



**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Financial Statements
and
Supplementary Information
December 31, 2017
(With Independent Auditor's Report Thereon)**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Goodwill Industries of Orange County,
California and Affiliate

We have audited the accompanying combined financial statements of Goodwill Industries of Orange County and Affiliate (the Organization), which comprise the combined statement of financial position as of December 31, 2017, and the related combined statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

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

INDEPENDENT AUDITOR'S REPORT
(Continued)

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of December 31, 2017, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplemental combining information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined 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 combined financial statements as a whole.

Report on Summarized Comparative Information

We have previously audited the Organization's combined financial statements, and we expressed an unmodified audit opinion on those audited combined financial statements in our report dated May 31, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2016 is consistent, in all material respects, with the audited combined financial statements from which it has been derived.

KSJG, LLP

June 18, 2018

KSJG, LLP

100 Spectrum Center Drive, Suite 1000, Irvine, California 92618

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Financial Position
December 31, 2017**

(with summarized financial information as of December 31, 2016)

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>	
				<u>2017</u>	<u>2016</u>
Current assets:					
Cash and cash equivalents	\$ 2,757,833	\$ --	\$ --	\$ 2,757,833	\$ 2,903,226
Investments (Note 2)	15,674,585	750	52,980	15,728,315	13,303,964
Accounts receivable (net of allowance for doubtful accounts of \$115,703 and \$107,352, respectively) (Notes 5 and 6)	3,674,176	--	--	3,674,176	3,142,603
Current portion of contributions receivable - net (Notes 2 and 3)	--	265,119	--	265,119	1,082,719
Inventory (Notes 5 and 6)	1,731,455	--	--	1,731,455	1,634,500
Prepaid expenses	971,551	--	--	971,551	898,629
Total current assets	24,809,600	265,869	52,980	25,128,449	22,965,641
Non-current assets:					
Restricted cash (Note 8)	300,000	--	--	300,000	470,000
Contributions receivable - net (Notes 2 and 3)	--	1,070,171	--	1,070,171	2,354,378
Deposits	421,722	--	--	421,722	412,081
Land, buildings and equipment - net of accumulated depreciation (Notes 4, 5 and 6)	23,426,785	--	--	23,426,785	24,065,739
Total assets	\$ 48,958,107	\$ 1,336,040	\$ 52,980	\$ 50,347,127	\$ 50,267,839
 <u>LIABILITIES AND NET ASSETS</u>					
Current liabilities:					
Accounts payable	\$ 2,000,353	\$ --	\$ --	\$ 2,000,353	\$ 1,595,191
Accrued salaries, wages, and vacation payable	2,759,000	--	--	2,759,000	3,148,299
Current portion of notes payable (Note 6)	400,000	--	--	400,000	400,000
Current portion of bonds payable (Note 9)	355,000	--	--	355,000	335,000
Other current accrued liabilities (Note 10)	2,245,696	--	--	2,245,696	1,232,239
Total current liabilities	7,760,049	--	--	7,760,049	6,710,729
Non-current liabilities:					
Derivative instruments (Notes 2 and 8)	143,805	--	--	143,805	259,281
Notes payable - net (Note 6)	886,000	--	--	886,000	1,282,000
Bonds payable - net (Note 9)	4,012,174	--	--	4,012,174	4,354,808
Other accrued liabilities (Note 10)	2,921,759	--	--	2,921,759	2,754,467
Total liabilities	15,723,787	--	--	15,723,787	15,361,285
Commitments and contingencies and related party transactions (Notes 13 and 14)					
Net assets (Notes 11 and 12):					
Unrestricted	33,234,320	--	--	33,234,320	31,415,727
Temporarily restricted	--	1,336,040	--	1,336,040	3,437,847
Permanently restricted	--	--	52,980	52,980	52,980
Total net assets	33,234,320	1,336,040	52,980	34,623,340	34,906,554
Total liabilities and net assets	\$ 48,958,107	\$ 1,336,040	\$ 52,980	\$ 50,347,127	\$ 50,267,839

See accompanying notes to combined financial statements

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Activities
Year Ended December 31, 2017**

(with summarized financial information for the year ended December 31, 2016)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2017	2016
Public support and revenue:					
Public support:					
Indirect public support	\$ 5,111	\$ --	\$ --	\$ 5,111	\$ 10,675
Contributions	1,486,050	16,900	--	1,502,950	4,309,915
Donated merchandise	35,548,535	--	--	35,548,535	32,850,458
Total public support	<u>37,039,696</u>	<u>16,900</u>	<u>--</u>	<u>37,056,596</u>	<u>37,171,048</u>
Revenue:					
Thrift store sales	57,696,333	--	--	57,696,333	55,127,712
Other sales	2,260,840	--	--	2,260,840	1,745,779
Contract services	5,210,565	--	--	5,210,565	5,114,369
Rehabilitation revenue	21,761,352	--	--	21,761,352	19,141,962
Technology services	4,212,584	--	--	4,212,584	3,269,404
Interest and other income	463,357	--	--	463,357	292,834
Realized and unrealized gains on investments, net	1,881,541	--	--	1,881,541	614,230
Realized (losses) on disposal of land, buildings and equipment	--	--	--	--	(11,771)
Realized gains on assets disposed of through restructuring	99,240	--	--	99,240	--
Unrealized gains on derivative instruments	115,476	--	--	115,476	107,058
Total revenue	<u>93,701,288</u>	<u>--</u>	<u>--</u>	<u>93,701,288</u>	<u>85,401,577</u>
Net assets released from restrictions	<u>2,118,707</u>	<u>(2,118,707)</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total public support and revenue	<u>132,859,691</u>	<u>(2,101,807)</u>	<u>--</u>	<u>130,757,884</u>	<u>122,572,625</u>
Expenses:					
Program services:					
Store operations	76,535,503	--	--	76,535,503	71,656,921
Processing of donated merchandise	9,337,295	--	--	9,337,295	8,456,735
Solicitation and transportation	7,377,092	--	--	7,377,092	7,406,189
Rehabilitation	20,681,935	--	--	20,681,935	18,624,657
Contract services	5,477,014	--	--	5,477,014	5,113,720
Technology services	1,632,356	--	--	1,632,356	1,202,156
Total program services	<u>121,041,195</u>	<u>--</u>	<u>--</u>	<u>121,041,195</u>	<u>112,460,378</u>
Supporting services:					
General and administrative	7,035,856	--	--	7,035,856	7,808,640
Fundraising	2,964,047	--	--	2,964,047	1,037,534
Total supporting services	<u>9,999,903</u>	<u>--</u>	<u>--</u>	<u>9,999,903</u>	<u>8,846,174</u>
Total expenses	<u>131,041,098</u>	<u>--</u>	<u>--</u>	<u>131,041,098</u>	<u>121,306,552</u>
Change in net assets	1,818,593	(2,101,807)	--	(283,214)	1,266,073
Net assets at beginning of year	<u>31,415,727</u>	<u>3,437,847</u>	<u>52,980</u>	<u>34,906,554</u>	<u>33,640,481</u>
Net assets at end of year	<u>\$ 33,234,320</u>	<u>\$ 1,336,040</u>	<u>\$ 52,980</u>	<u>\$ 34,623,340</u>	<u>\$ 34,906,554</u>

See accompanying notes to combined financial statements

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Functional Expenses
Year Ended December 31, 2017**
(with summarized financial information for the year ended December 31, 2016)

	Program Services						Subtotal
	Store Operations	Processing of Donated Merchandise	Solicitation and Transportation	Rehabilitation	Contract Services	Technology Services	
Salaries and related expenses:							
Salaries and wages	\$ 16,394,089	\$ 4,658,787	\$ 3,723,227	\$ 14,293,864	\$ 3,074,705	\$ 561,430	\$ 42,706,102
Employee benefits	842,192	784,781	407,679	1,545,799	606,792	37,099	4,224,342
Payroll taxes	1,113,176	319,969	273,423	1,063,999	219,719	43,058	3,033,344
Workers' compensation	645,415	229,192	238,715	330,424	384,204	13,239	1,841,189
Total salaries and related expenses	<u>18,994,872</u>	<u>5,992,729</u>	<u>4,643,044</u>	<u>17,234,086</u>	<u>4,285,420</u>	<u>654,826</u>	<u>51,804,977</u>
Other expenses:							
Cost of goods sold	42,735,620	144,229	678	20	44	--	42,880,591
Professional services	1,817,849	64,452	77,294	757,384	180,295	77,428	2,974,702
Supplies	840,985	323,669	156,090	131,486	344,651	11,135	1,808,016
Telephone	165,083	39,967	106,375	219,774	33,731	237,940	802,870
Postage	1,010,834	36,900	15,702	3,931	624	--	1,067,991
Occupancy	7,945,442	2,084,520	1,112,684	598,327	326,950	191,536	12,259,459
Equipment rent and maintenance	149,563	82,488	47,630	25,792	25,634	59,622	390,729
Advertising	400,781	--	--	128,349	--	56,632	585,762
Printing and publishing	143,897	13,840	6,895	136,992	6,913	4,220	312,757
Travel and vehicle	51,417	39,784	804,068	948,910	55,458	32,929	1,932,566
Conferences, conventions and meetings	68,382	16,385	3,025	71,665	9,445	21,917	190,819
Membership and dues to national organization	146,322	--	--	46,407	8,579	6,276	207,584
Awards, grants and special assistance	4,145	4,693	708	81,074	447	2,311	93,378
Interest expense	--	--	--	--	--	--	--
Bad debt expense	--	--	--	12,722	504	26,937	40,163
Other operating expenses	1,364	--	--	1,082	--	--	2,446
Income tax expense	38,337	--	--	--	--	178,263	216,600
Total expenses before depreciation	<u>74,514,893</u>	<u>8,843,656</u>	<u>6,974,193</u>	<u>20,398,001</u>	<u>5,278,695</u>	<u>1,561,972</u>	<u>117,571,410</u>
Depreciation	<u>2,020,610</u>	<u>493,639</u>	<u>402,899</u>	<u>283,934</u>	<u>198,319</u>	<u>70,384</u>	<u>3,469,785</u>
Total expenses	<u>\$ 76,535,503</u>	<u>\$ 9,337,295</u>	<u>\$ 7,377,092</u>	<u>\$ 20,681,935</u>	<u>\$ 5,477,014</u>	<u>\$ 1,632,356</u>	<u>\$ 121,041,195</u>

(Combined statement of functional expenses continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Functional Expenses
(Continued)**

Year Ended December 31, 2017

(with summarized financial information for the year ended December 31, 2016)

	<u>Supporting Services</u>				<u>Total Expenses</u>	
	<u>Subtotal</u>	<u>General & Admin</u>	<u>Fund Raising</u>	<u>Subtotal</u>	<u>2017</u>	<u>2016</u>
Salaries and related expenses:						
Salaries and wages	\$ 42,706,102	\$ 3,936,092	\$ 389,917	\$ 4,326,009	\$ 47,032,111	\$ 43,351,402
Employee benefits	4,224,342	362,202	17,390	379,592	4,603,934	4,644,272
Payroll taxes	3,033,344	265,849	16,195	282,044	3,315,388	3,124,213
Workers' compensation	1,841,189	93,794	6,103	99,897	1,941,086	2,665,644
Total salaries and related expenses	<u>51,804,977</u>	<u>4,657,937</u>	<u>429,605</u>	<u>5,087,542</u>	<u>56,892,519</u>	<u>53,785,531</u>
Other expenses:						
Cost of goods sold	42,880,591	89	3	92	42,880,683	39,753,866
Professional services	2,974,702	848,432	43,904	892,336	3,867,038	3,294,165
Supplies	1,808,016	113,627	7,761	121,388	1,929,404	1,792,587
Telephone	802,870	83,639	8,685	92,324	895,194	746,028
Postage	1,067,991	12,325	3,776	16,101	1,084,092	1,129,759
Occupancy	12,259,459	288,283	21,712	309,995	12,569,454	11,889,209
Equipment rent and maintenance	390,729	178,112	39,961	218,073	608,802	678,354
Advertising	585,762	10,758	47,862	58,620	644,382	713,960
Printing and publishing	312,757	72,598	40,982	113,580	426,337	407,640
Travel and vehicle	1,932,566	39,900	3,954	43,854	1,976,420	1,906,604
Conferences, conventions and meetings	190,819	137,139	300,547	437,686	628,505	640,220
Membership and dues to national organization	207,584	32,730	1,811	34,541	242,125	222,206
Awards, grants and special assistance	93,378	26,830	695	27,525	120,903	102,462
Interest expense	--	219,087	--	219,087	219,087	201,907
Bad debt expense	40,163	--	2,008,294	2,008,294	2,048,457	21,855
Other operating expenses	2,446	--	--	--	2,446	663
Income tax expense	216,600	--	--	--	216,600	12,804
Total expenses before depreciation	<u>117,571,410</u>	<u>6,721,486</u>	<u>2,959,552</u>	<u>9,681,038</u>	<u>127,252,448</u>	<u>117,299,820</u>
Depreciation	<u>3,469,785</u>	<u>314,370</u>	<u>4,495</u>	<u>318,865</u>	<u>3,788,650</u>	<u>4,006,732</u>
Total expenses	<u>\$ 121,041,195</u>	<u>\$ 7,035,856</u>	<u>\$ 2,964,047</u>	<u>\$ 9,999,903</u>	<u>\$ 131,041,098</u>	<u>\$ 121,306,552</u>

See accompanying notes to combined financial statements

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Cash Flows
Year Ended December 31, 2017**

(with summarized financial information for the year ended December 31, 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ (283,214)	\$ 1,266,073
Adjustment to reconcile changes in net assets to net cash provided by operating activities:		
Change in donated inventory	(96,955)	105,259
Provision for bad debts	2,036,852	(66,964)
Depreciation	3,788,650	4,006,732
Interest expense - debt issuance costs	16,366	14,366
Realized and unrealized (earnings) on investments, net	(2,311,241)	(885,902)
Realized losses on the disposal of land, buildings and equipment	--	11,771
Unrealized (gains) on derivative instruments	(115,476)	(107,058)
(Increase) decrease in:		
Restricted cash	170,000	--
Accounts receivable - net	(539,924)	404,372
Contributions receivable - net	73,306	(2,230,465)
Prepaid expenses	(72,922)	(190,068)
Deposits	(9,641)	(57,712)
Increase (decrease) in:		
Accounts payable	405,162	(648,239)
Accrued salaries, wages and vacation payable	(389,299)	(62,291)
Income tax payable	--	(2,000)
Other accrued liabilities	1,180,749	(130,285)
Net cash provided by operating activities	<u>3,852,413</u>	<u>1,427,589</u>

(Combined statement of cash flows continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Combined Statement of Cash Flows
(Continued)**

Year Ended December 31, 2017

(with summarized financial information for the year ended December 31, 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from investing activities:		
Purchase of investments	(122,291)	(1,426,987)
Proceeds from the sale of investments	9,181	26,798
Purchase of land, buildings and equipment	(3,149,696)	(3,815,384)
Proceeds from sale of land, buildings and equipment	--	8,487
Net cash (applied to) investing activities	<u>(3,262,806)</u>	<u>(5,207,086)</u>
Cash flows from financing activities:		
Principal repayments of bonds	(335,000)	(320,000)
Note payable origination costs	--	(20,000)
Proceeds from issuance of note	--	2,000,000
Principal repayments on note payable	(400,000)	(300,000)
Net cash (used in) provided by financing activities	<u>(735,000)</u>	<u>1,360,000</u>
Net (decrease) in cash	(145,393)	(2,419,497)
Cash and cash equivalents at beginning of year	<u>2,903,226</u>	<u>5,322,723</u>
Cash and cash equivalents at end of year	<u>\$ 2,757,833</u>	<u>\$ 2,903,226</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	<u>\$ 207,101</u>	<u>\$ 150,575</u>

See accompanying notes to combined financial statements

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Goodwill Industries of Orange County, California provides evaluation, rehabilitation, training, and employment services for people with disabilities and other barriers in the local community. Revenue to fund these services is derived from thrift store sales, donated merchandise, rehabilitation services, contract services, job placement, veteran services, contributions, fund-raising activities, grants from federal and state agencies and other charitable organizations, technology services, and indirect public support. Goodwill operates thrift stores and provides services throughout Orange County. Programs and services offered include Employment Training and Job Readiness programs, the Goodwill Fitness Center – Orange County’s only facility specially designed for people suffering from chronic illnesses and physical disabilities, the Tierney Center for Veteran Services – helping veterans and their families find resources and services they need, the Assistive Technology Exchange Center (ATEC) – which provides access to more than 1,000 state-of-the-art technology devices for children and adults with disabilities, and many more programs that serve those facing barriers in Orange County.

In 2001, Goodwill formed Landmark Services, Inc., an affiliate, as a nonprofit public benefit corporation. Landmark is dedicated to assisting individuals with severe disabilities in obtaining productive and valuable training and employment under federal set aside programs and other commercial ventures.

Principles of Combination - The combined financial statements include the accounts of Goodwill Industries of Orange County, California as well as Landmark Services, Inc. All inter-entity accounts and transactions have been eliminated in the combination.

Basis of Presentation - The accompanying combined financial statements include the accounts of Goodwill Industries of Orange County, California as well as its affiliate, Landmark Services, Inc. (collectively, the “Organization”), and have been prepared on the accrual basis of accounting. Net assets are classified based on the existence or absence of third-party donor restrictions and are reported as follows:

- Unrestricted net assets represent the portion of expendable funds available for support of operations.
- Temporarily restricted net assets are classified as such based on donor stipulations that they be used in a later period, be used for a specific purpose, or both. As donor restrictions are satisfied, amounts are reclassified to the unrestricted class as net assets released from restrictions.
- Permanently restricted net assets represent an endowment to be held in perpetuity. Investment income earned on this endowment is unrestricted.

The Organization’s policy is to record temporarily restricted gifts that are received and spent in the same year as unrestricted support.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comparative Data - The combined financial statements include prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization's combined financial statements for the year ended December 31, 2016 from which the summarized information was derived.

Concentration of Credit Risk - The Organization maintains cash deposits with a major bank, which are FDIC insured up to \$250,000. As of December 31, 2017, the Organization had certain monies deposited in excess of the FDIC insurance limit.

Cash and Cash Equivalents - The Organization considers all highly liquid investments with an original maturity of three months or less when purchased and money market funds to be cash equivalents.

Donated Merchandise - The Organization estimates the value of its donated merchandise at fair value at the date of contribution.

Investments - Investments represent monies invested in mutual funds, marketable securities, U.S. government securities, alternative assets, a master limited partnership fund, and a hedge fund. Investments in equity securities with readily determined fair values and all debt securities, alternative assets, a master limited partnership fund, and the hedge fund are reported at fair market value with realized and unrealized gains and losses included in the combined statement of activities.

The Organization has adopted policies for its investments that are intended to produce results that exceed the price and yield results of custom benchmarks while assuming a moderate level of risk.

Derivative Instruments - Interest rate swap contracts are reported at fair value and are recognized in the combined statement of financial position as either assets or liabilities, depending on the rights or obligations under the contracts. Such derivative instruments are used to hedge against the risk resulting from the variability of interest rates. Changes in fair value of derivative instruments are recognized as a change in net assets in the period of change.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contributed Services - A number of volunteers have made significant contributions of their time to support the Organization's functions. Only those amounts for which an objective basis is available to measure the value of such services are reflected in the combined financial statements. Contributed services are recognized if the services (a) create or enhance long-lived assets, or (b) require specialized skills, are provided by individuals possessing those skills and would need to be purchased if not provided by donation. As of December 31, 2017, the value of this contributed time does not meet the criteria for recognition of contributed services and, accordingly, is not reflected in the accompanying combined financial statements.

Land, Buildings and Equipment - Land, buildings and equipment are stated at cost. Depreciation and amortization expenses are calculated on the straight-line method. The depreciation and amortization methods are designed to amortize the cost of the assets over the estimated useful lives, in years, of the respective assets as follows:

Buildings	10 to 30 years
Building improvements	5 to 10 years
Furniture and equipment	3 to 10 years
Vehicles	3 to 10 years
Computer hardware	2 ½ years
Computer software	2 years

Maintenance and repairs are charged to expense as incurred. Renewals and improvements of a major nature are capitalized. At the time of retirement or other disposition of property and equipment, or once property and equipment have been fully depreciated, the cost and accumulated depreciation are removed from the accounts and any resulting gains or losses are reflected in income.

Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows (undiscounted and without interest) expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 support, revenues and expenses during the reporting period. Actual results could differ from those estimates.

Functional Allocation of Expenses - The costs of providing the various programs and other activities have been summarized on a functional basis in the combined statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income Taxes - Goodwill Industries of Orange County, California and Landmark Services, Inc. are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code), and are exempt from state income taxes under the comparable state tax code, as charitable organizations whereby only unrelated business income, as defined by Section 512(a)(1) of the Code, is subject to federal income tax.

The Organization has adopted the provisions of the accounting standard relating to accounting and reporting for uncertainty in income taxes. For the Organization, these provisions could be applicable to the incurrence of unrelated business income. Because of the Organization's general tax-exempt status, adoption of the standard does not have a material impact on the Organization's combined financial statements.

Sales Taxes - The Organization collects sales taxes from customers on certain nonexempt sales and remits the entire amounts to the governmental authorities. The Organization's accounting policy is to exclude the taxes collected and remitted from revenue and expenses.

Net Assets - Unrestricted net assets include quasi-endowment accounts. Such accounts primarily represent transactions that the Organization's board of directors have designated as income-producing investments where the principal is not to be used to support the Organization's general activities. Such assets have no donor-imposed restrictions or the restrictions have already expired. Quasi-endowments totaled \$463,951 at December 31, 2017 and have been included in unrestricted net assets in the accompanying combined statement of financial position (Note 12).

Advertising Costs - All advertising costs, which include direct response advertising costs, are expensed by the Organization as they are incurred. Total advertising cost for the year ended December 31, 2017 was \$644,382.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contributory Retirement Plan - Effective January 1, 1989, the Organization adopted a contributory retirement plan (the "Plan") covering all employees over 21 years of age, who generally work 20 or more hours per week and are not student employees. The Plan, as amended in July 2017, provides for an employer matching contribution up to a maximum of 3.5%. Under the employer matching formula, a participant is matched at a rate of 100% of the first 1%, followed by 50% of the next 5% of eligible wages contributed to the Plan. Participating employees may contribute up to a maximum allowable limit established annually by the Internal Revenue Service. Participants become fully vested in employer matching contributions after four years of service. Effective May 14, 2016, the Plan was amended to exclude employees who normally work less than 20 hours per week, and student employees. Until the Plan was further amended in July 2017, all employer contributions were eliminated through an amendment in July 2016. The total amount charged to expense related to the plan for the year ended December 31, 2017 was \$613,746.

Leases - The Organization leases certain trucks, equipment and retail stores under operating and capital leases. Leases which meet certain criteria are classified as capital leases, and 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 leased properties at the beginning of the respective lease terms. Such assets are amortized in a manner consistent with the Organization's normal depreciation policies over the related lease terms or their economic lives. Interest expense relating to the lease liabilities is recorded at constant rates of interest over the terms of the leases. Leases which do not meet such criteria are classified as operating leases, and related rentals are charged to expense as incurred. As of December 31, 2017, the Organization had no capital leases.

Restricted Cash - The Organization has restricted cash of \$300,000 at December 31, 2017 on deposit with a financial institution in conjunction with the cash collateral interest rate swap agreement (Note 8). The deposited amount can fluctuate based on interest rates. The minimum collateral deposit is \$300,000 and the funds may not be used by the Organization until the termination or expiration of the agreement.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measurements - The carrying value of financial instruments in the combined financial statements approximates fair value.

For fair value measurements of financial assets and financial liabilities (Note 2), and for fair value measurements of non-financial items that are recognized and disclosed at fair value in the combined financial statements on a recurring basis, the Organization has adopted generally accepted accounting principles (GAAP) standards that define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

GAAP establishes a three-level fair value hierarchy that describes the inputs that are used to measure the fair values of respective assets and liabilities:

- Level 1: fair values are based on quoted prices in active markets for identical assets and liabilities. The Organization's Level 1 assets include registered mutual funds.
- Level 2: fair values are based on observable inputs that include: quoted market prices for similar assets or liabilities, quoted market prices that are not in an active market, or other inputs that are observable in the market and can be corroborated by observable market data for substantially the full term of the asset. The Organization's Level 2 assets include charitable gift annuities and investments in a master limited partnership fund, and Level 2 liabilities include derivative instruments.
- Level 3: fair values are calculated by the use of pricing models and/or discounted cash flow methodologies, and may require significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data. The Organization's Level 3 assets include alternative assets, investments in a hedge fund, and contributions receivable.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair values may not be realized in the immediate settlement of the financial asset or liability. In addition, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in amounts disclosed.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements – In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. Under ASU No. 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:

- A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and
- A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term.

ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2019.

The Organization is currently evaluating the impact of the provisions of ASU 2016-02 on the presentation of its combined financial statements.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers: Topic 606*. Under Topic 606, an entity is required to recognize revenue upon transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The Organization is currently assessing the impact of Topic 606 on the financial statements. Topic 606 is effective for the Organization’s year ended December 31, 2019.

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Under ASU No. 2016-14, not-for-profit entities will be required to provide additional information as follows:

- Transition to a two-class net asset classification;
- Liquidity and availability disclosures;
- Expense reporting presented by function and nature and the allocation methodology disclosed;
- Investment returns will be required to be presented, net of all investment expenses; and
- Statement of cash flows changes where the direct method no longer needs the indirect reconciliation.

(Note 1 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued) - ASU No. 2016-14 is effective for fiscal years beginning after December 15, 2017. The Organization is in the process of assessing the potential impact of ASU 2016-14 on its combined financial statements.

Reclassifications - The combined financial statements for the year ended December 31, 2016 contain certain reclassifications, which have no effect on changes in net assets, to conform to the current period presentation at December 31, 2017.

Subsequent Events - The Organization evaluated subsequent events through June 18, 2018, the date these combined financial statements were available to be issued. Except for the event described in Note 15, there were no material subsequent events that required recognition or additional disclosure in these combined financial statements.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 2 - INVESTMENTS AND FINANCIAL ASSETS AND LIABILITIES

The following table summarizes the fair values of the Organization's investments and other applicable assets and liabilities at December 31, 2017 in accordance with these fair-value levels:

	<i>Assets at Fair Value as of December 31, 2017</i>			<i>Total</i>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Mutual funds:				
Balanced funds	\$ 98,983	\$ --	\$ --	\$ 98,983
Fixed income funds	3,043,775	--	--	3,043,775
Domestic funds	2,464,665	--	--	2,464,665
International funds	4,671,950	--	--	4,671,950
Total mutual funds	<u>10,279,373</u>	<u>--</u>	<u>--</u>	<u>10,279,373</u>
Hedge fund	--	--	4,705,807	4,705,807
Master limited partnership fund	--	278,434	--	278,434
Charitable gift annuities	--	750	--	750
Alternative assets	--	--	463,951	463,951
Total investments	<u>10,279,373</u>	<u>279,184</u>	<u>5,169,758</u>	<u>15,728,315</u>
Contributions receivable - net	<u>--</u>	<u>--</u>	<u>1,335,290</u>	<u>1,335,290</u>
Total assets	<u>\$ 10,279,373</u>	<u>\$ 279,184</u>	<u>\$ 6,505,048</u>	<u>\$ 17,063,605</u>
Liabilities:				
Derivative instruments	<u>\$ --</u>	<u>\$ 143,805</u>	<u>\$ --</u>	<u>\$ 143,805</u>
Total liabilities	<u>\$ --</u>	<u>\$ 143,805</u>	<u>\$ --</u>	<u>\$ 143,805</u>

(Note 2 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 2 - INVESTMENTS AND FINANCIAL ASSETS AND LIABILITIES (Continued)

Investment income for the year ended December 31, 2017 is summarized as follows:

Interest and dividend income	\$ 429,700
Investment fees	(70,399)
Realized and unrealized gains, net	<u>1,881,541</u>
	<u>\$ 2,240,842</u>

The following table sets forth a summary of all of the Organization's Level 3 assets measured at fair value for the year ended December 31, 2017.

	<u>Investments</u>	<u>Contributions Receivable</u>
Balance, beginning of year	\$ 4,134,411	\$ 3,437,097
New contributions/payments received (net)	335,000	(364,064)
Change in allowance for uncollectibles	--	118,228
Write-offs (Note 15)	--	(2,008,295)
Change in present value discount	--	152,324
Interest and dividends	2,455	--
Investment fees	(9,990)	--
Investment gains (net)	<u>707,882</u>	<u>--</u>
Balance, end of year	<u>\$ 5,169,758</u>	<u>\$ 1,335,290</u>

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 3 - CONTRIBUTIONS RECEIVABLE

The Organization has recognized uncollected contribution promises as temporarily restricted support. These receivables represent unconditional promises to give to the Organization to be collected through 2021. Uncollected promises at December 31, 2017 that are expected to be collected within one year are recorded at the estimated net realizable value. Uncollected promises at December 31, 2017 that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on those amounts are computed using a 5% rate applicable in the year in which the promises were made. Amortization of the discount is included in contributions revenue for the year ended December 31, 2017. Future collections of the contributions receivable are scheduled as follows:

Amounts due in:	
Less than one year	\$ 265,119
One to five years	1,025,226
More than five years	<u>200,000</u>
	1,490,345
Less: allowance for uncollectibles	(74,907)
Less: unamortized discount	<u>(80,148)</u>
	<u>\$ 1,335,290</u>

NOTE 4 - LAND, BUILDINGS AND EQUIPMENT

Land, buildings and equipment are recorded at cost and consist of the following at December 31, 2017:

Buildings and improvements	\$ 26,165,653
Furniture and equipment	7,976,441
Vehicles	808,123
Computer hardware	41,829
Computer software	593,354
Land	3,550,563
Construction in process	<u>147,501</u>
Total land, buildings and equipment	39,283,464
Less accumulated depreciation	<u>(15,856,679)</u>
Net land, buildings and equipment	<u>\$ 23,426,785</u>

Total depreciation expense for the year ended December 31, 2017 was \$3,788,650.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 5 - LINE OF CREDIT

At December 31, 2017, the Organization has a \$3,510,000 revolving line of credit with a bank to be drawn down upon as needed with an interest rate of 0.5% above prime rate (prime rate at December 31, 2017 was 4.50%). This bank borrowing is collateralized by accounts receivable, inventory and land, buildings and equipment, and is set to expire on August 1, 2018. There was no outstanding balance on this line of credit at December 31, 2017.

The Organization has \$2,225,000 of stand-by letters of credit with the bank in connection with its workers' compensation policy (Note 7), which is part of the total indebtedness allowed under the revolving line of credit and subject to the same terms and conditions. At December 31, 2017, the Organization did not have any balances outstanding against this credit facility. These letters of credit reduce the available amount which can be borrowed against the bank's revolving line of credit. Accordingly, availability on the line of credit was \$1,285,000 at December 31, 2017.

The Organization had a \$4,257,063 direct-pay letter of credit with the bank, independent of the revolving line of credit, in connection with the 2006 Bonds (Note 9). At December 31, 2017, the Organization did not have any balances outstanding against this credit facility. The letter of credit is renewed annually on March 9, unless notice is given by either party. This bank borrowing was collateralized by real property at the main campus in Santa Ana, California.

Under the terms of the above agreement, the Organization is subject to maintaining a maximum debt to tangible net worth ratio, a minimum level of EBITDA coverage ratio, change in net assets, capital expenditures and unencumbered liquid assets. The Organization was not in compliance with two covenants at December 31, 2017, and obtained a bank waiver on June 15, 2018.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 6 –NOTE PAYABLE

Note payable at December 31, 2017 is summarized as follows:

Note payable to bank in quarterly installments of \$100,000 to principal, monthly payments of interest at either the prime rate in effect or LIBOR plus 3%, due in March 2021, secured by accounts receivable, inventory, and machinery and equipment.	\$ 1,300,000
Less: unamortized deferred loan costs	(14,000)
Less: current portion	<u>(400,000)</u>
	<u>\$ 886,000</u>

The annual aggregate maturities of notes payable are as follows:

Years ending December 31:	
2018	\$ 400,000
2019	400,000
2020	400,000
2021	<u>100,000</u>
	<u>\$ 1,300,000</u>

For the year ended December 31, 2017, interest expense incurred on the aforementioned note payable was \$63,902 and amortization associated with the cost of issuing the note totaled \$4,000.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 7 - SELF INSURANCE

The Organization carries a large-deductible workers' compensation policy and is responsible for paying the first \$350,000 of each claim occurrence up to \$4,588,000 in aggregate per policy plan year. The Organization has paid certain amounts of the claims known to date and has provided additional accrued liabilities for an estimate of the ultimate claims known to date. In developing these estimates, the Organization uses estimated losses (loss picks) provided by actuaries of the insurance broker to estimate the ultimate claim exposure. Given the estimation nature of this area, it is reasonably possible that future adjustments to these estimates will be required. Based upon the information known at December 31, 2017, management believes it has provided adequate reserves for all claims that will be paid by the Organization.

Accrued liabilities for workers' compensation for the year ended December 31, 2017 was \$2,906,406 which includes a current portion of \$786,272 and a long-term portion of \$2,120,134. These amounts are included in other current accrued liabilities and other accrued liabilities, respectively, in the Organization's combined statement of financial position (Note 10). The following is a reconciliation of the changes in the Organization's accrual for workers' compensation for the year ended December 31, 2017:

		<u><i>Workers'</i></u> <u><i>Compensation</i></u>
Balance, beginning of year	\$	2,659,874
Cash payments made on open claims		(1,531,958)
Cash payments for premiums and fees		(451,711)
Provision		<u>2,230,201</u>
Balance, end of year	\$	<u><u>2,906,406</u></u>

The Organization has elected to be self-insured for the purposes of employees' unemployment claims and has elected to reimburse the Employment Development Department, under the prorated cost of benefits method, for all claims filed by its employees. Estimated accrued unemployment liability at December 31, 2017 of \$160,000 represents estimated future claims arising from payroll paid up to December 31, 2017 and this amount is included in other accrued liabilities in the Organization's combined statement of financial position.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 8 - DERIVATIVE INSTRUMENTS

The Organization used variable-rate debt to finance the \$9,850,000 Variable Rate Demand Revenue Bonds issued in 2006 (2006 Bonds) (Note 9). The debt obligations expose the Organization to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of its interest payments. To meet this objective, management entered into interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. The swaps changed the variable-rate cash flows exposure on the debt obligations to fixed-rate cash flows. Under the terms of the interest rate swaps, the Organization receives variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt.

By using derivative financial instruments to hedge its exposure to changes in interest rates, the Organization exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Organization, which creates credit risk for the Organization. When the fair value of a derivative contract is negative, the Organization owes the counterparty and, therefore, it does not possess credit risk. The Organization minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing the monitoring parameters that limit the types and degree of market risk that may be undertaken.

On February 12, 2010, the Organization entered into an interest rate swap transaction, collateralized by cash, with an effective date of February 12, 2010, and a termination date of January 1, 2020. The swap contract was executed with the purpose of fixing the interest rate on approximately 50% of the 2006 and 2008 Bonds (Note 9). The 2008 Bonds were prepaid in full during the year ended December 31, 2013. Under the terms of the agreement, the Organization pays interest at a fixed rate of 3.06% and receives interest at 70% of 3-month LIBOR. The difference between interest earned and the interest obligation accrued is received or paid the first day of each month and is recorded as interest expense. During the year ended December 31, 2017, total interest expense paid through the arrangement was \$104,681. At December 31, 2017, the notional amount was \$4,987,500 and the estimated liability on the contract reflected on the combined statement of financial position was \$143,805. A cumulative gain of \$115,476 from changes in the swap's contract fair value has been recognized as a change in net assets in the current period. At December 31, 2017, the required cash on deposit with a financial institution totaled \$300,000 and is included as restricted cash in the combined statement of financial position.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 9 - BONDS PAYABLE

On March 9, 2006, the Organization authorized the issuance of \$9,850,000 of Variable Rate Demand Revenue Bonds, payable to the California Infrastructure and Economic Development Bank. The bonds mature on March 1, 2031 and bear interest at a Weekly Interest Rate as determined by the Remarketing Agent. The debt repayment schedule provides for principal payments commencing March 1, 2007. The bonds are supported by a direct-pay letter of credit with a bank (Note 5). The costs associated with this bond issue are being amortized over twenty-five years and are net against the long-term portion of bonds payable on the accompanying combined statement of financial position. The proceeds of these bonds were used to finance the renovation and expansion of the Organization's retail and wholesale store facilities, to make certain improvements related to street beautification and parking lot lighting and to purchase equipment and fixtures to be used or installed in conjunction with the project. As of December 31, 2017, the current portion of bonds payable was \$355,000 and the long-term portion of the bonds payable was \$4,012,174, which is net of \$162,826 unamortized bond issuance costs.

The annual aggregate maturities of bond obligations are as follows:

Years ending December 31:	
2018	\$ 355,000
2019	370,000
2020	390,000
2021	410,000
2022	430,000
Thereafter	<u>2,575,000</u>
	<u>\$ 4,530,000</u>

For the year ended December 31, 2017, interest expense incurred on the aforementioned bonds payable was \$38,138 and amortization associated with the cost of issuing the bonds totaled \$12,366, which has been included in interest expense in the accompanying statement of functional expenses.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 10 - OTHER ACCRUED LIABILITIES

Aggregate other current liabilities and other accrued liabilities at December 31, 2017 consist of the following:

Deferred rent	\$ 799,881
Loss contingencies (Note 13)	894,235
Unemployment benefits (Note 7)	160,000
Workers' compensation (Note 7)	2,906,406
Other	<u>406,933</u>
	5,167,455
Less: other current accrued liabilities	<u>(2,245,696)</u>
Other accrued liabilities	<u>\$ 2,921,759</u>

NOTE 11 - NET ASSETS

Temporarily restricted net assets at December 31, 2017 consist of the following:

Charitable Gift Annuity investments in which the Organization is the beneficiary of the assets upon the death of the donor	\$ 750
Uncollected contribution promises	<u>1,335,290</u>
Total temporarily restricted net assets	<u>\$ 1,336,040</u>

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 12 - ENDOWMENTS

The endowment consists of various individual funds established for a variety of purposes, consisting of both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowment. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Directors has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), which the State of California has enacted, as requiring the preservation of the historic dollar value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as permanently restricted net assets:

- The original value of gifts donated to the permanent endowment,
- The original value of subsequent gifts to the permanent endowment, and
- Accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time accumulation is added to the fund.

Endowment Net Assets Composition by Type of Fund

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment fund	\$ --	\$ 52,980	\$ 52,980
Board-designated endowment fund	<u>463,951</u>	<u>--</u>	<u>463,951</u>
Total	<u>\$ 463,951</u>	<u>\$ 52,980</u>	<u>\$ 516,931</u>

(Note 12 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 12 - ENDOWMENTS (Continued)

Changes in Endowment Net Assets

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 410,737	\$ 52,980	\$ 463,717
Investment return:			
Investment income, net	2,455	--	2,455
Net appreciation (realized and unrealized)	50,759	--	50,759
Total investment return	53,214	--	53,214
Total	\$ 463,951	\$ 52,980	\$ 516,931

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. There were no such deficiencies as of December 31, 2017.

Return Objectives and Risk Parameters

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity as well as board-designated funds. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of major indices (e.g. S&P 500) while assuming a moderate level of investment risk. The Organization expects its endowment funds, over time, to provide an average annual rate of return of the National Consumer Price Index plus 5% for the aggregate investments over a period of five years. Actual returns in any given year may vary from this amount.

(Note 12 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 12 - ENDOWMENTS (Continued)

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation to achieve its long-term objectives within prudent risk constraints.

Spending Policy and Investment Objectives

The Organization has a policy that allows for the appropriation for distribution each year of up to 5% of its endowment fund's average year-end value over the past three years, provided that such payout shall not cause the total value of the endowment account to decline below the cumulative value of the original amounts donated. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 2% annually. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

Leases

The Organization leases trucks, office equipment and certain retail stores under noncancelable operating lease agreements. The monthly rents on the aforementioned leases range from \$5,449 to \$128,752 expiring at various dates through May 2026. Under the leasing arrangements for the retail stores, the Organization is required to pay property taxes and common area charges (maintenance, utilities and property insurance) attributable to the leases.

The Organization also leases space for various attended donation centers. The operating lease agreements are month to month and require monthly payments ranging from \$160 to \$1,093.

(Note 13 continued on the following page)

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 13 – COMMITMENTS AND CONTINGENCIES (Continued)

Future minimum annual rental payments under noncancelable operating leases at December 31, 2017 are as follows:

Years ending December 31:	
2018	\$ 6,484,578
2019	5,324,915
2020	4,510,292
2021	4,161,030
2022	3,813,207
Thereafter	<u>3,760,165</u>
	<u>\$ 28,054,187</u>

Rent expense was \$8,119,645 for the year ended December 31, 2017, which is included in occupancy expenses in the accompanying statement of functional expenses.

Loss Contingencies

The Organization is subject to certain outside claims and litigation arising in the ordinary course of business. The Organization's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Organization or unasserted claims that may result in such proceedings, the Organization's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Organization's combined financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

**Notes to Combined Financial Statements
(Continued)
December 31, 2017**

NOTE 14 - RELATED PARTY TRANSACTIONS

Landmark Services, Inc. pays Goodwill Industries of Orange County, California, a related entity through common board members, approximately \$21,580 a month for administrative services. The total amount received for such administrative and other services for the year ended December 31, 2017 amounted to \$258,960. This amount has been eliminated during the combination.

In addition, during 2016, Landmark Services, Inc. made a subordinated advance of \$1,000,000 to Goodwill Industries of Orange County, California, primarily to accommodate expansion and other financing needs of this related entity. Payments of \$17,440 are made monthly and bear an annual interest rate of 1.80% through the maturity date of March 2021. Interest charged to Goodwill Industries of Orange County, California for the year ended December 31, 2017 was \$13,795 and the balance of the note for the year ended December 31, 2017 was \$657,798. These amounts have been eliminated during the combination.

NOTE 15 – SUBSEQUENT EVENTS

In May 2018, management received additional information about four pledges that were included in contributions receivable on the accompanying combined statement of financial position at December 31, 2017. Based on the information, management determined that the collectability of these four pledges, totaling \$1,823,008, had become remote. Accordingly, these contributions receivable were written off as of December 31, 2017. The result of this write off was a reduction to net assets of \$1,530,803 during the year ended December 31, 2017, which is the net effect of the write off of the four pledges offset by a reversal of the related allowance for doubtful accounts reserve and discount for present value of \$90,761 and \$201,444, respectively.

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

Supplementary Information

**Goodwill Industries of Orange County, California
Statement of Financial Position
December 31, 2017**

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 1,505,503	\$ --	\$ --	\$ 1,505,503
Investments	15,674,585	750	52,980	15,728,315
Accounts receivable (net of allowance for doubtful accounts of \$98,076)	3,169,564	--	--	3,169,564
Current portion of contributions receivable - net	--	265,119	--	265,119
Inventory	1,731,455	--	--	1,731,455
Prepaid expenses	905,535	--	--	905,535
Total current assets	<u>22,986,642</u>	<u>265,869</u>	<u>52,980</u>	<u>23,305,491</u>
Non-current assets:				
Restricted cash	300,000	--	--	300,000
Contributions receivable - net	--	1,070,171	--	1,070,171
Deposits	421,722	--	--	421,722
Land, buildings and equipment - net of accumulated depreciation	<u>23,281,037</u>	<u>--</u>	<u>--</u>	<u>23,281,037</u>
Total assets	<u>\$ 46,989,401</u>	<u>\$ 1,336,040</u>	<u>\$ 52,980</u>	<u>\$ 48,378,421</u>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Accounts payable	\$ 1,877,596	\$ --	\$ --	\$ 1,877,596
Accrued salaries, wages, and vacation payable	2,608,135	--	--	2,608,135
Current portion of due to Landmark Services, Inc.	198,740	--	--	198,740
Current portion of notes payable	400,000	--	--	400,000
Current portion of bonds payable	355,000	--	--	355,000
Other current accrued liabilities	1,863,295	--	--	1,863,295
Total current liabilities	<u>7,302,766</u>	<u>--</u>	<u>--</u>	<u>7,302,766</u>
Non-current liabilities:				
Derivative instruments	143,805	--	--	143,805
Due to Landmark Services, Inc. (Note 14)	459,058	--	--	459,058
Notes payable - net	886,000	--	--	886,000
Bonds payable - net	4,012,174	--	--	4,012,174
Other accrued liabilities	<u>2,682,676</u>	<u>--</u>	<u>--</u>	<u>2,682,676</u>
Total liabilities	<u>15,486,479</u>	<u>--</u>	<u>--</u>	<u>15,486,479</u>
Net assets:				
Unrestricted	31,502,922	--	--	31,502,922
Temporarily restricted	--	1,336,040	--	1,336,040
Permanently restricted	--	--	52,980	52,980
Total net assets	<u>31,502,922</u>	<u>1,336,040</u>	<u>52,980</u>	<u>32,891,942</u>
Total liabilities and net assets	<u>\$ 46,989,401</u>	<u>\$ 1,336,040</u>	<u>\$ 52,980</u>	<u>\$ 48,378,421</u>

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

Supplementary Information

**Goodwill Industries of Orange County, California
Statement of Activities
Year Ended December 31, 2017**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Public support and revenue:				
Public support:				
Indirect public support	\$ 5,111	\$ --	\$ --	\$ 5,111
Contributions	1,486,050	16,900	--	1,502,950
Donated merchandise	35,548,535	--	--	35,548,535
Total public support	<u>37,039,696</u>	<u>16,900</u>	<u>--</u>	<u>37,056,596</u>
Revenue:				
Thrift store sales	57,696,333	--	--	57,696,333
Other sales	2,260,840	--	--	2,260,840
Contract services	1,170,727	--	--	1,170,727
Rehabilitation revenue	21,761,352	--	--	21,761,352
Technology services	4,212,584	--	--	4,212,584
Interest and other income	448,019	--	--	448,019
Realized and unrealized gains on investments, net	1,881,541	--	--	1,881,541
Realized gains on assets disposed of through restructuring	99,240	--	--	99,240
Unrealized gains on derivative instruments	115,476	--	--	115,476
Total revenue	<u>89,646,112</u>	<u>--</u>	<u>--</u>	<u>89,646,112</u>
Net assets released from restrictions	<u>2,118,707</u>	<u>(2,118,707)</u>	<u>--</u>	<u>--</u>
Total public support and revenue	<u>128,804,515</u>	<u>(2,101,807)</u>	<u>--</u>	<u>126,702,708</u>
Expenses:				
Program services:				
Store operations	76,535,502	--	--	76,535,502
Processing of donated merchandise	9,337,295	--	--	9,337,295
Solicitation and transportation	7,377,092	--	--	7,377,092
Rehabilitation	20,681,935	--	--	20,681,935
Contract services	1,748,685	--	--	1,748,685
Technology services	1,632,356	--	--	1,632,356
Total program services	<u>117,312,865</u>	<u>--</u>	<u>--</u>	<u>117,312,865</u>
Supporting services:				
General and administrative	6,639,102	--	--	6,639,102
Fundraising	2,964,047	--	--	2,964,047
Total supporting services	<u>9,603,149</u>	<u>--</u>	<u>--</u>	<u>9,603,149</u>
Total expenses	<u>126,916,014</u>	<u>--</u>	<u>--</u>	<u>126,916,014</u>
Change in net assets	1,888,501	(2,101,807)	--	(213,306)
Net assets at beginning of year	<u>29,614,421</u>	<u>3,437,847</u>	<u>52,980</u>	<u>33,105,248</u>
Net assets at end of year	<u>\$ 31,502,922</u>	<u>\$ 1,336,040</u>	<u>\$ 52,980</u>	<u>\$ 32,891,942</u>

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

Supplementary Information

**Landmark Services, Inc.
Statement of Financial Position
December 31, 2017**

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 1,252,330	\$ --	\$ --	\$ 1,252,330
Accounts receivable (net of allowance for doubtful accounts of \$9,276)	504,612	--	--	504,612
Current portion note receivable due from Goodwill Industries of Orange County	198,740	--	--	198,740
Prepaid expenses	66,016	--	--	66,016
Total current assets	<u>2,021,698</u>	<u>--</u>	<u>--</u>	<u>2,021,698</u>
Non-current assets:				
Land, buildings and equipment - net of accumulated depreciation	145,748	--	--	145,748
Due from Goodwill Industries of Orange County (Note 14)	459,058	--	--	459,058
Total long-term assets	<u>604,806</u>	<u>--</u>	<u>--</u>	<u>604,806</u>
Total assets	<u>\$ 2,626,504</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 2,626,504</u>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Accounts payable	\$ 122,757	\$ --	\$ --	\$ 122,757
Accrued salaries, wages, and vacation payable	150,865	--	--	150,865
Other current accrued liabilities	382,401	--	--	382,401
Total current liabilities	<u>656,023</u>	<u>--</u>	<u>--</u>	<u>656,023</u>
Non-current liabilities				
Other accrued liabilities	239,083	--	--	239,083
Total liabilities	<u>895,106</u>	<u>--</u>	<u>--</u>	<u>895,106</u>
Net assets:				
Unrestricted	1,731,398	--	--	1,731,398
Total net assets	<u>1,731,398</u>	<u>--</u>	<u>--</u>	<u>1,731,398</u>
Total liabilities and net assets	<u>\$ 2,626,504</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 2,626,504</u>

**GOODWILL INDUSTRIES OF ORANGE COUNTY,
CALIFORNIA AND AFFILIATE**

Supplementary Information

**Landmark Services, Inc.
Statement of Activities
Year Ended December 31, 2017**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenue:				
Contract services	\$ 4,039,838	\$ --	\$ --	\$ 4,039,838
Interest and other income	15,338	--	--	15,338
Total revenue	<u>4,055,176</u>	<u>--</u>	<u>--</u>	<u>4,055,176</u>
Expenses:				
Contract services	3,728,329	--	--	3,728,329
Total program services	<u>3,728,329</u>	<u>--</u>	<u>--</u>	<u>3,728,329</u>
Supporting services:				
General and administrative	396,755	--	--	396,755
Total supporting services	<u>396,755</u>	<u>--</u>	<u>--</u>	<u>396,755</u>
Total expenses	<u>4,125,084</u>	<u>--</u>	<u>--</u>	<u>4,125,084</u>
Change in net assets	(69,908)	--	--	(69,908)
Net assets at beginning of year	<u>1,801,306</u>	<u>--</u>	<u>--</u>	<u>1,801,306</u>
Net assets at end of year	<u>\$ 1,731,398</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 1,731,398</u>