



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

**Combined Financial Statements
and
Supplementary Information
December 31, 2016
(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, 2016, 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 combined 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, 2016, 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 25, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015 is consistent, in all material respects, with the audited combined financial statements from which it has been derived.

: Kushner, Smith, Joanou, and Gregson, LLP

May 31, 2017

Kushner, Smith, Joanou, and Gregson, 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, 2016

(with summarized financial information as of December 31, 2015)

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>	
				<u>2016</u>	<u>2015</u>
Current assets:					
Cash and cash equivalents	\$ 2,903,226	\$ --	\$ --	\$ 2,903,226	\$ 5,322,723
Investments (Note 2)	13,250,234	750	52,980	13,303,964	11,017,873
Accounts receivable (net of allowance for doubtful accounts of \$107,352 and \$174,316, respectively) (Notes 5 and 6)	3,142,603	--	--	3,142,603	3,480,011
Current portion of contributions receivable - net (Notes 2 and 3)	--	1,082,719	--	1,082,719	428,960
Inventory (Note 5 and 6)	1,634,500	--	--	1,634,500	1,739,759
Prepaid expenses	898,629	--	--	898,629	708,561
Total current assets	21,829,192	1,083,469	52,980	22,965,641	22,697,887
Non-current assets:					
Restricted cash (Note 8)	470,000	--	--	470,000	470,000
Contributions receivable - net (Notes 2 and 3)	--	2,354,378	--	2,354,378	777,672
Deposits	412,081	--	--	412,081	354,369
Land, buildings and equipment - net of accumulated depreciation (Notes 4, 5 and 6)	24,065,739	--	--	24,065,739	24,277,345
Total assets	\$ 46,777,012	\$ 3,437,847	\$ 52,980	\$ 50,267,839	\$ 48,577,273
 <u>LIABILITIES AND NET ASSETS</u>					
Current liabilities:					
Accounts payable	\$ 1,595,191	\$ --	\$ --	\$ 1,595,191	\$ 2,243,430
Accrued salaries, wages, and vacation payable	3,148,299	--	--	3,148,299	3,210,590
Current portion of notes payable (Note 6)	400,000	--	--	400,000	--
Current portion of bonds payable (Note 9)	335,000	--	--	335,000	320,000
Income taxes payable	--	--	--	--	2,000
Other current accrued liabilities (Note 10)	720,642	--	--	720,642	626,158
Total current liabilities	6,199,132	--	--	6,199,132	6,402,178
Non-current liabilities:					
Derivative instruments (Notes 2 and 8)	259,281	--	--	259,281	366,339
Notes payable - net (Note 6)	1,282,000	--	--	1,282,000	--
Bonds payable - net (Note 9)	4,354,808	--	--	4,354,808	4,677,442
Other accrued liabilities (Note 10)	3,266,064	--	--	3,266,064	3,490,833
Total liabilities	15,361,285	--	--	15,361,285	14,936,792
Commitments and contingencies and related party transactions (Notes 13 and 14)					
Net assets (Notes 11 and 12):					
Unrestricted	31,415,727	--	--	31,415,727	32,369,756
Temporarily restricted	--	3,437,847	--	3,437,847	1,217,745
Permanently restricted	--	--	52,980	52,980	52,980
Total net assets	31,415,727	3,437,847	52,980	34,906,554	33,640,481
Total liabilities and net assets	\$ 46,777,012	\$ 3,437,847	\$ 52,980	\$ 50,267,839	\$ 48,577,273

See accompanying notes to combined financial statements

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

**Combined Statement of Activities
Year Ended December 31, 2016**

(with summarized financial information for the year ended December 31, 2015)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	
				<u>2016</u>	<u>2015</u>
Public support and revenue:					
Public support:					
Indirect public support	\$ 10,675	\$ --	\$ --	\$ 10,675	\$ 1,875
Contributions	1,582,864	2,727,051	--	4,309,915	2,710,292
Donated merchandise	32,850,458	--	--	32,850,458	34,803,144
Total public support	<u>34,443,997</u>	<u>2,727,051</u>	<u>--</u>	<u>37,171,048</u>	<u>37,515,311</u>
Revenue:					
Thrift store sales	55,127,712	--	--	55,127,712	55,165,281
Other sales	1,745,779	--	--	1,745,779	2,187,143
Contract services	5,114,369	--	--	5,114,369	7,391,050
Rehabilitation revenue	19,141,962	--	--	19,141,962	16,898,569
Technology services	3,269,404	--	--	3,269,404	2,495,189
Interest and other income	292,834	--	--	292,834	399,568
Realized and unrealized gains (losses) on investments, net	614,230	--	--	614,230	(588,037)
Realized (losses) on disposal of land, buildings and equipment	(11,771)	--	--	(11,771)	(270,765)
Realized (losses) on assets disposed of through restructuring	--	--	--	--	(177,639)
Unrealized gains on derivative instruments	107,058	--	--	107,058	73,974
Total revenue	<u>85,401,577</u>	<u>--</u>	<u>--</u>	<u>85,401,577</u>	<u>83,574,333</u>
Net assets released from restrictions	<u>506,949</u>	<u>(506,949)</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total public support and revenue	<u>120,352,523</u>	<u>2,220,102</u>	<u>--</u>	<u>122,572,625</u>	<u>121,089,644</u>
Expenses:					
Program services:					
Store operations	71,656,921	--	--	71,656,921	71,540,353
Processing of donated merchandise	8,456,735	--	--	8,456,735	7,417,990
Solicitation and transportation	7,406,189	--	--	7,406,189	6,915,841
Rehabilitation	18,624,657	--	--	18,624,657	17,675,778
Contract services	5,113,720	--	--	5,113,720	7,190,579
Technology services	1,202,156	--	--	1,202,156	1,046,793
Restructuring	--	--	--	--	285,835
Total program services	<u>112,460,378</u>	<u>--</u>	<u>--</u>	<u>112,460,378</u>	<u>112,073,169</u>
Supporting services:					
General and administrative	7,808,640	--	--	7,808,640	8,017,423
Fundraising	1,037,534	--	--	1,037,534	1,157,905
Total supporting services	<u>8,846,174</u>	<u>--</u>	<u>--</u>	<u>8,846,174</u>	<u>9,175,328</u>
Total expenses	<u>121,306,552</u>	<u>--</u>	<u>--</u>	<u>121,306,552</u>	<u>121,248,497</u>
Change in net assets	(954,029)	2,220,102	--	1,266,073	(158,853)
Net assets at beginning of year	<u>32,369,756</u>	<u>1,217,745</u>	<u>52,980</u>	<u>33,640,481</u>	<u>33,799,334</u>
Net assets at end 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>

See accompanying notes to combined financial statements

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

**Combined Statement of Functional Expenses
Year Ended December 31, 2016**
(with summarized financial information for the year ended December 31, 2015)

	Program Services						Subtotal
	Store Operations	Processing of Donated Merchandise	Solicitation and Transportation	Rehabilitation	Contract Services	Technology Services	
Salaries and related expenses:							
Salaries and wages	\$ 15,197,996	\$ 4,127,901	\$ 3,815,066	\$ 12,137,808	\$ 2,843,496	\$ 539,097	\$ 38,661,364
Employee benefits	959,837	411,473	432,969	1,624,068	647,518	44,801	4,120,666
Payroll taxes	2,040,405	728,073	542,818	1,374,823	546,338	63,137	5,295,594
Total salaries and related expenses	<u>18,198,238</u>	<u>5,267,447</u>	<u>4,790,853</u>	<u>15,136,699</u>	<u>4,037,352</u>	<u>647,035</u>	<u>48,077,624</u>
Other expenses:							
Cost of goods sold	39,519,511	235,954	31	12	(1,697)	--	39,753,811
Professional services	1,368,073	47,554	9,419	758,548	157,761	29,726	2,371,081
Supplies	786,176	320,667	155,958	117,396	306,461	8,345	1,695,003
Telephone	191,545	44,757	91,971	221,794	35,044	74,930	660,041
Postage	1,023,184	69,005	12,086	4,871	332	31	1,109,509
Occupancy	7,594,524	1,875,455	1,044,704	540,426	318,204	192,633	11,565,946
Equipment rent and maintenance	160,749	43,293	130,633	27,724	11,386	65,840	439,625
Advertising	360,045	59	10,573	269,640	11	13,540	653,868
Printing and publishing	141,016	13,289	9,330	128,701	6,584	846	299,766
Travel and vehicle	54,077	43,128	734,309	952,182	53,706	39,892	1,877,294
Conferences, conventions and meetings	58,057	10,404	1,478	69,208	7,049	27,440	173,636
Membership and dues to national organization	128,579	--	--	46,795	8,722	4,469	188,565
Awards, grants and special assistance	3,811	4,252	1,684	65,446	682	--	75,875
Interest expense	--	--	--	--	--	--	--
Bad debt expense	--	--	--	21,351	504	--	21,855
Other operating expenses	619	--	--	--	--	44	663
Total expenses before depreciation	<u>69,588,204</u>	<u>7,975,264</u>	<u>6,993,029</u>	<u>18,360,793</u>	<u>4,942,101</u>	<u>1,104,771</u>	<u>108,964,162</u>
Depreciation	<u>2,068,717</u>	<u>481,471</u>	<u>413,160</u>	<u>263,864</u>	<u>171,619</u>	<u>97,385</u>	<u>3,496,216</u>
Total expenses	<u>\$ 71,656,921</u>	<u>\$ 8,456,735</u>	<u>\$ 7,406,189</u>	<u>\$ 18,624,657</u>	<u>\$ 5,113,720</u>	<u>\$ 1,202,156</u>	<u>\$ 112,460,378</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, 2016

(with summarized financial information for the year ended December 31, 2015)

	<u>Supporting Services</u>				<u>Total Expenses</u>	
	<u>Subtotal</u>	<u>General & Admin</u>	<u>Fund Raising</u>	<u>Subtotal</u>	<u>2016</u>	<u>2015</u>
Salaries and related expenses:						
Salaries and wages	\$ 38,661,364	\$ 4,276,261	\$ 413,777	\$ 4,690,038	\$ 43,351,402	\$ 41,854,401
Employee benefits	4,120,666	497,821	25,785	523,606	4,644,272	5,893,696
Payroll taxes	5,295,594	460,135	34,128	494,263	5,789,857	5,298,812
Total salaries and related expenses	<u>48,077,624</u>	<u>5,234,217</u>	<u>473,690</u>	<u>5,707,907</u>	<u>53,785,531</u>	<u>53,046,909</u>
Other expenses:						
Cost of goods sold	39,753,811	53	2	55	39,753,866	41,503,208
Professional services	2,371,081	872,876	50,208	923,084	3,294,165	3,143,300
Supplies	1,695,003	84,266	13,318	97,584	1,792,587	1,690,123
Telephone	660,041	76,938	9,049	85,987	746,028	644,093
Postage	1,109,509	12,064	8,186	20,250	1,129,759	1,067,277
Occupancy	11,565,946	318,154	17,913	336,067	11,902,013	11,243,032
Equipment rent and maintenance	439,625	199,118	39,611	238,729	678,354	666,433
Advertising	653,868	7,652	52,440	60,092	713,960	511,054
Printing and publishing	299,766	83,246	24,628	107,874	407,640	416,486
Travel and vehicle	1,877,294	21,610	7,700	29,310	1,906,604	2,153,149
Conferences, conventions and meetings	173,636	158,708	307,876	466,584	640,220	598,527
Membership and dues to national organization	188,565	27,395	6,246	33,641	222,206	188,902
Awards, grants and special assistance	75,875	8,183	18,404	26,587	102,462	62,625
Interest expense	--	201,907	--	201,907	201,907	169,422
Bad debt expense	21,855	--	--	--	21,855	240,708
Other operating expenses	663	--	--	--	663	(142)
Total expenses before depreciation	<u>108,964,162</u>	<u>7,306,387</u>	<u>1,029,271</u>	<u>8,335,658</u>	<u>117,299,820</u>	<u>117,345,106</u>
Depreciation	<u>3,496,216</u>	<u>502,253</u>	<u>8,263</u>	<u>510,516</u>	<u>4,006,732</u>	<u>3,903,391</u>
Total expenses	<u>\$ 112,460,378</u>	<u>\$ 7,808,640</u>	<u>\$ 1,037,534</u>	<u>\$ 8,846,174</u>	<u>\$ 121,306,552</u>	<u>\$ 121,248,497</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, 2016**

(with summarized financial information for the year ended December 31, 2015)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ 1,266,073	\$ (158,853)
Adjustment to reconcile changes in net assets to net cash provided by operating activities:		
Change in donated inventory	105,259	(83,156)
Provision for bad debts	(66,964)	78,734
Depreciation	4,006,732	3,903,391
Interest expense - debt issuance costs	14,366	12,367
Realized and unrealized (earnings) losses on investments, net	(885,902)	224,328
Realized losses (gains) on the disposal of land, buildings and equipment	11,771	270,765
Realized losses on assets disposed of through restructuring	--	177,639
Unrealized (gains) on derivative instruments	(107,058)	(73,973)
(Increase) decrease in:		
Restricted cash	--	400,000
Accounts receivable - net	404,372	(217,960)
Contributions receivable - net	(2,230,465)	(162,743)
Prepaid expenses	(190,068)	117,420
Deposits	(57,712)	(83,733)
Increase (decrease) in:		
Accounts payable	(648,239)	(206,501)
Accrued salaries, wages and vacation payable	(62,291)	(1,113,681)
Income tax payable	(2,000)	--
Other accrued liabilities	(130,285)	486,538
Net cash provided by operating activities	<u>1,427,589</u>	<u>3,570,582</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, 2016

(with summarized financial information for the year ended December 31, 2015)

	<u>2016</u>	<u>2015</u>
Cash flows from investing activities:		
Purchase of investments	(1,426,987)	(12,686)
Proceeds from the sale of investments	26,798	1,321,850
Purchase of land, buildings and equipment	(3,815,384)	(3,901,623)
Proceeds from sale of land, buildings and equipment	8,487	35,296
Net cash (applied to) investing activities	<u>(5,207,086)</u>	<u>(2,557,163)</u>
Cash flows from financing activities:		
Principal repayments of bonds	(320,000)	(305,000)
Note payable origination costs	(20,000)	--
Proceeds from issuance of note	2,000,000	--
Principal repayments on note payable	(300,000)	--
Net cash provided by (used in) financing activities	<u>1,360,000</u>	<u>(305,000)</u>
Net (decrease) increase in cash	(2,419,497)	708,419
Cash and cash equivalents at beginning of year	<u>5,322,723</u>	<u>4,614,304</u>
Cash and cash equivalents at end of year	<u>\$ 2,903,226</u>	<u>\$ 5,322,723</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	<u>\$ 150,575</u>	<u>\$ 158,608</u>

See accompanying notes to combined financial statements

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

**Notes to Combined Financial Statements
December 31, 2016**

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, veterans 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 located throughout 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, 2016**

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, 2015 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, 2016, 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, 2016**

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, 2016, 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, 2016**

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 Company's accounting policy is to exclude the taxes collected and remitted from revenue and expenses.

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 \$410,737 at December 31, 2016 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, 2016 was \$713,960.

Contributory Retirement Plan - Effective January 1, 1989, the Organization adopted a contributory retirement plan covering all employees over 21 years of age. The plan, as amended in 1990, provides for an employer base contribution of 4.0% of participating employees' salaries, as defined, for all participating employees that contribute at least 1% of their eligible salary during the plan year. Participating employees may also contribute up to a maximum allowable limit established by the Internal Revenue Service. The Organization matches 100% of these contributions up to a maximum of 3.0% of salary. Participants become fully vested 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. Effective July 9, 2016, the plan was amended to eliminate the employer base contribution of 4.0% and all employer matching. The total amount charged to expense related to the plan for the year ended December 31, 2016 was \$773,822.

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, 2016, the Organization had no capital leases.

Restricted Cash - The Organization has restricted cash of \$470,000 at December 31, 2016 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.

(Note 1 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

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, 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements - In February 2016, the Financial Accounting Standards Board (FASB) 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 in the process of assessing the potential impact of the ASU on its combined financial statements.

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.

ASU No. 2016-14 is effective for fiscal years beginning after December 15, 2018. The Organization is in the process of assessing the potential impact of the ASU on its combined financial statements.

(Note 1 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued) - Effective December 31, 2016, the Organization retrospectively adopted Accounting Standards Update No. 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03), which requires debt issuance costs to be included in the carrying value of the related debt liability, when recognized, on the face of the balance sheet. In addition, amounts previously reported as amortization expense in the combined statement of activities, combined statement of functional expenses, and combined statement of cash flows, are now to be reported as interest expense. Other than reclassification impact to the aforementioned combined financial statements, the adoption of ASU 2015-03 did not impact the Organization's combined financial condition, liquidity or results of operations.

Reclassifications - The combined financial statements for the year ended December 31, 2015 contain certain reclassifications, which have no effect on changes in net assets, to conform to the current period presentation at December 31, 2016.

Subsequent Events - The Organization evaluated subsequent events through May 31, 2017, the date these combined financial statements were available to be issued. 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, 2016**

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, 2016 in accordance with these fair-value levels:

	<i>Assets at Fair Value as of December 31, 2016</i>			<i>Total</i>
	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	
Assets:				
Mutual funds:				
Balanced funds	\$ 86,279	\$ --	\$ --	\$ 86,279
Fixed income funds	2,568,050	--	--	2,568,050
Domestic funds	2,427,579	--	--	2,427,579
International funds	3,789,139	--	--	3,789,139
Total mutual funds	<u>8,871,047</u>	--	--	<u>8,871,047</u>
Hedge fund	--	--	3,723,674	3,723,674
Master limited partnership fund				
	--	297,756	--	297,756
Charitable gift annuities	--	750	--	750
Alternative assets	--	--	410,737	410,737
Total investments	<u>8,871,047</u>	<u>298,506</u>	<u>4,134,411</u>	<u>13,303,964</u>
Contributions receivable - net	--	--	3,437,097	3,437,097
Total assets	<u>\$ 8,871,047</u>	<u>\$ 298,506</u>	<u>\$ 7,571,508</u>	<u>\$ 16,741,061</u>
Liabilities:				
Derivative instruments	\$ --	\$ 259,281	\$ --	\$ 259,281
Total liabilities	<u>\$ --</u>	<u>\$ 259,281</u>	<u>\$ --</u>	<u>\$ 259,281</u>

(Note 2 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

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

Investment income for the year ended December 31, 2016 is summarized as follows:

Interest and dividend income	\$ 271,672
Investment fees	(66,082)
Realized and unrealized gains, net	<u>614,230</u>
	<u>\$ 819,820</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, 2016.

	<u>Investments</u>	<u>Contributions Receivable</u>
Balance, beginning of year	\$ 2,666,544	\$ 1,206,632
New contributions/payments received (net)	1,275,000	2,483,010
Change in allowance for uncollectibles	--	(130,018)
Change in present value discount	--	(122,527)
Interest and dividends	3,406	--
Investment fees	(9,186)	--
Investment gains (net)	<u>198,647</u>	<u>--</u>
Balance, end of year	<u>\$ 4,134,411</u>	<u>\$ 3,437,097</u>

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

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 2025. Uncollected promises at December 31, 2016 that are expected to be collected within one year are recorded at the estimated net realizable value. Uncollected promises at December 31, 2016 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, 2016. Future collections of the contributions receivable are scheduled as follows:

Amounts due in:	
Less than one year	\$ 1,082,719
One to five years	2,418,985
More than five years	<u>361,000</u>
	3,862,704
Less: allowance for uncollectibles	(193,135)
Less: unamortized discount	<u>(232,472)</u>
	<u>\$ 3,437,097</u>

NOTE 4 - LAND, BUILDINGS AND EQUIPMENT

Land, buildings and equipment are recorded at cost and consist of the following at December 31, 2016:

Buildings and improvements	\$ 25,408,955
Furniture and equipment	7,781,218
Vehicles	726,810
Computer hardware	453,793
Computer software	1,027,727
Land	3,429,873
Construction in process	<u>147,501</u>
Total land, buildings and equipment	38,975,877
Less accumulated depreciation	<u>(14,910,138)</u>
Net land, buildings and equipment	<u>\$ 24,065,739</u>

Total depreciation expense for the year ended December 31, 2016 was \$4,006,732.

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 5 - LINE OF CREDIT

At December 31, 2016, 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, 2016 was 3.75%). This bank borrowing is collateralized by accounts receivable, inventories and land, buildings and equipment, and is set to expire on August 1, 2017. There was no outstanding balance on this line of credit at December 31, 2016.

The Organization has \$2,606,000 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, 2016, 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 \$904,000 at December 31, 2016.

The Organization had a \$4,936,975 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, 2016, the Organization did not have any balances outstanding against this credit facility. The letter of credit was renewed annually on March 9 of each year, unless notice was given by either party, with a final maturity on March 9, 2017. 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. As of December 31, 2016, the Organization was in compliance with the aforementioned financial covenants.

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 6 –NOTE PAYABLE

Note payable at December 31, 2016 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.	\$ 1,700,000
Less: unamortized deferred loan costs	(18,000)
Less: current portion	<u>(400,000)</u>
	<u><u>\$ 1,282,000</u></u>

The annual aggregate maturities of notes payable are as follows:

Years ending December 31:	
2017	\$ 400,000
2018	400,000
2019	400,000
2020	400,000
2021	<u>100,000</u>
	<u><u>\$ 1,700,000</u></u>

Interest expense associated with the cost of issuing the note totaled \$2,000 for the year ended December 31, 2016.

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

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 \$4,010,000 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, 2016, 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, 2016 was \$2,659,874 which includes a current portion of \$720,043 and a long-term portion of \$1,939,831. 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 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, 2016 of \$185,000 represents estimated future claims arising from payroll paid up to December 31, 2016 and this amount is included in other accrued liabilities in the Organization's combined statement of financial position.

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.

(Note 8 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 8 - DERIVATIVE INSTRUMENTS (Continued)

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. At December 31, 2016, the notional amount was \$4,987,500 and the estimated liability on the contract reflected on the combined statement of financial position was \$259,281. A cumulative gain of \$107,058 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, 2016, the required cash on deposit with a financial institution totaled \$470,000 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, 2016**

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, 2016, the current portion of bonds payable was \$335,000 and the long-term portion of the bonds payable was \$4,354,808, which is net of \$175,192 unamortized bond issuance costs.

The annual aggregate maturities of bond obligations are as follows:

Years ending December 31:	
2017	\$ 335,000
2018	355,000
2019	370,000
2020	390,000
2021	410,000
Thereafter	<u>3,005,000</u>
	<u>\$ 4,865,000</u>

Interest expense associated with the cost of issuing the bonds totaled \$12,366 for the year ended December 31, 2016, and is included with interest expense on the accompanying statement of functional expenses.

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 10 - OTHER ACCRUED LIABILITIES

Aggregate other current liabilities and other accrued liabilities at December 31, 2016 consist of the following:

Deferred rent	\$ 812,282
Loss contingencies (Note 13)	30,000
Unemployment benefits (Note 7)	185,000
Workers' compensation (Note 7)	2,659,874
Other	<u>299,550</u>
	3,986,706
Less: other current accrued liabilities	<u>(720,642)</u>
Other accrued liabilities	<u>\$ 3,266,064</u>

NOTE 11 - NET ASSETS

Temporarily restricted net assets at December 31, 2016 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>3,437,097</u>
Total temporarily restricted net assets	<u>\$ 3,437,847</u>

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.

(Note 12 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 12 - ENDOWMENTS (Continued)

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>	<i>Permanently Restricted</i>	<u>Total</u>
Donor-restricted endowment fund	\$ --	\$ 52,980	\$ 52,980
Board-designated endowment fund	<u>410,737</u>	<u>--</u>	<u>410,737</u>
Total	<u>\$ 410,737</u>	<u>\$ 52,980</u>	<u>\$ 463,717</u>

(Note 12 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

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	\$ 387,305	\$ 52,980	\$ 440,285
Investment return:			
Investment income, net	3,406	--	3,406
Net appreciation (realized and unrealized)	<u>20,026</u>	<u>--</u>	<u>20,026</u>
Total investment return	<u>23,432</u>	<u>--</u>	<u>23,432</u>
Total	<u>\$ 410,737</u>	<u>\$ 52,980</u>	<u>\$ 463,717</u>

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, 2016.

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, 2016**

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 \$2,564 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 none to \$1,078.

(Note 13 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 13 - COMMITMENTS AND CONTINGENCIES (Continued)

Future minimum annual rental payments under noncancelable operating leases at December 31, 2016 are as follows:

Years ending December 31:	
2017	\$ 6,093,345
2018	5,576,575
2019	4,662,127
2020	4,248,380
2021	3,895,830
Thereafter	<u>7,096,757</u>
	<u>\$ 31,573,014</u>

Rent expense related to the aforementioned operating lease agreements was \$7,859,105 for the year ended December 31, 2016.

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.

(Note 13 continued on the following page)

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

**Notes to Combined Financial Statements
(Continued)
December 31, 2016**

NOTE 13 - COMMITMENTS AND CONTINGENCIES (Continued)

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

At December 31, 2016 the Organization had accrued \$30,000 in its combined statement of financial position for pending legal proceedings against the Organization (Note 10).

NOTE 14 - RELATED PARTY TRANSACTIONS

Landmark Services, Inc. pays Goodwill Industries of Orange County, California, a related entity through common board members, approximately \$20,970 a month for administrative services. The total amount received for such administrative and other services for the year ended December 31, 2016 amounted to \$251,635. This amount has been eliminated during the combination.

In addition, 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, 2016 was \$14,468 and the balance of the note for the year ended December 31, 2016 was \$855,649. These amounts have been eliminated during the combination.

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

Supplementary Information

**Goodwill Industries of Orange County, California
Statement of Financial Position
December 31, 2016**

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 2,026,263	\$ --	\$ --	\$ 2,026,263
Investments	13,250,234	750	52,980	13,303,964
Accounts receivable (net of allowance for doubtful accounts of \$98,076)	2,755,374	--	--	2,755,374
Current portion of contributions receivable - net	--	1,082,719	--	1,082,719
Inventory	1,634,500	--	--	1,634,500
Prepaid expenses	840,200	--	--	840,200
Total current assets	<u>20,506,571</u>	<u>1,083,469</u>	<u>52,980</u>	<u>21,643,020</u>
Non-current assets:				
Restricted cash	470,000	--	--	470,000
Contributions receivable - net	--	2,354,378	--	2,354,378
Deposits	412,081	--	--	412,081
Land, buildings and equipment - net of accumulated depreciation	<u>23,928,349</u>	<u>--</u>	<u>--</u>	<u>23,928,349</u>
Total assets	<u>\$ 45,317,001</u>	<u>\$ 3,437,847</u>	<u>\$ 52,980</u>	<u>\$ 48,807,828</u>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Accounts payable	\$ 1,358,486	\$ --	\$ --	\$ 1,358,486
Accrued salaries, wages, and vacation payable	3,145,853	--	--	3,145,853
Current portion of due to Landmark Services, Inc.	195,490	--	--	195,490
Current portion of notes payable	400,000	--	--	400,000
Current portion of bonds payable	335,000	--	--	335,000
Other current accrued liabilities	641,853	--	--	641,853
Total current liabilities	<u>6,076,682</u>	<u>--</u>	<u>--</u>	<u>6,076,682</u>
Non-current liabilities:				
Derivative instruments	259,281	--	--	259,281
Due to Landmark Services, Inc. (Note 14)	655,247	--	--	655,247
Notes payable - net	1,282,000	--	--	1,282,000
Bonds payable - net	4,354,808	--	--	4,354,808
Other accrued liabilities	<u>3,074,562</u>	<u>--</u>	<u>--</u>	<u>3,074,562</u>
Total liabilities	<u>15,702,580</u>	<u>--</u>	<u>--</u>	<u>15,702,580</u>
Net assets:				
Unrestricted	29,614,421	--	--	29,614,421
Temporarily restricted	--	3,437,847	--	3,437,847
Permanently restricted	--	--	52,980	52,980
Total net assets	<u>29,614,421</u>	<u>3,437,847</u>	<u>52,980</u>	<u>33,105,248</u>
Total liabilities and net assets	<u>\$ 45,317,001</u>	<u>\$ 3,437,847</u>	<u>\$ 52,980</u>	<u>\$ 48,807,828</u>

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

Supplementary Information

**Goodwill Industries of Orange County, California
Statement of Activities
Year Ended December 31, 2016**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Public support and revenue:				
Public support:				
Indirect public support	\$ 10,675	--	\$ --	\$ 10,675
Contributions	1,582,864	2,727,051	--	4,309,915
Donated merchandise	32,850,458	--	--	32,850,458
Total public support	<u>34,443,997</u>	<u>2,727,051</u>	<u>--</u>	<u>37,171,048</u>
Revenue:				
Thrift store sales	55,127,712	--	--	55,127,712
Other sales	1,745,779	--	--	1,745,779
Contract services	1,271,795	--	--	1,271,795
Rehabilitation revenue	19,141,962	--	--	19,141,962
Technology services	3,269,404	--	--	3,269,404
Interest and other income	277,501	--	--	277,501
Realized and unrealized (losses) gains on investments, net	614,230	--	--	614,230
Realized (losses) gains on disposal of land, buildings and equipment (Note 14)	(11,771)	--	--	(11,771)
Unrealized gains on derivative instruments	107,058	--	--	107,058
Total revenue	<u>81,543,670</u>	<u>--</u>	<u>--</u>	<u>81,543,670</u>
Net assets released from restrictions	506,949	(506,949)	--	--
Total public support and revenue	<u>116,494,616</u>	<u>2,220,102</u>	<u>--</u>	<u>118,714,718</u>
Expenses:				
Program services:				
Store operations	71,656,920	--	--	71,656,920
Processing of donated merchandise	8,456,735	--	--	8,456,735
Solicitation and transportation	7,406,189	--	--	7,406,189
Rehabilitation	18,624,657	--	--	18,624,657
Contract services	1,790,066	--	--	1,790,066
Technology services	1,202,156	--	--	1,202,156
Total program services	<u>109,136,723</u>	<u>--</u>	<u>--</u>	<u>109,136,723</u>
Supporting services:				
General and administrative	7,442,325	--	--	7,442,325
Fundraising	1,037,534	--	--	1,037,534
Total supporting services	<u>8,479,859</u>	<u>--</u>	<u>--</u>	<u>8,479,859</u>
Total expenses	<u>117,616,582</u>	<u>--</u>	<u>--</u>	<u>117,616,582</u>
Change in net assets	(1,121,966)	2,220,102	--	1,098,136
Net assets at beginning of year	30,736,387	1,217,745	52,980	32,007,112
Net assets at end of year	<u>\$ 29,614,421</u>	<u>\$ 3,437,847</u>	<u>\$ 52,980</u>	<u>\$ 33,105,248</u>

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

Supplementary Information

**Landmark Services, Inc.
Statement of Financial Position
December 31, 2016**

<u>ASSETS</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 876,963	\$ --	\$ --	\$ 876,963
Accounts receivable (net of allowance for doubtful accounts of \$9,276)	387,229	--	--	387,229
Current portion note receivable due from Goodwill Industries of Orange County	195,490	--	--	195,490
Prepaid expenses	58,429	--	--	58,429
Total current assets	<u>1,518,111</u>	<u>--</u>	<u>--</u>	<u>1,518,111</u>
Non-current assets:				
Land, buildings and equipment - net of accumulated depreciation	137,390	--	--	137,390
Due from Goodwill Industries of Orange County (Note 14)	655,247	--	--	655,247
Total long-term assets	<u>792,637</u>	<u>--</u>	<u>--</u>	<u>792,637</u>
Total assets	<u>\$ 2,310,748</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 2,310,748</u>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Accounts payable	\$ 236,705	\$ --	\$ --	\$ 236,705
Accrued salaries, wages, and vacation payable	2,446	--	--	2,446
Other current accrued liabilities	78,789	--	--	78,789
Total current liabilities	<u>317,940</u>	<u>--</u>	<u>--</u>	<u>317,940</u>
Non-current liabilities				
Other accrued liabilities	191,502	--	--	191,502
Total liabilities	<u>509,442</u>	<u>--</u>	<u>--</u>	<u>509,442</u>
Net assets:				
Unrestricted	1,801,306	--	--	1,801,306
Total net assets	<u>1,801,306</u>	<u>--</u>	<u>--</u>	<u>1,801,306</u>
Total liabilities and net assets	<u>\$ 2,310,748</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 2,310,748</u>

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

Supplementary Information

**Landmark Services, Inc.
Statement of Activities
Year Ended December 31, 2016**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenue:				
Contract services	\$ 3,842,574	\$ --	\$ --	\$ 3,842,574
Interest and other income	15,333	--	--	15,333
Total revenue	<u>3,857,907</u>	<u>--</u>	<u>--</u>	<u>3,857,907</u>
Expenses:				
Contract services	3,323,654	--	--	3,323,654
Total program services	<u>3,323,654</u>	<u>--</u>	<u>--</u>	<u>3,323,654</u>
Supporting services:				
General and administrative	366,316	--	--	366,316
Total supporting services	<u>366,316</u>	<u>--</u>	<u>--</u>	<u>366,316</u>
Total expenses	<u>3,689,970</u>	<u>--</u>	<u>--</u>	<u>3,689,970</u>
Change in net assets	167,937	--	--	167,937
Net assets at beginning of year	<u>1,633,369</u>	<u>--</u>	<u>--</u>	<u>1,633,369</u>
Net assets at end of year	<u>\$ 1,801,306</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 1,801,306</u>