

Consolidated Financial Statements
and Report of Independent
Certified Public Accountants

**Goodwill Industries of
Southeastern Wisconsin, Inc.
and Affiliates**

December 31, 2018 and 2017

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates

Report on the financial statements

We have audited the accompanying consolidated financial statements of Goodwill Industries of Southeastern Wisconsin, Inc. (a Wisconsin non-stock, not-for-profit organization) and Affiliates (collectively, Goodwill), which comprise the consolidated statements of financial position as of December 31, 2018 and 2017, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates as of December 31, 2018 and 2017, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Appleton, Wisconsin
June 12, 2019

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
December 31,
(In thousands)

ASSETS	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 53,117	\$ 42,413
Accounts receivable, net	12,384	12,521
Inventories and supplies, net	9,611	10,680
Prepaid expenses and other assets	<u>2,139</u>	<u>1,913</u>
Total current assets	77,251	67,527
Property, plant and equipment, net	140,655	147,166
Investments	690	688
Other long-term assets	<u>-</u>	<u>25</u>
TOTAL ASSETS	<u>\$218,596</u>	<u>\$215,406</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Current maturities of long-term debt and capital leases	\$ 3,671	\$ 3,624
Accounts payable	10,367	10,050
Accrued liabilities	21,641	18,720
Contract liability	<u>733</u>	<u>838</u>
Total current liabilities	36,412	33,232
Long-term debt, less current maturities and bond issuance costs	38,066	41,197
Obligations under capital leases, less current maturities	1,063	1,319
Other long-term liabilities	<u>1,535</u>	<u>1,762</u>
Total liabilities	77,076	77,510
Net assets		
Without donor restrictions	141,269	137,535
With donor restrictions	<u>251</u>	<u>361</u>
Total net assets	<u>141,520</u>	<u>137,896</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$218,596</u>	<u>\$215,406</u>

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
CONSOLIDATED STATEMENT OF ACTIVITIES
Year ended December 31, 2018
(In thousands)

	Without donor restrictions	With donor restrictions	Total
Operating revenue and support			
Retail services	\$164,651	\$ -	\$164,651
Food and administrative services	78,611	-	78,611
Participant services	30,869	-	30,869
Other revenues	<u>6,813</u>	<u>-</u>	<u>6,813</u>
Total operating revenue	280,944	-	280,944
Contributions	2,287	273	2,560
In-kind contributions	117,059	-	117,059
Participant programs	11,374	-	11,374
Miscellaneous income	3,461	-	3,461
Net assets released from restrictions	<u>383</u>	<u>(383)</u>	<u>-</u>
Total operating revenue and support and net assets released from restrictions	415,508	(110)	415,398
Operating expenses			
Program services	380,746	-	380,746
Management and general	29,471	-	29,471
Fundraising	<u>617</u>	<u>-</u>	<u>617</u>
Total operating expenses	<u>410,834</u>	<u>-</u>	<u>410,834</u>
Excess of operating revenue and support and net assets released from restrictions over operating expenses	4,674	(110)	4,564
Non-operating activities			
Loss on disposal of property, plant and equipment	<u>(940)</u>	<u>-</u>	<u>(940)</u>
Change in net assets	3,734	(110)	3,624
Net assets, beginning of year	<u>137,535</u>	<u>361</u>	<u>137,896</u>
Net assets, end of year	<u>\$141,269</u>	<u>\$ 251</u>	<u>\$141,520</u>

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
CONSOLIDATED STATEMENT OF ACTIVITIES
Year ended December 31, 2017
(In thousands)

	Without donor restrictions	With donor restrictions	Total
Operating revenue and support			
Retail services	\$161,464	\$ -	\$161,464
Food and administrative services	73,792	-	73,792
Participant services	28,153	-	28,153
Other revenues	<u>23,552</u>	<u>-</u>	<u>23,552</u>
Total operating revenue	286,961	-	286,961
Contributions	1,518	232	1,750
In-kind contributions	109,865	-	109,865
Participant programs	13,473	-	13,473
Miscellaneous income	1,968	-	1,968
Net assets released from restrictions	<u>371</u>	<u>(371)</u>	<u>-</u>
Total operating revenue and support and net assets released from restrictions	414,156	(139)	414,017
Operating expenses			
Program services	382,407	-	382,407
Management and general	25,086	-	25,086
Fundraising	<u>635</u>	<u>-</u>	<u>635</u>
Total operating expenses	<u>408,128</u>	<u>-</u>	<u>408,128</u>
Excess of operating revenue and support and net assets released from restrictions over operating expenses	6,028	(139)	5,889
Non-operating activities			
Loss on disposal of property, plant and equipment	<u>(34)</u>	<u>-</u>	<u>(34)</u>
Change in net assets	5,994	(139)	5,855
Net assets, beginning of year	<u>131,541</u>	<u>500</u>	<u>132,041</u>
Net assets, end of year	<u>\$137,535</u>	<u>\$ 361</u>	<u>\$137,896</u>

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
Year ended December 31, 2018
(In thousands)

	Program services	Management and general	Fundraising	Total
Salaries	\$119,066	\$14,462	\$222	\$133,750
Employee benefits	21,609	2,212	16	23,837
Payroll taxes	<u>9,400</u>	<u>1,008</u>	<u>14</u>	<u>10,422</u>
Total salaries and related expenses	150,075	17,682	252	168,009
In-kind supplies	116,753	-	-	116,753
Supplies and other	51,580	218	12	51,810
Rent and occupancy	25,882	2,086	5	27,973
Professional fees and contracted services	14,448	3,289	247	17,984
Depreciation	12,833	943	-	13,776
Advertising	2,469	2,098	-	4,567
Transportation	3,355	372	1	3,728
Equipment purchases, rental and maintenance	2,669	1,238	50	3,957
Interest expense	49	1,296	-	1,345
Conferences and training	174	249	46	469
Specific assistance to individuals	406	-	-	406
Bad debt expense, net	<u>53</u>	<u>-</u>	<u>4</u>	<u>57</u>
Total expenses	<u>\$380,746</u>	<u>\$29,471</u>	<u>\$617</u>	<u>\$410,834</u>

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
Year ended December 31, 2017
(In thousands)

	Program services	Management and general	Fundraising	Total
Salaries	\$120,497	\$12,870	\$236	\$133,603
Employee benefits	23,194	2,399	30	25,623
Payroll taxes	<u>9,865</u>	<u>880</u>	<u>15</u>	<u>10,760</u>
Total salaries and related expenses	153,556	16,149	281	169,986
In-kind supplies	109,808	-	-	109,808
Supplies and other	60,085	177	10	60,272
Rent and occupancy	25,200	360	10	25,570
Professional fees and contracted services	11,420	3,279	212	14,911
Depreciation	13,386	951	-	14,337
Advertising	2,823	1,735	-	4,558
Transportation	3,233	239	1	3,473
Equipment purchases, rental and maintenance	2,225	1,081	60	3,366
Interest expense	57	779	-	836
Conferences and training	203	336	59	598
Specific assistance to individuals	426	-	-	426
Bad debt expense, net	<u>(15)</u>	<u>-</u>	<u>2</u>	<u>(13)</u>
Total expenses	<u>\$382,407</u>	<u>\$25,086</u>	<u>\$635</u>	<u>\$408,128</u>

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
STATEMENTS OF CASH FLOWS
December 31, 2018 and 2017
(In thousands)

	2018	2017
Cash flows from operating activities		
Change in net assets	\$ 3,624	\$ 5,855
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	13,799	14,361
Realized and unrealized loss (gain) on investments	39	(99)
Unrealized gain on interest rate swaps	(169)	(513)
Loss on disposal of property, plant and equipment	940	34
Accounts receivable allowance	(31)	33
Changes in operating assets and liabilities		
Accounts receivable	168	(1,051)
Inventories and supplies	1,069	934
Prepaid expenses and other assets	(226)	919
Accounts payable and accrued liabilities	2,996	1,668
Deferred income	(105)	366
Other long-term assets and liabilities	(8)	94
Net cash provided by operating activities	22,096	22,601
Cash flows from investing activities		
Capital expenditures	(8,030)	(6,861)
Proceeds from sale of property, plant and equipment	320	1,266
Purchases of investments	(66)	(60)
Net cash used in investing activities	(7,776)	(5,655)
Cash flows from financing activities		
Issuance of long-term debt	-	290
Repayment of long-term debt	(3,091)	(2,843)
Payments under capital lease obligations	(525)	(637)
Net cash used in financing activities	(3,616)	(3,190)
Net increase in cash and cash equivalents	10,704	13,756
Cash and cash equivalents, beginning of year	42,413	28,657
Cash and cash equivalents, end of year	\$ 53,117	\$ 42,413
Supplemental disclosure of cash flow information		
Cash payments for interest	\$ 1,471	\$ 1,311
Non-cash transactions		
Purchases of property and equipment financed through capital leases	\$ 470	\$ 508
Purchases of property and equipment in accounts payable	242	-
Donated goods and materials contributed for resale	116,752	108,959

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

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017
(In thousands)

NOTE A - ORGANIZATION

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates (collectively, Goodwill) was formed in 1919 and is a Wisconsin non-stock, not-for-profit corporation. The mission of Goodwill is to provide training, employment and supportive services for people with disabilities or disadvantages who seek greater independence. Disabilities or disadvantages include physical or intellectual disabilities, mental health issues, skill limitations, lack of education and job preparation, communication challenges and other socio-economic disadvantages.

Goodwill pursues its mission by employing people with disabilities and other barriers within the organization's own operations in southeastern Wisconsin and northeastern Illinois. In addition, Goodwill provides social services, community programs, vocational training, transitional employment, employment services and supportive services for individuals who have disabilities, are disadvantaged or have other special needs, in order to enhance their employment opportunities, prevent or alleviate rehabilitation problems and facilitate their ability to live independently in the community.

Goodwill Industries of Southeastern Wisconsin, Inc. has the following affiliates and subsidiaries: Goodwill Industries of Metropolitan Chicago, Inc. is a separate, not-for-profit entity that focuses on providing mission services in the Metropolitan Chicago area. Goodwill Retail Services, Inc. is a separate, not-for-profit entity responsible for the retail stores operated by Goodwill. Goodwill Manufacturing, Inc. is a separate, not-for-profit corporation that provides assembly, laundry, packaging and recycling services. Goodwill Industries of Southeastern Wisconsin, Inc. is the sole member and manager of Goodwill TalentBridge, LLC.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies used by Goodwill is as follows:

Financial Statement Presentation

The consolidated financial statements are prepared on the accrual basis of accounting. All significant intercompany activity has been eliminated.

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements of Not-For-Profit Entities, which is intended to improve how a not-for-profit entity classifies its net assets, as well as the information it presents in its financial statements about liquidity and availability of resources, functional expenses and investment return. ASU 2016-14 shall be applied retrospectively. Goodwill adopted this guidance beginning January 1, 2018, and as such, prior year financial statements have been adjusted to conform with the new guidance. There was no impact on the Organization's previously reported net assets or change in net assets.

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. This has been accomplished by classification of net assets and transactions as without donor restrictions or with donor restrictions, as follows:

Without donor restrictions

Net assets and transactions are not subject to donor-imposed stipulations.

With donor restrictions

Net assets and transactions are subject to donor-imposed stipulations that will be met by the actions of Goodwill and/or the passage of time. As of December 31, 2018 and 2017, Goodwill has \$251 and \$361, respectively, of net assets restricted by donors.

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

All contributions are considered to be available for general operating purposes unless specifically restricted by the donor. Contribution revenue is reported as an increase in net assets without donor restrictions unless use of the related assets is limited by donor-imposed restrictions. Donor restricted contributions whose purpose has been fulfilled and/or the stipulated time period has elapsed are reported as reclassifications between net assets with donor restrictions and net assets without donor restrictions.

Contributed Goods and Services and Donations In-Kind

Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue and classified in accordance with donor-imposed restrictions on the contributions. An allowance for uncollectible contributions receivable is provided based on management's judgment and consideration of such factors as prior collection history, type of contributions and nature of fundraising activity.

Goods and materials contributed to Goodwill for resale are recorded at estimated fair market value based on retail sales prices. Costs associated with refurbishing these goods and materials are charged to expense as incurred.

In-kind contributions and grants received for goods or services are recorded at estimated fair value at the date of donation.

Grants are received from various federal, state and local governments, governmental agencies and other not-for-profit organizations. Expenditures of government grants are for the purposes specified by the funding source.

Revenue Recognition

Revenue is measured based on a consideration specified in a contract with a customer. Goodwill recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU requires that an entity recognize revenue for the transfer of goods or services to a customer at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. Goodwill adopted the new standard as of January 1, 2018 using the modified retrospective method and applied the new standard to all contracts. Goodwill included additional disclosures required by the new accounting guidance in Note G. There were no material changes in the timing of its recognition of revenue or net assets as a result of the adoption. Comparative information has been adjusted to reflect changes under Topic 606.

As a result of adopting Topic 606, deferred income was reclassified to a contract liability on the consolidated statements of financial position as of December 31, 2017. There was no other impact of applying Topic 606 to the consolidated financial statements.

Cash and Cash Equivalents

Goodwill considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

Goodwill maintains its cash balances in two financial institutions, which at times may exceed federally insured limits. Goodwill has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Investments

Goodwill reports investments at fair value, with net appreciation and depreciation reported in the consolidated statements of activities.

Goodwill's investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the values of investments, it is at least reasonably possible that changes in risk in the near term could materially affect Goodwill's investment holdings.

Investments are designated and intended for the use of satisfying the liabilities of the 457(b) plan, as described in note J.

Accounts Receivable

The majority of Goodwill's accounts receivable is due from companies in the manufacturing industry and from government agencies. Credit is extended based on an evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 10 to 30 days and are stated as amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. Goodwill determines its allowance by considering a number of factors, including the length of time accounts receivable are past due, Goodwill's previous loss history, the customer's current ability to pay its obligation to Goodwill, and the condition of the general economy and the industry as a whole. Goodwill writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. Total allowances for uncollectible balances was \$370 and \$339 as of December 31, 2018 and 2017, respectively.

Inventories and Supplies

Inventories primarily represent merchandise held for resale and component packaging supplies. In-kind contributions of merchandise inventory held for resale are recorded at estimated fair market value based on retail sales prices. Component packaging supply inventory is recorded at the lower of cost or market determined on a first-in, first-out basis.

Property, Plant and Equipment

Purchases of property, plant and equipment are recorded at cost. Donated assets are capitalized at estimated fair value when received. Leased property under capital leases is capitalized at the lesser of the useful life of the leased asset or the term of the lease. Goodwill capitalizes all qualifying purchases over \$5. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the assets ranging as follows: land improvements from 5 to 15 years; buildings and improvements from 4 to 50 years; and equipment and vehicles from 3 to 15 years. Leased assets are depreciated using the straight-line method over the lesser of the lease term or the estimated useful lives of the assets ranging from 5 to 10 years. Amortization of assets held under capital leases is included in depreciation expense.

Bond Issuance Costs

Bond issuance costs represent trust fees, legal fees and other costs associated with the various bond issuances, and are netted against long-term debt on the consolidated statements of financial position.

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

These costs are amortized over the life of the bonds (11 to 25 years). Amortization expense was \$25 for the years ended December 31, 2018 and 2017, respectively.

Contract Liability

Contract liability consists of funds received in advance of providing services and supplies related to certain government service contracts. The majority of the balance as of December 31, 2018 and 2017, relates to a significant contract with a branch of the U.S. government.

Cost Allocation

The financial statements report certain expense categories that are attributable to more than one support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Expenses by function have been allocated between program services, management and general, and fundraising classifications on a functional basis in the accompanying statements of functional expenses. Such expenses include occupancy, service management, program management, depreciation, and general and administrative expenses, which are allocated on the basis of square footage occupied or used, or on the basis of the total direct cost of the benefiting program.

Advertising

Goodwill expenses the cost of advertising as incurred. Advertising expense for the years ended December 31, 2018 and 2017, was \$4,567 and \$4,558, respectively.

Income Taxes

Goodwill Industries of Southeastern Wisconsin, Inc., Goodwill Industries of Metropolitan Chicago, Inc., Goodwill Retail Services, Inc. and Goodwill Manufacturing, Inc. have received determination letters from the Internal Revenue Service (IRS) indicating that they are exempt from federal income taxes, except for taxes pertaining to unrelated business income under section 501(c)(3) of the Internal Revenue Code.

Goodwill TalentBridge, LLC has been organized as a limited liability company and, accordingly, is not subject to federal or state income taxes. All income tax attributes of the entity are passed through to its sole member, Goodwill Industries of Southeastern Wisconsin, Inc. The entity is included in the consolidated information return filed by Goodwill Industries of Southeastern Wisconsin, Inc.

The FASB issued guidance related to the uncertainty of income tax positions, which clarifies the accounting for uncertainty in income taxes recognized in an organization's financial statements and requires additional disclosure. Goodwill recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority. As of December 31, 2018, Goodwill does not believe there is any uncertainty with respect to its tax positions.

Goodwill files information returns in the U.S. federal and the states of Wisconsin and Illinois jurisdictions. Tax years open under the federal statute of limitations include 2015 through 2018. Tax years open under the state of Wisconsin and state of Illinois statutes include 2014 through 2018. Goodwill has not historically filed any unrelated business income tax returns but is expected to file for 2018 for federal and the states of Wisconsin and Illinois jurisdictions. Tax years remain open for years in which an income tax return has not been filed.

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

On December 22, 2017, tax reform legislation commonly known as the Tax Cuts and Jobs Act of 2017 (the Act) was passed; resulting in significant modifications to existing tax law. There were no material effects on Goodwill's financial statements as a result of the Act.

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 relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 2017 consolidated financial statements to conform to the 2018 presentation. The reclassifications did not have an impact on prior year net assets or changes in net assets.

New Accounting Pronouncement

In February 2016, the FASB issued ASU No. 2016-02, Leases, (Topic 842), which requires organizations that lease assets (lessees) to recognize the assets and related liabilities for the rights and obligations created by the leases on the statements of financial position for leases with terms exceeding 12 months. ASU 2016-02 defines a lease as a contract or part of a contract that conveys the right to control the use of identified assets for a period of time in exchange for consideration. The lessee in a lease will be required to initially measure the right-of-use asset and the lease liability at the present value of the remaining lease payments, as well as capitalize initial direct costs as part of the right-of-use asset. ASU No. 2016-02 is effective for Goodwill in 2019. Goodwill is currently evaluating the impact the new guidance may have on the consolidated financial statements.

NOTE C - INVENTORIES AND SUPPLIES

Inventories and supplies, net consists of the following as of December 31:

	<u>2018</u>	<u>2017</u>
Components	\$ 49	\$ 1,420
Retail merchandise	8,904	8,782
Food	429	383
Laundry	<u>229</u>	<u>245</u>
Gross inventory	9,611	10,830
Less reserve for excess and obsolete	<u>-</u>	<u>(150)</u>
Inventories and supplies, net	<u>\$9,611</u>	<u>\$10,680</u>

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

NOTE D - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, net consists of the following as of December 31:

	<u>2018</u>	<u>2017</u>
Land	\$ 31,628	\$ 31,628
Land improvements	8,646	7,825
Buildings and improvements	175,254	172,388
Equipment and vehicles	55,018	53,822
Construction in process	<u>2,160</u>	<u>2,558</u>
Total property, plant and equipment	272,706	268,221
Less accumulated depreciation and amortization	<u>(132,051)</u>	<u>(121,055)</u>
Property, plant and equipment, net	<u>\$ 140,655</u>	<u>\$ 147,166</u>

NOTE E - LINE-OF-CREDIT AGREEMENT

Goodwill has a working capital line-of-credit agreement with a bank, secured by substantially all assets, under which it may borrow up to \$13,500 as of December 31, 2018. The agreement expires on May 31, 2020. Borrowings under the line-of-credit agreement bear interest at a variable rate (4.10% as of December 31, 2018). There was no outstanding balance as of December 31, 2018 and 2017. The line-of-credit agreement contains certain restrictive covenants which, among other things, require Goodwill to maintain certain financial ratios. Goodwill was in compliance with these covenants as of December 31, 2018 and 2017.

Goodwill Industries of Southeastern Wisconsin, Inc. and Affiliates
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017
(In thousands)

NOTE F - LONG-TERM DEBT

Long-term debt, payable by Goodwill, consists of the following as of December 31:

	<u>2018</u>	<u>2017</u>
WHEFA Revenue Bonds, Series 2014A, due in annual installments ranging from \$540 to \$840 through May 2029. The bonds bear interest, due monthly, at variable rates (2.98% at December 31, 2018). Collateralized by certain buildings.	\$ 7,752	\$ 8,340
WHEFA Revenue Bonds, Series 2014B, due in annual installments ranging from \$135 to \$210 through May 2029. The bonds bear interest, due monthly, at variable rates (2.98% at December 31, 2018). Collateralized by certain buildings.	1,938	2,085
WHEFA Revenue Bonds, Series 2014C, due in annual installments ranging from \$570 to \$1,210 through November 2035. The bonds bear interest, due monthly, at variable rates (3.20% at December 31, 2018). Collateralized by certain buildings.	15,217	15,835
WHEFA Revenue Bonds, Series 2014D, due in annual installments ranging from \$475 to \$735 through August 2025. The bonds bear interest, due monthly, at variable rates (2.55% at December 31, 2018). Collateralized by certain buildings.	4,535	5,075
WHEFA Revenue Bonds, Series 2012, due in annual installments ranging from \$430 to \$640 through February 2037. The bonds bear interest, due monthly, at variable rates (3.04% at December 31, 2018). Collateralized by certain buildings.	11,160	11,675
Notes payable to bank for various equipment loans, due in monthly installments ranging from \$0.2 to \$4. These notes bear interest, due monthly, at a fixed rate ranging from 4.45% to 4.50%.	310	518
Note payable to bank, due in annual installments of \$475 each August 1 through 2019. The note bears interest, due monthly, at a fixed rate of 2.77%. Collateralized by certain buildings.	<u>475</u>	<u>950</u>
Total debt	41,387	44,478
Less current maturities	(3,023)	(2,959)
Less unamortized bond issuance costs	<u>(298)</u>	<u>(322)</u>
Long-term debt, less current maturities and unamortized bond issuance costs	<u>\$38,066</u>	<u>\$41,197</u>

During 2010, Goodwill entered into a guaranty agreement whereby provisions of the agreement provide that certain entities of the consolidated group are jointly liable for the outstanding debt of Goodwill Industries of Southeastern Wisconsin, Inc.

In an effort to reduce the risk of incurring higher interest costs in periods of rising interest rates, Goodwill is party to various interest rate swap agreements. The agreements effectively convert variable-rate debt to

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fixed-rate debt to the extent of the notional amount of the swaps. The interest differential is reflected as an adjustment to interest expense as incurred and the fair value of the swaps are reflected on the consolidated statements of financial position in other long-term liabilities. The following is a summary of Goodwill's interest rate swaps at December 31:

Maturity date	Fixed rate	Total interest rate	Notional amount	Outstanding notional amount	Fair value liability	
					2018	2017
July 1, 2019	3.15%	1.44%	\$ 4,595	\$ 360	\$ (3)	\$ (15)
May 1, 2019	2.39	0.68	15,000	9,690	(25)	(155)
May 2, 2022	(a)	(a)	8,940	8,940	(117)	(147)
December 1, 2024	1.85	0.19	3,500	3,000	-	(56)
December 1, 2024	2.51	0.63	11,160	11,160	(288)	-
December 1, 2025	2.69	0.72	8,139	8,272	(351)	-
Terminated swaps in 2018					-	(580)
					<u>\$(784)</u>	<u>\$(953)</u>

(a) There is no effective interest rate as of December 31, 2018, as interest payments begin on May 1, 2019.

The total decrease in the fair value of interest rate swaps was recognized in interest expense as income of \$169 and \$513 in 2018 and 2017, respectively.

The bonds payable contain certain restrictive covenants that, among other things, require Goodwill to maintain certain financial ratios. Goodwill was in compliance with these covenants as of December 31, 2018 and 2017.

Aggregate scheduled principal payments on long-term debt and amortization expense of bond issuance costs as of December 31, 2018, are as follows:

	Long-term debt	Bond issuance costs
2019	\$ 3,023	\$ 25
2020	2,646	25
2021	2,751	25
2022	2,856	25
2023	2,959	25
Thereafter	<u>27,152</u>	<u>173</u>
	<u>\$41,387</u>	<u>\$298</u>

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NOTE G - REVENUES

Nature of goods and services

The following is a description of principal activities from which Goodwill generates its revenue. The products and services, as well as the nature, timing of satisfaction of performance obligations and significant payment terms are as follows:

- i. Retail revenues - Revenue and payment is recognized at the point of sale.
- ii. Food and administrative services - Revenue is recognized when allowable and reimbursable expenditures are incurred, and upon meeting the legal or contractual requirements of the funding source. Payment is due monthly.
- iii. Participant services - These types of contracts include laundry services, staffing and other services. Customers do not take control of goods and services under these contracts until it is completed. Revenue is recognized in the period service is provided or goods are shipped. Customers are invoiced upon the service being provided or shipment being made. Payment is typically due within thirty days of receipt of invoice.
- iv. Other revenues - Other revenues represents manufacturing, recycling, and other services, none of which are individually significant. Revenue is recognized in the period service is provided or goods are shipped. Customers are invoiced upon the service being provided or shipment being made. Payment is typically due within thirty days of receipt of invoice.

Disaggregation of revenue

Refer to the consolidated statements of activities for the disaggregation of revenues.

Contract liability

Goodwill recognizes contract liabilities when the revenues earned from the contract with the U.S. Naval Supply Systems Command varies from the cash received. Contract liabilities at December 31, 2018 and 2017 were approximately \$733 and \$838. This represents performance obligations to provide services for future periods.

Goodwill has elected, as a practical expedient, not to disclose additional information about unsatisfied performance obligations for contracts with customers that have an expected duration of one year or less.

Sales taxes collected and remitted

Goodwill presents sales taxes collected from its customers and remitted to governmental agencies on a net basis (excluded from revenues) in its consolidated financial statements.

NOTE H - LEASES

Goodwill is obligated under capital leases for certain equipment and vehicles that expire in October 2024. As of December 31, 2018 and 2017, property, plant and equipment include \$4,766 and \$4,414, respectively, of equipment under these capitalized leases and \$3,162 and \$2,596, respectively, of related accumulated depreciation and amortization.

Goodwill leases various retail and other operational facilities under non-cancelable operating lease agreements. Certain leases call for escalating rental payments. Goodwill also leases certain rehabilitation

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center facilities under leases that are cancelable only in the event that certain government funding ceases. These leases are considered non-cancelable for financial reporting purposes.

As of December 31, 2018, future minimum lease payments under capital leases and operating leases are as follows:

	Capital leases	Operating leases
2019	\$ 681	\$11,814
2020	392	11,562
2021	304	10,660
2022	178	9,864
2023	133	9,207
Thereafter	<u>111</u>	<u>33,389</u>
Total minimum lease payments	1,799	<u>\$86,496</u>
Less amounts representing interest	<u>87</u>	
Present value of net minimum lease payments	<u>\$1,712</u>	

Total rental expense under all operating leases was \$12,722 and \$11,516 in 2018 and 2017, respectively.

Goodwill has rental agreements expiring in 2019. Total rental income was \$1,128 and \$188 in 2018 and 2017, respectively. Future minimum rental income to be received is \$884 in 2019.

NOTE I - SIGNIFICANT FUNDING AGENCIES AND CUSTOMERS

Goodwill has contracts with the U.S. Naval Supply Systems Command to provide food, laundry and administrative services. The contracts expire on September 30, 2028. Goodwill recognized revenue of \$78,611 and \$73,792 in 2018 and 2017, or 29% and 24%, respectively, of operating revenue and support related to this customer. This customer accounted for \$4,599 and \$4,007 or 38% and 32%, respectively, of the total accounts receivable balance as of December 31, 2018 and 2017.

Goodwill receives a substantial amount of funding from various federal and state agencies including the United States Department of Health and Human Services and the Wisconsin Department of Health and Family Services. Governmental grant awards are generally subject to renewal by grantor agencies on an annual basis.

A customer other than noted above accounted for \$1,281 and \$1,162 in 2018 and 2017, respectively, or 10% and 9%, respectively, of the total accounts receivable balance as of December 31, 2018 and 2017.

NOTE J - EMPLOYEE BENEFIT PLANS

Goodwill has a defined contribution plan that covers substantially all of its full-time employees. The plan covers eligible employees who have completed one year of service, as defined in the plan, and have attained the age of 21. The IRS has determined that the plan is a qualified tax-exempt plan. Goodwill contributes, on a monthly basis, 5% of the first \$25 of total eligible compensation and 8% of compensation thereafter to the plan up to the IRS annual limitations. Participant contributions are not permitted under the plan agreement. Participants become 100% vested in Goodwill's contributions after three years of vesting

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service, as defined in the plan. During 2018 and 2017, Goodwill's contributions, net of forfeitures, to the plan were \$4,608 and \$4,496, respectively.

Goodwill has a 403(b) retirement plan that permits employees to defer a portion of their compensation, subject to annual IRS limitations. There were no employer contributions to the 403(b) plan for the years ended December 31, 2018 and 2017.

Goodwill has a 457(b) tax-deferred compensation plan that is available to certain management employees. Participants may defer income into the plan on a pretax or post-tax basis, subject to annual IRS limitations. An asset and a liability of \$690 and \$688 are included on Goodwill's consolidated statements of financial position as of December 31, 2018 and 2017, respectively, within investments and other long-term liabilities.

NOTE K - CONTINGENCIES

Government contracts are subject to audit and adjustment by funding agencies. If government revenue is recorded for expenditures that are subsequently disallowed, Goodwill may be required to repay the questioned costs to the funding agency. Management of Goodwill is not aware of any disallowed expenditures that would have a material adverse effect on its consolidated financial statements.

Goodwill is involved in various legal proceedings, claims and administrative actions arising in the normal course of business. In the opinion of management, Goodwill's liability, if any, under any pending litigation or administrative proceeding will not materially affect its financial condition.

NOTE L - RELATED PARTIES

Certain members of Goodwill's board of directors are employed by various companies with which Goodwill does business.

Goodwill's operating revenue includes approximately \$32 and \$13 for 2018 and 2017, respectively, from companies with which certain Goodwill directors and management staff members are associated. Goodwill's purchased services and products include approximately \$4,833 and \$1,864 for 2018 and 2017, respectively, from companies with which certain Goodwill directors and management staff members are associated.

Contributions include donations received from Goodwill directors and management staff members, which totaled \$77 and \$118 for 2018 and 2017, respectively. Outstanding pledges from Goodwill directors and management staff members totaled \$4 at December 31, 2018 and 2017.

NOTE M - DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS

The FASB accounting guidance on fair value measurement requires certain financial assets and liabilities be carried at fair value. Fair value is 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 (exit price). Classification of the financial asset or liability within the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value. The following is a summary:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

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Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The determination of where an asset or liability falls in the fair value hierarchy requires significant judgment. Goodwill evaluates its hierarchy disclosures each year and, based on various factors, it is possible that an asset or liability may be classified differently from year to year; however, Goodwill expects that changes in classifications between different levels will be rare.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value. There have been no changes to the valuation methodologies used at December 31, 2018 and 2017.

Bond and stock mutual funds - Valued based on quoted market prices as of the date of the statement of financial position, as determined based on the market prices for the individual investments comprising each fund.

Derivative liability (interest rate swaps) - The fair value of Goodwill's interest rate swap agreements is based on estimates using standard pricing models as of the date of the consolidated statements of financial position. The fair value of the interest rate swaps is based on quotes from the counterparty of these instruments and represents the estimated amount that Goodwill would expect to receive or pay to terminate the agreements.

The carrying amount of Goodwill's financial instruments, which include trade accounts receivable, trade accounts payable and accrued liabilities, approximates their fair values at December 31, 2018 and 2017, due to their short maturities. The carrying value of long-term debt, including the current portion, approximates fair value because the interest rate approximates the current market rate of interest available to Goodwill.

The following table presents information about Goodwill's assets and liabilities measured at fair value as of December 31, 2018, and indicates the fair value hierarchy of the valuation techniques utilized by Goodwill to determine such fair value.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets				
Bond and stock mutual funds	\$690	\$ -	\$ -	\$690
Liabilities				
Derivative liability, net (interest rate swaps)	-	785	-	785

The following table presents information about Goodwill's assets and liabilities measured at fair value as of December 31, 2017, and indicates the fair value hierarchy of the valuation techniques utilized by Goodwill to determine such fair value.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets				
Bond and stock mutual funds	\$688	\$ -	\$ -	\$688
Liabilities				
Derivative liability, net (interest rate swaps)	-	953	-	953

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NOTE N - LIQUIDITY AND AVAILABILITY

To meet cash needs for general expenditures, Goodwill has net current financial assets, available within one year of the financial statement date, consisting of the following as of December 31, 2018:

Cash and cash equivalents	\$53,117
Accounts receivable, net	<u>12,384</u>
	<u>\$65,501</u>

Overall cash and investment amounts and performance are reviewed annually by the Audit, Risk and Compliance Committee of the Board of Directors. As more fully described in note E, Goodwill also has availability under the line of credit of \$13,500 should an unanticipated liquidity need be identified.

NOTE O - SUBSEQUENT EVENTS

Goodwill evaluated its December 31, 2018, consolidated financial statements for subsequent events through June 12, 2019, the date the consolidated financial statements were available to be issued. Goodwill is not aware of any subsequent events that would require recognition or disclosure in the consolidated financial statements.