Independent Auditors**

### **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, a California nonprofit corporation, which comprise the statements of financial position as of December 31, 2014 and 2013, and the related statements of activities, and cash flows for the years 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.

#### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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 Watts Healthcare Corporation as of December 31, 2014 and 2013, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Report on Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses 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 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 June 10, 2015 on our consideration of Watts Healthcare 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* when considering Watts Healthcare Corporation's internal control over financial reporting and compliance.

*Vasquez + Company LLP*

**Los Angeles, California  
June 10, 2015**

**Watts Healthcare Corporation**  
**Statements of Financial Position**

		December 31	
		2014	2013
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	\$	1,824,656	\$ 650,082
Patient accounts receivable, net of allowance for doubtful accounts of \$1,316,543 in 2014 and \$1,899,366 in 2013		7,431,991	8,331,030
Grants and contracts receivable, net of allowance for doubtful accounts of \$493,297 in 2014 and \$413,904 in 2013		1,347,617	1,816,157
Prepaid expenses and other current assets		49,123	25,084
<b>Total current assets</b>		<b>10,653,387</b>	<b>10,822,353</b>
<b>Noncurrent assets</b>			
Property and equipment, net		9,159,063	9,456,293
Restricted cash		-	234,734
Other assets		55,471	55,471
<b>Total assets</b>	<b>\$</b>	<b>19,867,921</b>	<b>\$ 20,568,851</b>
<b>LIABILITIES AND NET ASSETS</b>			
<b>Current liabilities</b>			
Accounts payable	\$	390,471	\$ 503,633
Accrued expenses		726,969	745,758
Accrued salaries		650,500	546,160
Accrued vacation and sick leave		1,525,886	1,464,563
Claims payable		121,649	266,161
Contract advances		158,910	554,082
Notes payable - current portion		91,405	3,976,563
<b>Total current liabilities</b>		<b>3,665,790</b>	<b>8,056,920</b>
<b>Noncurrent liabilities</b>			
Notes payable, net of current portion		4,165,356	1,341,985
<b>Total liabilities</b>		<b>7,831,146</b>	<b>9,398,905</b>
<b>Net assets</b>			
Unrestricted		10,036,775	9,169,946
Unrestricted - board-designated		2,000,000	2,000,000
<b>Total net assets</b>		<b>12,036,775</b>	<b>11,169,946</b>
<b>Total liabilities and net assets</b>	<b>\$</b>	<b>19,867,921</b>	<b>\$ 20,568,851</b>

*See notes to financial statements.*

**Watts Healthcare Corporation**  
**Statements of Activities**

	Year ended December 31	
	2014	2013
<b>Revenues and other support</b>		
Patient service revenue (net of contractual allowances)	\$ 19,385,948	\$ 21,899,791
Provision for doubtful accounts	<u>(1,701,811)</u>	<u>(2,355,419)</u>
Net patient service revenue	17,684,137	19,544,372
Grants and contracts	13,465,250	13,327,155
Other revenues	<u>1,738,391</u>	<u>635,411</u>
<b>Total revenues and other support</b>	<b><u>32,887,778</u></b>	<b><u>33,506,938</u></b>
<b>Expenses</b>		
Program services		
Primary care	12,239,686	13,703,279
Specialty care	4,715,435	4,667,112
Ancillary care	2,636,304	2,821,545
Clinical support	4,978,956	4,687,168
Substance abuse	1,974,181	2,174,105
WIC program	3,956,117	3,777,416
Other programs	<u>1,413,423</u>	<u>1,478,607</u>
Total program services	31,914,102	33,309,232
Supporting services		
Fundraising	<u>106,847</u>	<u>96,803</u>
<b>Total expenses</b>	<b><u>32,020,949</u></b>	<b><u>33,406,035</u></b>
<b>Change in net assets</b>	<b>866,829</b>	<b>100,903</b>
<b>Net assets - unrestricted</b>		
Beginning of year	<u>11,169,946</u>	<u>11,069,043</u>
End of year	<b><u>\$ 12,036,775</u></b>	<b><u>\$ 11,169,946</u></b>

*See notes to financial statements.*

**Watts Healthcare Corporation**  
**Statements of Cash Flows**

	Year ended December 31	
	2014	2013
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 866,829	\$ 100,903
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation	635,086	623,584
Provision for doubtful accounts	1,701,811	2,543,077
Gain from exercise of put option	(1,259,662)	-
(Increase) decrease in operating assets:		
Patient accounts receivable	(723,379)	(4,370,816)
Grants and contracts receivable	389,147	(92,037)
Prepaid expenses and other current assets	(24,039)	52,389
Increase (decrease) in operating liabilities:		
Accounts payable	(113,162)	(245,105)
Accrued expenses	(18,789)	191,063
Accrued salaries	104,340	(58,437)
Accrued vacation and sick leave	61,323	(56,354)
Claims payable	(144,512)	(2,331)
Contract advances	(395,172)	499,447
<b>Net cash provided by (used in) operating activities</b>	<b>1,079,821</b>	<b>(814,617)</b>
<b>Cash flows from investing activities</b>		
Acquisition of property and equipment	(337,856)	(538,447)
<b>Net cash used in investing activities</b>	<b>(337,856)</b>	<b>(538,447)</b>
<b>Cash flows from financing activities</b>		
Decrease (increase) in restricted cash	234,734	(11,894)
Proceeds from loan refinancing	4,210,782	-
Loan payments	(4,012,907)	-
<b>Net cash used in financing activities</b>	<b>432,609</b>	<b>(11,894)</b>
<b>Change in cash and cash equivalents</b>	<b>1,174,574</b>	<b>(1,364,958)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>650,082</b>	<b>2,015,040</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 1,824,656</b>	<b>\$ 650,082</b>
<b>Supplemental disclosure of cashflow information</b>		
Interest paid during the year	<b>\$ 270,774</b>	<b>\$ 335,274</b>

*See notes to financial statements.*

**NOTE 1 ORGANIZATION**

Watts Healthcare Corporation (WHCC) is a non-profit corporation supported by federal, state, and local grants, private foundation grants, and revenues from operations. 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 (3) primary health care facilities, two (2) are located in the Watts district and one (1) is located in the Crenshaw district of the City of Los Angeles. WHCC provides service delivery sites for substance abuse treatment, HIV, and women, infant and children (WIC) nutrition at six (6) additional locations throughout South Los Angeles County. 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 the Organization is to provide high quality comprehensive health services to the communities it serves, regardless of the patient's ability to pay.

During the years ended December 31, 2014 and 2013, WHCC received the following mix of revenues from grantors, patients and third-party payors:

	<b>2014</b>	2013
Patient fees (primarily Medi-Cal and Medicare)	<b>41%</b>	46%
Managed care contracts	<b>13%</b>	13%
Grants and other contracts	<b>41%</b>	39%
Other revenues	<b>5%</b>	2%
	<b>100%</b>	100%

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Accounting**

WHCC prepares its financial statements on the accrual basis of accounting. WHCC classifies revenues, gains, expenses, and losses into three net asset categories according to the existence or absence of donor-imposed restrictions. Accordingly, net assets of WHCC and changes therein are classified and reported as follows:

- *Unrestricted* - Net assets that are not subject to donor-imposed stipulations.
- *Unrestricted - Board-designated* - Unrestricted net assets set aside by the Board of Directors for future financial and property and equipment improvement programs.
- *Temporarily restricted* - Net assets subject to donor-imposed stipulations that may or will be met by either actions of WHCC and/or the passage of time.
- *Permanently restricted* - Net assets subject to donor-imposed stipulations that must be maintained in perpetuity. Generally, the donors of these assets permit WHCC to use all or part of the income earned on the related investments for general or specific purposes.

**NOTE 2      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Cash and Cash Equivalents**

Cash and cash equivalents have been defined as deposits and highly liquid investments with original maturities of 90 days or less at the date of purchase.

**Patient Accounts Receivable**

Patient accounts receivable are reported at net realizable value. In evaluating the collectability of accounts receivable, the Organization analyzes its collection history and identifies trends for each of its major payor sources of revenues to estimate the appropriate allowance for doubtful accounts. Management regularly reviews data about these major payor sources of revenues in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Organization analyzes contractually due amounts and provides an allowance for doubtful accounts, 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), the Organization records a provision for uncollectible accounts in the period of services on the basis of its past experience. The difference between the standard rates (or the discounted rates if negotiated or provided by the sliding fee or other policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Organization's allowance for doubtful accounts for self-pay patients did not significantly change from the previous year.

**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 \$2,000; 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 3 to 10 years. The American Hospital Association Estimated Useful Lives of Depreciable Hospital Assets is used as the guideline for determining useful lives of assets.

**NOTE 2      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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 2012, 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, 2014 and 2013 are as follows:

	2014	2013
Accrued sick leave	\$ <b>598,929</b>	\$     583,696
Accrued vacation leave	<b>926,957</b>	880,867
<b>Total \$</b>	<b>1,525,886</b>	<b>1,464,563</b>

**Leases**

Leases, which in substance transfer all the benefits and risks equivalent to ownership of the property, are classified as capital leases. The related assets and liabilities are recorded, at amounts equal to the lesser of the present value of the minimum lease payments or the fair value of the leased property, at the beginning of the respective lease terms. Generally, such assets are amortized over their economic lives. All other leases are classified as operating leases and related rentals are charged to expense as incurred.

**Revenue Recognition**

Net patient service revenue

The Organization has agreements with third-party payors that provide for payments to the Organization at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered and includes estimated retroactive adjustments. Retroactive adjustments are considered in recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

**NOTE 2      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Revenue Recognition (Continued)**

Grants and Contracts

WHCC recognizes revenues from federal grants and state contracts when eligible costs are incurred for cost reimbursement grants and when the contracted services are performed for performance-based grants. Revenue is recognized to the extent of expenditures incurred not to exceed grant and contract awards for cost reimbursement grants. When grants and contracts budget periods do not coincide with WHCC's reporting period, revenues are recognized based on actual costs incurred through the period.

Contributions

WHCC reports gifts of cash and other assets as restricted contributions if they are received with donor stipulations limiting the use of the donated assets and if the restrictions are not met in the period of receipt. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets. If a stipulated time restriction ends or a purpose restriction is accomplished during the year the donation is received, the donation is recognized as unrestricted revenue.

**Functional Expenses Allocation**

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

**Fair Value Measurements**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. WHCC reports its assets and liabilities that are measured at fair value using a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1*    Quoted prices in active markets for identical assets or liabilities.
- Level 2*    Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3*    Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

**NOTE 2      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Fair Value Measurements (Continued)**

An asset's or liability's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. At each reporting period, we perform a detailed analysis of our assets and liabilities that are measured at fair value. All assets and liabilities for which the fair value measurement is based on significant unobservable inputs or instruments which trade infrequently and therefore have little or no price transparency are classified as Level 3.

WHCC's financial assets and liabilities include primarily cash and cash equivalents, patient accounts receivable, grants and contracts receivable, and accounts payable and accrued liabilities. Because of the short-term nature of the cash, receivables, accounts payable and accrued liabilities, the carrying amounts of these assets and liabilities approximate their fair value.

**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, 2014, WHCC's bank deposits exceeded the balance insured by the FDIC by approximately \$1,863,797.

**Use of Estimates**

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

**Non-Profit Status**

WHCC (tax identification number 75-3046480) is a tax-exempt organization under Internal Revenue Code Section 501(c)(3) and California Revenue and Taxation Code Section 23701(d). Accordingly, no provision has been made for income taxes.

**Uncertainty in Income Taxes**

WHCC recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. WHCC does not believe its financial statements as of and for the years ended December 31, 2014 and 2013 include any uncertain tax positions.

WHCC's income tax returns remain subject to examination for all tax years ended on or after December 31, 2010 with regard to all tax positions and results reported.

**NOTE 3 CASH AND CASH EQUIVALENTS**

Cash and cash equivalents balance at December 31, 2014 and 2013 consist of the following:

	2014	2013
Cash on hand	\$ 1,450	\$ 1,350
Operating accounts	1,823,206	648,732
	\$ 1,824,656	\$ 650,082

**NOTE 4 PATIENT ACCOUNTS RECEIVABLE AND SERVICE REVENUE**

As at December 31, patient accounts receivable consists of the following:

	2014	2013
Medi-Cal/Managed care	\$ 15,917,171	\$ 15,808,028
FQHC reconciliation/PPS cost report settlement/rate differential	3,566,808	2,259,407
Clinic fees	10,926,422	11,542,262
	30,410,401	29,609,697
Less allowance for contractual accounts	(21,661,867)	(19,379,301)
Patient accounts receivable, net of contractual allowances	8,748,534	10,230,396
Less allowance for uncollectible accounts	(1,316,543)	(1,899,366)
Net \$	7,431,991	\$ 8,331,030

Patient service revenue is recorded at WHCC's established rates. Contractual adjustments and deductions from patient service revenue represent the difference between charges for the services provided calculated based on established rates and anticipated reimbursement for such services.

**NOTE 5      PROPERTY AND EQUIPMENT**

As at December 31, property and equipment consists of the following:

	2014	2013
Land	\$ 5,386,653	\$ 5,386,653
Building and improvements	3,101,234	3,021,013
Leasehold improvements	31,626	31,626
Furniture and equipment	1,933,037	1,709,532
Transportation equipment	183,967	183,967
Computer systems	1,735,762	1,701,632
Total	12,372,279	12,034,423
Less accumulated depreciation	3,213,216	2,578,130
Net \$	9,159,063	\$ 9,456,293

For the years ended December 31, 2014 and 2013, provision for depreciation amounted to \$635,086 and \$623,584, respectively. The land and building and improvements were used as collateral to secure the promissory notes (see Note 6).

**NOTE 6      NOTES PAYABLE**

As at December 31, notes payable consist of the following:

	2014	2013
Note A	\$ -	\$ 3,969,668
Note B (see Note 7)	-	1,348,880
Note C	4,256,761	-
Total	4,256,761	5,318,548
Less current portion	91,405	3,976,563
Notes payable, noncurrent portion	\$ 4,165,356	\$ 1,341,985

On August 25, 2014, WHCC entered into an agreement with Capital Impact Partners (CIP), a nonprofit 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 shall be used solely to refinance a loan in the principal amount of \$3,969,668 (Note A) 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.

**NOTE 6        NOTES PAYABLE (CONTINUED)**

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.

In August 2014, the principal balance of \$1,348,880 under Note B was extinguished as a result of the termination of the management and servicing agreements between NCBDC CDE 22, LLC and U.S. Bancorp Community Development Corporation and exercise of the put option agreement by WHCC. See Note 7 for additional information.

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

Schedule of repayments on the note is as follows:

Year ending December 31	Amount
2015	\$     91,405
2016	95,456
2017	100,883
2018	106,000
2019	111,377
Thereafter	3,751,640
	\$   4,256,761

**NOTE 7        NEW MARKET TAX CREDIT FINANCING**

In August 2007, NCBDC CDE 22, LLC (the Investment Fund), a Delaware corporation, was formed as part of New Market Tax Credit Financing for Watts Healthcare Corporation (WHCC). Community Development Funding, LLC (the CDF), a Minnesota limited liability company, was the non-managing member of the Investment Fund. U.S. Bancorp Community Development Corporation, a Minnesota corporation, had contracted with the CDF as the investing member of the Investment Fund and agreed to make capital contributions to the Investment Fund in exchange for a sole membership interest. U.S. Bancorp Community Development Corporation is a Community Development Entity and recipient of a new markets tax credit allocation from the Internal Revenue Service. In August 2014, pursuant to the original Project documents, all management and servicing agreements between the parties were terminated. Simultaneously, WHCC purchased (for \$16,703) U.S. Bancorp Community Development Corporation's interest in the Investment Fund under a "put" option as provided for under the original Project documents, thereby extinguishing WHCC Note B debt. As a result of these events (the Unwind), a gain on Unwind (\$1,348,880 in other income net of fees) was \$1,259,662 recorded as shown on the statement of activities for year ended December 31, 2014.

**NOTE 8 UNRESTRICTED BOARD-DESIGNATED NET ASSETS**

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

**NOTE 9 LINE OF CREDIT**

On August 17, 2012, WHCC entered into a revolving line of credit with Citibank, N.A. in the amount of \$1,500,000 with a variable interest rate term. The interest rate is subject to change from time to time based on changes in an independent index which is the greater of its prime rate or minimum interest rate set by the bank. At December 31, 2013, WHCC had no outstanding loan balance from the line of credit. This line of credit is renewable every year. The credit line expired on April 19, 2014. WHCC is negotiating for a new credit line with other financial institutions.

**NOTE 10 RETIREMENT PLAN**

WHCC contributes 5%-8% of eligible employees' gross salaries to an approved defined contribution 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 \$628,063 and \$720,723 for 2014 and 2013, respectively.

**NOTE 11 COMMITMENTS AND CONTINGENCIES**

**Operating Leases**

WHCC occupies certain facilities under both month-to-month and long-term lease agreements expiring through December 2017. Future minimum rental payments under these non-cancelable lease terms in excess of one year at December 31, 2014 are as follows:

<u>Year ending December 31.</u>	
2015	\$ 131,306
2016	368,796
2017	<u>302,446</u>
Total future minimum lease payments	<u>\$ 802,548</u>

Total rent expenses amounted to \$584,424 and \$583,984 for the years ended December 31, 2014 and 2013, respectively, under such operating leases.

**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.

**NOTE 11      COMMITMENTS AND CONTINGENCIES (CONTINUED)**

**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 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, 2012 through 2014. 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 2011 and prior have been completed and final settlements received as of December 31, 2014. WHCC recognized income of approximately \$1,714,046 and \$1,187,766 in 2014 and 2013, respectively, related to changes in estimates on prior year settlements.

**NOTE 12      MANAGED CARE CONTRACTS**

Payment agreements have been established with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Premiums are due monthly (calculated on a prospectively determined capitated rate) and are recognized as revenues during the period in which WHCC is obligated to provide services to its members.

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 organization 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 \$121,649 and \$266,161 are presented as claims payable as of December 31, 2014 and 2013, respectively.

**NOTE 13      SUBSEQUENT EVENTS**

WHCC has evaluated events subsequent to December 31, 2014 to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through June 10, 2015, the date the financial statements were available to be issued. Based upon this evaluation, it was determined that no subsequent events occurred that require recognition or additional disclosure in the financial statements.

**Watts Healthcare Corporation**  
**Schedule of Functional Expenses**  
**Year ended December 31, 2014**  
**(With Comparative Totals for 2013)**

	2014												2014	2013
	Program Services							Support Services						
	Primary Care Services	Specialty Services	Ancillary Services	Clinical Support Services	Substance Abuse Programs	WIC Program Services	Other Programs	Total	General and Administrative Services	Elimination	Fund Raising	Total		
Salaries and wages	\$ 6,892,816	\$ 1,757,653	\$ 1,571,736	\$ 1,817,648	\$ 929,077	\$ 1,919,058	\$ 833,557	\$ 15,721,545	\$ 2,241,798	\$ (2,241,798)	\$ -	\$ -	\$ 15,721,545	\$ 15,346,661
Fringe benefits	2,936,111	748,702	669,508	774,258	395,756	817,455	355,068	6,696,858	954,336	(954,336)	-	-	6,696,858	6,194,512
<b>Total salaries &amp; fringe benefits</b>	<b>9,828,927</b>	<b>2,506,355</b>	<b>2,241,244</b>	<b>2,591,906</b>	<b>1,324,833</b>	<b>2,736,513</b>	<b>1,188,625</b>	<b>22,418,403</b>	<b>3,196,134</b>	<b>(3,196,134)</b>	<b>-</b>	<b>-</b>	<b>22,418,403</b>	<b>21,541,173</b>
Other operating expenses:														
Consulting and contracted services	835,149	730,488	184,726	389,985	69,886	80,843	61,196	2,352,273	543,286	(543,286)	106,847	106,847	2,459,120	2,903,597
Space costs	299,662	12,379	2,555	989,466	156,625	638,835	-	2,099,522	16,531	(16,531)	-	-	2,099,522	1,983,787
Supplies	702,620	489,332	68,474	152,388	197,585	84,243	58,071	1,752,713	238,690	(238,690)	-	-	1,752,713	3,381,611
Healthcare claims	-	432,596	-	-	-	-	-	432,596	-	-	-	-	432,596	821,595
Equipment rentals and leases	78,947	76,831	29,625	105,483	19,842	88,025	16,940	415,693	66,658	(66,658)	-	-	415,693	393,173
Data processing	9,277	218,007	771	87,363	6,809	2,130	22	324,379	77,431	(77,431)	-	-	324,379	288,840
Travel, conferences and training	83,197	18,374	34,209	37,049	15,425	83,434	45,040	316,728	176,879	(176,879)	-	-	316,728	295,365
Interest expense	-	-	-	205,490	65,284	-	-	270,774	9,498	(9,498)	-	-	270,774	335,274
Telephone	42,841	3,676	4,564	139,979	15,178	61,661	2,315	270,214	23,402	(23,402)	-	-	270,214	216,935
Dues and subscriptions	29,300	54,757	16,438	62,778	13,943	20,951	3,788	201,955	147,709	(147,709)	-	-	201,955	208,921
Insurance	2,814	35,115	-	77,217	25,934	4,865	8,275	154,220	87,312	(87,312)	-	-	154,220	201,539
Recruitment	124,769	-	-	10,593	-	-	1,070	136,432	62,820	(62,820)	-	-	136,432	90,711
Printing, postage and publication	43,545	7,332	9,349	41,413	2,308	24,211	4,956	133,114	45,459	(45,459)	-	-	133,114	119,930
Other operating expenses before depreciation	2,252,121	2,078,887	350,711	2,299,204	588,819	1,089,198	201,673	8,860,613	1,495,675	(1,495,675)	106,847	106,847	8,967,460	11,241,278
Depreciation	158,638	130,193	44,349	87,846	60,529	130,406	23,125	635,086	228,657	(228,657)	-	-	635,086	623,584
<b>Total expenses</b>	<b>\$ 12,239,686</b>	<b>\$ 4,715,435</b>	<b>\$ 2,636,304</b>	<b>\$ 4,978,956</b>	<b>\$ 1,974,181</b>	<b>\$ 3,956,117</b>	<b>\$ 1,413,423</b>	<b>\$ 31,914,102</b>	<b>\$ 4,920,466</b>	<b>\$ (4,920,466)</b>	<b>\$ 106,847</b>	<b>\$ 106,847</b>	<b>\$ 32,020,949</b>	<b>\$ 33,406,035</b>

**Watts Healthcare Corporation**  
**Schedule of Functional Expenses**  
**Year ended December 31, 2013**  
**(With Comparative Totals for 2012)**

	2013													2013	2012	
	Program Services								Support Services				Total Expenses			Total Expenses
	Primary Care Services	Specialty Services	Ancillary Services	Clinical Support Services	Substance Abuse Programs	WIC Program Services	Other Programs	Total	General and Administrative Services	Elimination	Fund Raising	Total				
Salaries and wages	\$ 6,672,680	\$ 1,644,247	\$ 1,635,984	\$ 1,633,894	\$ 1,021,627	\$ 1,893,351	\$ 844,878	\$ 15,346,661	\$ 2,162,837	\$ (2,162,837)	\$ -	\$ -	\$ 15,346,661	\$ 15,514,720		
Fringe benefits	2,628,366	640,144	694,579	681,103	435,944	762,354	352,022	6,194,512	904,588	(904,588)	-	-	6,194,512	5,968,547		
<b>Total salaries and fringe benefits</b>	<b>9,301,046</b>	<b>2,284,391</b>	<b>2,330,563</b>	<b>2,314,997</b>	<b>1,457,571</b>	<b>2,655,705</b>	<b>1,196,900</b>	<b>21,541,173</b>	<b>3,067,425</b>	<b>(3,067,425)</b>	<b>-</b>	<b>-</b>	<b>21,541,173</b>	<b>21,483,267</b>		
Other operating expenses:																
Supplies	2,377,746	476,031	92,617	121,727	181,661	66,397	65,432	3,381,611	48,712	(48,712)	-	-	3,381,611	2,595,052		
Consulting and contracted services	1,274,720	716,914	240,442	356,757	71,492	74,217	72,252	2,806,794	453,898	(453,898)	96,803	96,803	2,903,597	2,284,089		
Space costs	272,138	12,052	1,212	902,219	155,503	625,202	15,461	1,983,787	46,267	(46,267)	-	-	1,983,787	1,874,227		
Healthcare claims	-	821,595	-	-	-	-	-	821,595	-	-	-	-	821,595	1,059,881		
Equipment rentals and leases	63,102	61,115	41,440	107,020	28,606	43,937	47,953	393,173	70,592	(70,592)	-	-	393,173	380,860		
Interest expense	-	-	33	234,208	101,033	-	-	335,274	3,420	(3,420)	-	-	335,274	337,980		
Travel, conferences and training	95,677	31,107	30,370	20,033	12,170	88,430	17,578	295,365	183,239	(183,239)	-	-	295,365	327,244		
Data processing	15,534	-	1,116	268,074	-	3,724	392	288,840	73,927	(73,927)	-	-	288,840	201,405		
Telephone	39,492	4,770	3,160	102,103	14,482	50,926	2,002	216,935	22,843	(22,843)	-	-	216,935	281,660		
Dues and subscriptions	25,717	38,869	16,233	44,448	57,876	17,034	8,744	208,921	140,104	(140,104)	-	-	208,921	227,591		
Insurance	3,164	79,590	-	76,576	22,440	6,448	13,321	201,539	60,784	(60,784)	-	-	201,539	222,767		
Printing, postage and publication	26,908	7,939	12,566	30,479	5,718	27,110	9,210	119,930	36,165	(36,165)	-	-	119,930	116,334		
Recruitment	59,962	-	-	22,140	-	2,705	5,904	90,711	66,128	(66,128)	-	-	90,711	63,246		
Other operating expenses before depreciation:	4,254,160	2,249,982	439,189	2,285,784	650,981	1,006,130	258,249	11,144,475	1,206,079	(1,206,079)	96,803	96,803	11,241,278	9,972,336		
Depreciation	148,073	132,739	51,793	86,387	65,553	115,581	23,458	623,584	235,946	(235,946)	-	-	623,584	512,362		
<b>Total expenses</b>	<b>\$ 13,703,279</b>	<b>\$ 4,667,112</b>	<b>\$ 2,821,545</b>	<b>\$ 4,687,168</b>	<b>\$ 2,174,105</b>	<b>\$ 3,777,416</b>	<b>\$ 1,478,607</b>	<b>\$ 33,309,232</b>	<b>\$ 4,509,450</b>	<b>\$ (4,509,450)</b>	<b>\$ 96,803</b>	<b>\$ 96,803</b>	<b>\$ 33,406,035</b>	<b>\$ 31,967,965</b>		

**Report of Independent Auditors on Internal Control over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with Government Auditing Standards**

**Board of Directors  
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, which comprise the statement of financial position as of December 31, 2014, and the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 10, 2015.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Watts Healthcare 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 Watts Healthcare Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Watts Healthcare 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 Watts Healthcare 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* when considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Vasquez + Company LLP*

**Los Angeles, California  
June 10, 2015**

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801 South Grand Avenue, Suite 400 • Los Angeles, California 90017-4646 • Ph. (213) 873-1700 • Fax (213) 873-1777