

**LUTHERAN SOCIAL SERVICE OF MINNESOTA
AND AFFILIATES**

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Lutheran Social Service of Minnesota and Affiliates
St. Paul, Minnesota

We have audited the accompanying consolidated financial statements of Lutheran Social Service of Minnesota and Affiliates, which comprise the consolidated statements of financial position as of September 30, 2013 and 2012, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lutheran Social Service of Minnesota and Affiliates as of September 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter Regarding a Correction of an Error

As described in Note 14 to the financial statements, certain errors resulting in understatement of amounts previously reported for pledges receivables and grants revenue as of September 30, 2012, were discovered. Accordingly, amounts reported for pledges receivable and grants revenue have been restated in the 2012 financial statements now presented, and an adjustment has been made to net assets as of September 30, 2012, to correct the error. Our opinion is not modified with respect to that matter.



CliftonLarsonAllen LLP

Minneapolis, Minnesota
January 28, 2014

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2013 AND 2012

	2013			Lutheran Social Service Consolidated
	Lutheran Social Service	LSS PAA LP & Rolling Hills	LSS PAA LP & Rolling Hills Elimination	
ASSETS				
CURRENT ASSETS				
Cash and Cash Equivalents	\$ 6,029,364	\$ 573,891	\$ -	\$ 6,603,255
Pledge Receivable	650,704	-	-	650,704
Account Receivable	14,208,931	15,425	(17,224)	14,207,132
Other Current Assets	651,875	10,475	-	662,350
Total Current Assets	<u>21,540,874</u>	<u>599,791</u>	<u>(17,224)</u>	<u>22,123,441</u>
Net Land, Building and Equipment	34,661,485	12,923,853	(152,000)	47,433,338
Investment	3,110,294	-	-	3,110,294
Intangible Assets: Goodwill	1,379,207	-	-	1,379,207
Long-Term Pledge Receivable	440,444	-	-	440,444
Other Assets Limited to Use	61,585	1,134,279	(1,053,306)	142,558
Other Assets	1,587,157	310,635	(86,000)	1,811,792
Loan Receivable	11,100,529	-	(629,000)	10,471,529
Beneficial Interest in Perpetual Trust	2,645,229	-	-	2,645,229
Total Assets	<u>\$ 76,526,804</u>	<u>\$ 14,968,558</u>	<u>\$ (1,937,530)</u>	<u>\$ 89,557,832</u>
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accounts Payable, Accrued Liabilities and Deferred Income	\$ 4,819,729	\$ 203,581	\$ (17,224)	\$ 5,006,086
Conditional Grants, Current	109,354	-	-	109,354
Borrowing Under Line of Credit	2,051,885	-	-	2,051,885
Accrued Payroll, Benefits, Taxes & Withholding	7,054,360	-	-	7,054,360
Current Portion of Long-Term Debt	879,705	-	-	879,705
Total Current Liabilities	<u>14,915,033</u>	<u>203,581</u>	<u>(17,224)</u>	<u>15,101,390</u>
Accrued Pension Liabilities	12,560,777	-	-	12,560,777
Obligation Under Trust Agreement	1,024,373	-	-	1,024,373
Conditional Grants, Long Term	1,760,181	-	-	1,760,181
Asset Retirement Obligation	3,642	-	-	3,642
Long-Term Debt, Less Current Portion	15,591,725	5,090,935	(629,000)	20,053,660
Total Liabilities	<u>45,855,731</u>	<u>5,294,516</u>	<u>(646,224)</u>	<u>50,504,023</u>
NET ASSETS				
Unrestricted	2,975,611	9,674,042	(1,291,306)	11,358,347
Temporarily Restricted	23,711,812	-	-	23,711,812
Permanently Restricted	3,983,650	-	-	3,983,650
Total Net Assets	<u>30,671,073</u>	<u>9,674,042</u>	<u>(1,291,306)</u>	<u>39,053,809</u>
Total Liabilities and Net Assets	<u>\$ 76,526,804</u>	<u>\$ 14,968,558</u>	<u>\$ (1,937,530)</u>	<u>\$ 89,557,832</u>

See accompanying Notes to Consolidated Financial Statements.

2012 (Restated)

Lutheran Social Service	LSS PAA LP	LSS PAA LP Elimination	Lutheran Social Service Consolidated
\$ 10,268,198	\$ 154,272	\$ -	\$ 10,422,470
804,857	-	-	804,857
9,173,724	2,238	(8,441)	9,167,521
439,034	1,553	-	440,587
<u>20,685,813</u>	<u>158,063</u>	<u>(8,441)</u>	<u>20,835,435</u>
30,661,695	7,396,999	(152,000)	37,906,694
2,880,528	-	(86,000)	2,794,528
1,079,207	-	-	1,079,207
183,070	-	-	183,070
39,423	80,973	-	120,396
1,296,738	314,333	-	1,611,071
11,100,529	-	(629,000)	10,471,529
2,574,870	-	-	2,574,870
<u>\$ 70,501,873</u>	<u>\$ 7,950,368</u>	<u>\$ (875,441)</u>	<u>\$ 77,576,800</u>
\$ 4,242,876	\$ 75,721	\$ (8,441)	\$ 4,310,156
109,354	-	-	109,354
180,335	-	-	180,335
7,191,021	-	-	7,191,021
808,489	-	-	808,489
<u>12,532,075</u>	<u>75,721</u>	<u>(8,441)</u>	<u>12,599,355</u>
17,729,608	-	-	17,729,608
947,883	-	-	947,883
1,869,536	-	-	1,869,536
3,642	-	-	3,642
<u>16,914,704</u>	<u>1,697,901</u>	<u>(629,000)</u>	<u>17,983,605</u>
49,997,448	1,773,622	(637,441)	51,133,629
(2,140,594)	6,176,746	(238,000)	3,798,152
18,732,319	-	-	18,732,319
3,912,700	-	-	3,912,700
<u>20,504,425</u>	<u>6,176,746</u>	<u>(238,000)</u>	<u>26,443,171</u>
<u>\$ 70,501,873</u>	<u>\$ 7,950,368</u>	<u>\$ (875,441)</u>	<u>\$ 77,576,800</u>

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
CONSOLIDATED STATEMENTS OF ACTIVITIES
SEPTEMBER 30, 2013 AND 2012

	2013			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
REVENUE AND PUBLIC SUPPORT				
Revenue:				
Government Fees and Grants	\$ 82,248,700	\$ 109,355	\$ -	\$ 82,358,055
Client Fees and Reimbursed Services	10,883,575	362	-	10,883,937
Investment Income	2,845	-	-	2,845
Others	680,903	16,179	376	697,458
Total Revenue	<u>93,816,023</u>	<u>125,896</u>	<u>376</u>	<u>93,942,295</u>
Public Support:				
Contributions	2,737,535	7,044,434	215	9,782,184
Grants (Nongovernmental)	640,600	1,315,919	-	1,956,519
Church	826,691	103,008	-	929,699
United Way	1,273,613	-	-	1,273,613
Total Public Support	<u>5,478,439</u>	<u>8,463,361</u>	<u>215</u>	<u>13,942,015</u>
Net Assets Released from Restriction	<u>3,785,470</u>	<u>(3,785,470)</u>	<u>-</u>	<u>-</u>
Total Revenue and Public Support	<u>103,079,932</u>	<u>4,803,787</u>	<u>591</u>	<u>107,884,310</u>
EXPENSES				
Program Service:				
Services for Children/Youth/Family/CFCL	24,970,916	-	-	24,970,916
Services for Senior	12,569,667	-	-	12,569,667
Services for People with Disabilities	52,540,952	-	-	52,540,952
Total Program Service Expenses	<u>90,081,535</u>	<u>-</u>	<u>-</u>	<u>90,081,535</u>
Support Service:				
Management and General	10,358,550	-	-	10,358,550
Fund Raising	2,148,381	-	-	2,148,381
Total Support Service Expenses	<u>12,506,931</u>	<u>-</u>	<u>-</u>	<u>12,506,931</u>
Total Expenses	<u>102,588,466</u>	<u>-</u>	<u>-</u>	<u>102,588,466</u>
CHANGE IN NET ASSETS - OPERATIONS	491,466	4,803,787	591	5,295,844
NON-OPERATING				
Pass-Through Revenues	5,561,003	-	-	5,561,003
Pass-Through Expenditures	<u>(5,561,003)</u>	<u>-</u>	<u>-</u>	<u>(5,561,003)</u>
Additional Pension Increase:				
(Increase) Decrease:				
Current Period	4,586,746	-	-	4,586,746
Change in Value of Split Interest Agreements	(13,323)	(54,762)	-	(68,085)
Change in Value of Trusts	-	-	70,359	70,359
Change in Value of Investment	51,316	230,468	-	281,784
Noncontrolling Interest of LSS Park Avenue Apartment LP & Rolling Hill St. Paul	2,443,990	-	-	2,443,990
Change in Nets Assets Non-Operating	<u>7,068,729</u>	<u>175,706</u>	<u>70,359</u>	<u>7,314,794</u>
CHANGE IN NET ASSETS	7,560,195	4,979,493	70,950	12,610,638
Net Assets - Beginning of the Year, as Restated	<u>3,798,152</u>	<u>18,732,319</u>	<u>3,912,700</u>	<u>26,443,171</u>
NET ASSETS END OF THE YEAR	<u>\$ 11,358,347</u>	<u>\$ 23,711,812</u>	<u>\$ 3,983,650</u>	<u>\$ 39,053,809</u>

See accompanying Notes to Consolidated Financial Statements.

2012 (Restated)			
Unrestricted	Temporarily Restricted	Permanently Restricted	Total
\$ 77,491,513	\$ 557,761	\$ -	\$ 78,049,274
11,044,636	-	-	11,044,636
1,242	-	7,220	8,462
553,064	1,360	-	554,424
<u>89,090,455</u>	<u>559,121</u>	<u>7,220</u>	<u>89,656,796</u>
1,983,626	1,394,993	649	3,379,268
852,298	2,536,563	-	3,388,861
796,532	72,412	-	868,944
1,182,646	-	-	1,182,646
<u>4,815,102</u>	<u>4,003,968</u>	<u>649</u>	<u>8,819,719</u>
3,763,242	(3,763,242)	-	-
<u>97,668,799</u>	<u>799,847</u>	<u>7,869</u>	<u>98,476,515</u>
25,218,746	-	-	25,218,746
10,645,840	-	-	10,645,840
49,197,958	-	-	49,197,958
<u>85,062,544</u>	<u>-</u>	<u>-</u>	<u>85,062,544</u>
9,065,004	-	-	9,065,004
1,938,301	-	-	1,938,301
<u>11,003,305</u>	<u>-</u>	<u>-</u>	<u>11,003,305</u>
<u>96,065,849</u>	<u>-</u>	<u>-</u>	<u>96,065,849</u>
1,602,950	799,847	7,869	2,410,666
5,300,299	-	-	5,300,299
<u>(5,300,299)</u>	<u>-</u>	<u>-</u>	<u>(5,300,299)</u>
-	-	-	-
(1,971,618)	-	-	(1,971,618)
9,113	(73,355)	-	(64,242)
-	-	308,154	308,154
202,368	229,572	-	431,940
<u>(276,107)</u>	<u>-</u>	<u>-</u>	<u>(276,107)</u>
<u>(2,036,244)</u>	<u>156,217</u>	<u>308,154</u>	<u>(1,571,873)</u>
(433,294)	956,064	316,023	838,793
<u>4,231,446</u>	<u>17,776,255</u>	<u>3,596,677</u>	<u>25,604,378</u>
<u>\$ 3,798,152</u>	<u>\$ 18,732,319</u>	<u>\$ 3,912,700</u>	<u>\$ 26,443,171</u>

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES
YEARS ENDED SEPTEMBER 30, 2013 AND 2012**

	2013			
	Program Service	Support Services		Total
		Management and General	Fund Raising	
Salaries	\$ 38,623,013	\$ 5,556,400	\$ 1,122,698	\$ 45,302,110
Employee Benefits and Payroll Taxes	10,396,365	1,495,789	287,499	12,179,653
Total Personnel Costs	<u>49,019,378</u>	<u>7,052,189</u>	<u>1,410,197</u>	<u>57,481,763</u>
Professional Fees and Contract Services	1,526,245	759,785	166,514	2,452,545
Supplies	772,068	41,207	6,807	820,082
Communication	1,268,157	254,166	243,722	1,766,044
Occupancy	5,298,843	680,330	100,854	6,080,026
Equipment	513,956	184,001	30,341	728,298
Transportation	2,376,977	121,161	30,425	2,528,563
Staff Development	767,449	395,115	124,680	1,287,244
Client and Volunteer Expense	25,652,614	43,500	8,861	25,704,975
Other	<u>1,121,663</u>	<u>739,075</u>	<u>25,981</u>	<u>1,886,719</u>
Total Expense Before Depreciation	88,317,349	10,270,529	2,148,381	100,736,258
Depreciation	<u>1,764,187</u>	<u>88,020</u>	<u>-</u>	<u>1,852,207</u>
Total Expense	<u><u>\$ 90,081,535</u></u>	<u><u>\$ 10,358,550</u></u>	<u><u>\$ 2,148,381</u></u>	<u><u>\$ 102,588,466</u></u>

See accompanying Notes to Consolidated Financial Statements.

2012

Program Service	Support Services		Total
	Management and General	Fund Raising	
\$ 38,132,245	\$ 5,020,073	\$ 1,014,328	\$ 44,166,646
10,373,904	1,346,390	250,106	11,970,400
<u>48,506,149</u>	<u>6,366,463</u>	<u>1,264,434</u>	<u>56,137,046</u>
1,451,711	850,854	109,255	2,411,820
765,503	34,829	6,793	807,125
1,338,700	234,719	321,244	1,894,663
5,004,197	601,202	101,522	5,706,921
527,352	203,934	31,914	763,200
2,358,512	92,733	24,670	2,475,915
795,442	428,091	61,486	1,285,019
21,977,727	53,617	5,182	22,036,526
<u>628,364</u>	<u>117,486</u>	<u>11,801</u>	<u>757,651</u>
83,353,657	8,983,928	1,938,301	94,275,886
<u>1,708,887</u>	<u>81,076</u>	<u>-</u>	<u>1,789,963</u>
<u>\$ 85,062,544</u>	<u>\$ 9,065,004</u>	<u>\$ 1,938,301</u>	<u>\$ 96,065,849</u>

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	\$ 12,610,638	\$ 838,793
Change in Value of Split Interest Agreements	54,763	66,958
Change in Value of Perpetual Trust	(54,008)	(472,361)
Adjustment for Pension Liability	(5,168,831)	992,961
Amortization of Deferred Gain from Tax Credit Financing	(463,690)	(463,690)
Noncash Donation of Capital Assets	(5,186,446)	-
Noncash Donations of Low Interest Loans	(109,355)	(109,355)
Increase in Accrued Interest	64,992	52,000
Bad Debt Expense	1,300,104	354,986
Realized and Unrealized Gain on Investments	(90,154)	(315,575)
Depreciation	2,090,535	2,025,630
Amortization of Capital Lease Assets	188,700	188,699
Amortization - Other	15,164	39,726
(Gain) Loss on Sale of Land, Building and Equipment	(104,077)	2,763
Increase in Receivables	(4,353,695)	(1,171,493)
Increase in Loan Receivable	(2,269,801)	-
Increase in Other Assets	(570,191)	(199,760)
Increase in Current Liabilities	559,269	288,930
Net Cash Provided (Used) by Operating Activities	(1,486,083)	2,119,212
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	(793,247)	(511,511)
Acquisition of Intangible Assets	(300,000)	-
Proceeds from Sale of Investments	730,125	483,655
Proceeds from Sale of Property and Equipment	266,504	135,935
Capital Expenditures	(6,781,861)	(1,118,887)
Net Cash Used by Investing Activities	(6,878,479)	(1,010,808)
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-Term Debt Payments	(832,600)	(990,978)
Net Change in Line of Credit Borrowings	-	180,335
Proceeds from Sunrise Bank line of credit - CHS	1,871,565	-
Proceeds from the Issuance of Debt Rolling Hills	3,342,174	-
Distribution from the perpetual trust	164,208	164,208
Net Cash Provided (Used) by Financing Activities	4,545,347	(646,435)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(3,819,215)	461,969
Cash and Cash Equivalents - Beginning of Year	10,422,470	9,960,501
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 6,603,255	\$ 10,422,470
SUPPLEMENTAL INFORMATION		
Cash Paid for Interest	\$ 274,405	\$ 291,196
NONCASH TRANSACTIONS		
Donated capital assets	\$ 5,186,446	\$ -

See accompanying Notes to Consolidated Financial Statements.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Lutheran Social Service of Minnesota and Affiliates (the Organization) is the largest statewide private social service agency in Minnesota and is affiliated with the six Minnesota synods of the Evangelical Lutheran Church in America. The consolidated financial statements of the Organization include the following Affiliates:

- Lutheran Social Service of Minnesota Foundation
- Rezek House LLC
- LSS Townhomes LLC
- LSS Supportive Housing LLC
- Partners in Community Supports, Inc.
- CFCL Lending LLC
- CFCL LLC
- LSS Development LLC
- LSS Park Avenue Apartments LP
- RH-Saint Paul Apartments LP
- LSS Rolling Hills LLC

Program services are grouped into three service categories, which are:

- Children, Youth, Families and the Center for Changing Lives
- Seniors
- People with Disabilities.

The Organization has over 350 program units in over 300 locations in the State of Minnesota that provided services to more than 100,000 persons in 2013.

Basis of Presentation

Net assets and revenues, public support, and expenses are classified based on the existence or absence of donor-imposed restrictions. Net assets of the Organization and changes therein are classified into the following three categories:

Unrestricted – Resources over which the board of directors has discretionary control. Designated amounts represent those assets which the board has set aside for a particular purpose.

Temporarily Restricted – Those resources subject to donor imposed restrictions which will be satisfied by actions of the Organization or passage of time.

Permanently Restricted – Those resources subject to a donor imposed restriction that they be maintained permanently by the Organization. The donors of these resources permit the Organization to use all or part of the income earned, including capital appreciation, or related investments for unrestricted or temporarily restricted purposes. For endowments, the Organization classifies as permanently restricted net assets the original value of the gifts to the endowment and the value of subsequent gifts to the endowment.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

Revenues are reported as increase in unrestricted net assets unless use of the related asset is limited by donor-imposed restrictions. Expenses are reported as decrease in unrestricted net assets. The Organization has elected to present temporarily restricted contributions, which are fulfilled in the same time period, within the unrestricted net asset class.

Cash and Cash Equivalents

The Organization considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. At times such deposits may be in excess of FDIC insurance limits. At times, the investment portfolio may contain cash and cash equivalents that are included in investments in the consolidated statement of financial position.

Investments

The Organization invests in a variety of investment vehicles. In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investments, changes in the values of investments will occur in the near term and such changes could materially affect the amounts reported.

Pledges Receivable

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Pledges that are expected to be collected within one year are recorded at their net realizable value. Pledges that are expected to be collected in future years are recorded at the present value of the amount expected to be collected. The discounts on those amounts are computed using an imputed interest rate applicable to the year in which the pledge is received. Conditional pledges are not included as support until such time as the conditions are substantially met.

Account Receivables

The Organization provides an allowance for uncollectible accounts based on the reserve method using management's judgment and the Organization's approved policy. Payment for services is required within 30 days of receipt of invoice. An allowance is estimated for accounts receivable based on the Organization's policy as well as historical experience of the Organization. The Organization policy is based on determined percentages of outstanding receivables by age of the balance. When all collection efforts have been exhausted, the receivable is written off against the related reserve. At September 30, 2013 and 2012, the allowance for uncollectible accounts was \$872,752 and \$309,273, respectively.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net Land, Buildings and Equipment

Property and equipment acquisitions are recorded at cost. Donated items are recorded at fair value on the date received. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Organization depreciates such assets over their estimates useful life, and releases such restrictions as to use by transferring amounts from temporarily restricted funds to unrestricted funds.

Long-Lived Assets

The Organization reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount.

Deferred Financing Costs

Financing costs incurred in obtaining financing are being amortized by the straight-line method over the applicable terms of the bonds. Amortization expense was \$10,310 and \$10,906, respectively for the years ended September 30, 2013 and 2012.

Intangible Assets: Goodwill

The Organization acquired controlling interest in Partners in Community Supports, Inc. (PICS) effective April 1, 2008 recognizing goodwill in the amount of \$729,207.

During fiscal year 2010, the Organization purchased substantially all the assets, excluding real estate, of Empowerment Services Inc. (ESI), a Minnesota corporation, recognizing goodwill in the amount of \$350,000.

On June 30, 2013 PICS acquired the customers of two other Fiscal Support entities (Dungarvin & CCP) recognizing an additional \$300,000 in Goodwill.

The Organization does not amortize goodwill. Goodwill is tested for impairment using a qualitative assessment to determine whether it is more likely than not that the fair value is less than its carrying amount.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Split Interest Agreements

The Organization is named as a beneficiary in various gift annuities, charitable remainder trusts, and unitrusts. Upon notification of the gift an asset is recorded for the difference between the fair value of those assets and the liability under the gift contracts with donors. The amount expected to be received is established at the time of the contribution using life expectancy actuarial tables, expected investment returns and annuity payments, and is revalued at the end of each fiscal year. Actual gains and losses resulting from the annual revaluation of these obligations are reflected as temporarily or permanently restricted, consistent with the method used to initially record the contributions.

The value of these gifts was \$986,462 and \$1,040,224 at September 30, 2013 and 2012, respectively. The assets are recorded in the Other Assets on the Consolidated Statements of Financial Position.

The Organization became the trustee for the Pittman Trust in 2007. The trust is held for 20 years. The trust provides that the lower of 8% of trust assets or the total interest and dividends earned by the trust will be distributed to the remainders. At the end of 20 years, the trust will pay out to the Organization. The value of the trust, as of 2013, is booked at present value of \$555,841 as an asset of \$1,580,214 and an offsetting liability of \$1,024,373 for the value of the future obligations under the trust. As of 2012, the value of the trust was booked at present value of \$470,043 as an asset of \$1,417,926 and an offsetting liability of \$947,883 for the values of the future obligations under the trust. The assets are recorded in the Investments line and the liability is recorded in the Obligation under Trust Agreement on the Consolidated Statements of Financial Position.

Conditional Grants

Forgivable loans have been recorded as conditional contributions. Revenue from these loans is being recognized evenly over the conditional use period. As such they are recorded as a long-term liability and included in Note 8, Long-Term Debt and Line of Credit.

Asset Retirement Obligation

A conditional asset retirement obligation is a legal obligation to perform an asset retirement activity in which the timing and/or settlement are conditional on a future event that may or may not be within the control of the entity. The Organization estimated the cost of any potential obligation to remove asbestos. The Organization used a future value rate assumption of 3% and a present value risk-free rate of 7% to determine the potential liability. The Organization has recorded a liability of \$3,642 at September 30, 2013 and 2012.

Government Contracts

Government contracts are recorded as revenue when earned. The rates for the waived service programs are determined each year through negotiations with various counties in the State of Minnesota. Revenue is earned when eligible expenditures, as defined in each grant or contract, are made. Funds received but not yet earned are shown as deferred revenue.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Government Contracts (Continued)

Expenditures under government contracts are subject to review by the granting authority. To the extent, if any, that such a review reduces expenditures allowable under these contracts, the Organization will record such disallowance at the time the final assessment is made.

The Organization receives a significant portion of its governmental service fees from Medicaid, Medical Assistance, Minnesota Supplemental Assistance, Social Security and Supplemental Security income which are subject to regulated rate increases.

Contributions

Contributions, unconditional promises to give, and other assets are recognized at fair values and are recorded as made. All contributions are available for unrestricted use unless specifically restricted by the donor.

The Organization reports gifts as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Adoption Fees

Revenue recognition of adoption fees occurs as follows: Half of the initial coordination fees are recognized at the initiation of the adoption process; the remaining portion is amortized over 18 months, management's estimated average length of time until an adoption is completed.

Advertising Expenses

Advertising expenditures are expensed as incurred. Advertising expense for the years ended September 30, 2013 and 2012 totaled \$192,398 and \$186,920, respectively.

Functional Expense Allocation

Expenses are allocated based on direct expenses whenever possible. Indirect expenses are allocated based on the best estimates of management.

Tax Exempt Status

Lutheran Social Service of Minnesota, Lutheran Social Service of Minnesota Foundation, and Partners In Community Supports, Inc. (PICS) have tax exempt status under Section 501(c)(3) of the Internal Revenue Code and Minnesota Statute. Rezek House LLC, LSS Townhomes LLC, LSS Supportive Housing LLC, CFCL Lending LLC, CFCL LLC, and LSS Rolling Hills LLC are single member limited liability companies, the activities of which are reported within the activities of the Organization as exempt activities. RH Saint Paul Apartments LP is a taxable partnership. The Organization has been classified as an organization that is a public charity under the Internal Revenue Code and charitable contributions by the donors are tax deductible.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Tax Exempt Status (Continued)

LSS Park Avenue Apartments LP and LSS Development LLC are taxable entities formed as part of the financing of Park Avenue Apartments. The project provides low income individuals and families a quality place to live at below market rates. After the tax credit financing period ends in 2024, the Organization has the option to acquire the property at a bargain purchase price from their financing partner.

RH Saint Paul Apartments LP and LSS Rolling Hills LLC are taxable entities formed as a part of the financing of Rolling Hills Apartments. This project, like Park Avenue Apartments provides low income individuals and families a quality place to live at below market rates. RH Saint Paul Apartments LP is a partnership between LSS Rolling Hills LLC (a single member LLC of Lutheran Social Services of Minnesota) and RH Developer LLC (a for profit company).

The Organization has adopted the income tax standard regarding the recognition and measurement of uncertain tax positions. The Organization has no current obligation for unrelated business income tax. The Organization's tax returns are subject to review and examination by federal and state authorities. The tax returns for the years 2010 to 2012 are open to examination by federal and state authorities.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events

In preparing these financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through January 28, 2014, the date the consolidated financial statements were available to be issued.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 2 PLEDGES RECEIVABLE

Pledges receivable at September 30, 2013 and 2012 consist of commitments from various donors. The discount rate has been imputed at 3.5%, which approximates the Organization's risk free borrowing rate at September 30, 2013 and 2012. The allowance for uncollectible accounts was \$24,915 and \$43,099 for 2013 and 2012, respectively.

	<u>2013</u>	<u>2012</u>
Unconditional Pledges Receivable	\$ 1,123,623	\$ 1,038,586
Unamortized Discount	(7,560)	(7,560)
Allowance for Uncollectible Accounts	<u>(24,915)</u>	<u>(43,099)</u>
Total	<u>\$ 1,091,148</u>	<u>\$ 987,927</u>
Amounts Due in:		
Less Than One Year	\$ 675,619	\$ 847,956
One to Five Years	<u>448,004</u>	<u>190,630</u>
Total	<u>\$ 1,123,623</u>	<u>\$ 1,038,586</u>

Pledges receivable are recorded on the financial statements as follows:

	<u>2013</u>	<u>2012</u>
Current Pledges Receivable	\$ 650,704	\$ 804,857
Long-Term Pledges Receivable	<u>440,444</u>	<u>183,070</u>
	<u>\$ 1,091,148</u>	<u>\$ 987,927</u>

Pledges receivable from board members and employees totaled \$328,457 and \$178,147 at September 30, 2013 and 2012, respectively.

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of these financial instruments. The fair value of pledges receivable, which is based on discounted cash flows using current interest rates, approximates the carrying value. The carrying values of investments and the beneficial interest in perpetual trust, which are the fair value, are based upon fair value measurements.

Fair Value Hierarchy

The Organization has categorized its financial instruments based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value of the instrument.

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Fair Value Hierarchy (Continued)

Financial assets recorded on the statement of financial position are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Organization has the ability to access (examples include active exchange-traded equity securities, listed derivatives, and most U.S. Government and agency securities).

Level 2 – Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in non-active markets (examples include corporate and municipal bonds, which trade infrequently);
- Pricing models whose inputs are observable for substantially the full term of the asset or liability (examples include most over-the-counter derivatives, including interest rate and currency swaps); and
- Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability (examples include certain residential and commercial mortgage related assets, including loans, securities, and derivatives).

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability (examples include certain private equity investments, long-term promises to give, split-interest agreements, and long-term grants payable).

The following table presents the Organization's value for those investments, excluding money market funds, measured at fair value on a recurring basis as of September 30:

	2013			Total
	Level 1	Level 2	Level 3	
INVESTMENT				
Equities	\$ 2,297,730	\$ -	\$ -	\$ 2,297,730
Mutual Funds	333,482	-	-	333,482
Bond	-	418,315	-	418,315
	<u>\$ 2,631,212</u>	<u>\$ 418,315</u>	<u>\$ -</u>	<u>\$ 3,049,527</u>
BENEFIT INTEREST IN PERPETUAL TRUST				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,645,229</u>	<u>2,645,229</u>

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Fair Value Hierarchy (Continued)

	2012			Total
	Level 1	Level 2	Level 3	
INVESTMENT				
Equities	\$ 1,453,613	\$ -	\$ -	\$ 1,453,613
Mutual Funds	843,665	-	-	843,665
Bond	-	441,921	-	441,921
	<u>\$ 2,297,278</u>	<u>\$ 441,921</u>	<u>\$ -</u>	<u>\$ 2,739,199</u>
BENEFIT INTEREST IN PERPETUAL TRUST				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,574,870</u>	<u>\$ 2,574,870</u>

The totals above do not include certain amounts as they are not measured on a recurring basis at fair value. The table below reconciles total investments:

	2013	2012
Total Investments	\$ 3,110,294	\$ 2,794,528
Investments Not Measured at Fair Value on a Recurring Basis:		
Cash and Cash Equivalents	<u>(60,767)</u>	<u>(55,329)</u>
Total Investments Measured at Fair Value on a Recurring Basis	<u>\$ 3,049,527</u>	<u>\$ 2,739,199</u>

Fair Value Measurements

The Organization uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Additional information on how the Organization measures fair value is as follows:

Investments – Investments are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

Beneficial interest in Perpetual Trusts – Perpetual Trusts are recorded at fair value on a recurring basis. Fair value measurement is estimated based upon the Organization's percentage interest in the fair value of the trust's assets, and, accordingly, are classified using Level 3 inputs. The underlying assets in the trusts are valued based upon quoted prices.

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

NOTE 3 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Level 3 Assets

The following table provides a summary of changes in fair value of the Organization's Level 3 financial assets for the years ended September 30, 2013 and 2012:

	Beneficial Interest in Perpetual Trust
Balance as of October 1, 2012	<u>\$ 2,574,870</u>
Distribution	(164,208)
Change in Value of Undistributed Trust Assets	<u>234,567</u>
Balance as of September 30, 2013	<u><u>\$ 2,645,229</u></u>
	Beneficial Interest in Perpetual Trust
Balance as of October 1, 2011	<u>\$ 2,266,716</u>
Distribution	(164,208)
Change in Value of Undistributed Trust Assets	<u>472,362</u>
Balance as of September 30, 2012	<u><u>\$ 2,574,870</u></u>

The fair value of long-term debt is estimated based on current rates offered to the Organization for debt of similar terms and maturities. Under this method, the Organization's fair value of long-term debt was approximately \$4.9 million more than the carrying value at September 30, 2013 and 2012.

NOTE 4 LAND, BUILDINGS, AND EQUIPMENT

Cost and related accumulated depreciation at September 30, 2013 and 2012 were:

	2013		2012	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	\$ 4,581,207	\$ -	\$ 3,481,707	\$ -
Land Improvement	940,108	603,207	940,108	563,546
Construction in Process	1,400,512	-	261,535	-
Building and Building Improvement	48,004,876	14,497,086	44,507,402	13,054,388
Equipment	13,389,920	6,375,960	7,355,093	5,794,407
Vehicles	201,948	164,672	180,170	151,372
Capital Lease - Vehicles	1,320,896	765,204	1,320,896	576,504
	<u>69,839,467</u>	<u>\$ 22,406,129</u>	<u>58,046,911</u>	<u>\$ 20,140,217</u>
Net Land, Building and Equipment	<u><u>\$ 47,433,338</u></u>		<u><u>\$ 37,906,694</u></u>	

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 5 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Defined Benefit Pension Plan

The Organization has a noncontributory defined benefit pension plan. The Organization froze its defined benefit pension plan for all participants. The plan provided for 100% vesting after five years of service or attainment of the normal retirement age of 65, with reduced compensation in cases of early retirement. Benefits are based on credited years of service and the average of the employee's highest compensation over a consecutive 36-month period during the 10 years prior to retirement.

The measurement dates used for the Plan disclosures are as of September 30, 2013 and 2012 and for the years then ended.

The changes in the projected benefit obligation are as follows:

	<u>2013</u>	<u>2012</u>
Change in Projected Benefit Obligation		
Projected Benefit Obligation at Beginning of Year	\$ 36,187,656	\$ 32,027,141
Interest Cost	1,607,826	1,654,884
Actuarial (Gain)/Loss	(2,045,537)	4,058,433
Benefits Paid	<u>(1,734,770)</u>	<u>(1,552,802)</u>
Projected Benefit Obligation at End of Year	<u><u>\$ 34,015,175</u></u>	<u><u>\$ 36,187,656</u></u>
Change in Plan Assets:		
Fair Value of Plan Assets at Beginning of Year	\$ 18,458,048	\$ 15,290,494
Actual Return on Plan Assets	3,670,456	3,048,536
Employer Contribution	1,200,000	1,800,000
Expenses	(139,336)	(128,180)
Benefits Paid	<u>(1,734,770)</u>	<u>(1,552,802)</u>
Fair Value of Plan Assets at End of Year	<u><u>\$ 21,454,398</u></u>	<u><u>\$ 18,458,048</u></u>
Funded Status of the Plan:		
Benefit Obligation	\$ 34,015,175	\$ 36,187,656
Fair Value of Plan Assets	<u>21,454,398</u>	<u>18,458,048</u>
Excess of Benefit Obligation Over		
Fair Value of Plan Assets	<u><u>\$(12,560,777)</u></u>	<u><u>\$(17,729,608)</u></u>
Components of Net Periodic Benefit Costs:		
Interest Cost	\$ 1,607,826	\$ 1,654,884
Expected Return on Plan Assets	(1,455,253)	(1,214,181)
Amortization of Net Loss	<u>465,342</u>	<u>380,640</u>
Net Periodic Pension Cost	<u><u>\$ 617,915</u></u>	<u><u>\$ 821,343</u></u>
Underfunded Plan Information:		
Projected Benefit Obligation at End of Year	\$ 34,015,175	\$ 36,187,656
Accumulated Benefit Obligation at End of Year	33,122,411	36,187,656
Fair Value of Assets at End of Year	21,454,398	18,458,048

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

NOTE 5 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (CONTINUED)

Defined Benefit Pension Plan (Continued)

Weighted average assumptions used to determine net periodic benefit cost are as follows:

	2013	2012
<u>Actuarial Assumptions</u>		
Assumptions Used to Determine Benefit Obligations at September 30:		
Assumed Discount Rate	5.25%	4.50%
Assumed Annual Increase in Salaries	-	-
Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended September 30:		
Assumed Discount Rate	4.50%	5.25%
Expected Long-Term Return on Plan Assets	8.00%	8.00%
Assumed Annual Increase in Salaries	-	-

Investment Allocation/Basis Used to Determine Expected Long-Term Rate of Return

This investment policy is to enhance the value of Defined Benefit Plan funds held in the portfolio(s) and at the same time provide a dependable, increasing source of income, which will be used to support benefit distributions of the Plan. The portfolio shall be composed of diversified assets, including both equities and fixed-income investments. The equities are designed to provide current income, growth of income and appreciation of principal. The fixed-income investments are intended to provide a predictable and reliable source of interest income while reducing the volatility of the portfolio. As a long-term policy guideline, equity investments will constitute 65% of Plan assets and fixed income (bonds and cash) 35% of the portfolio.

The percentage of the fair value of total plan assets held as of September 30, 2013 and 2012 (the measurement date) by asset category is as follows:

	2013	2012
The Plan Assets are invested as follows:		
Equity Securities	82%	77%
Debt Securities	18%	23%

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 5 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (CONTINUED)

Investment Allocation/Basis Used to Determine Expected Long-Term Rate of Return (Continued)

The Plan uses fair value measurement to record fair value adjustments to certain assets and to determine fair value disclosures. The following table presents the fair value hierarchy for the balances of the assets of the Plan measured at fair value on a recurring basis as of September 30:

	2013			
	Level 1	Level 2	Level 3	Total
INVESTMENT				
Equities	\$ 5,930,132	\$ -	\$ -	\$ 5,930,132
Mutual Funds	-	11,618,170	-	11,618,170
Bond	-	3,821,486	-	3,821,486
	<u>\$ 5,930,132</u>	<u>\$ 15,439,656</u>	<u>\$ -</u>	<u>\$ 21,369,788</u>
	2012			
	Level 1	Level 2	Level 3	Total
INVESTMENT				
Equities	\$ 4,872,479	\$ -	\$ -	\$ 4,872,479
Mutual Funds	-	9,285,856	-	9,285,856
Bond	-	4,220,048	-	4,220,048
	<u>\$ 4,872,479</u>	<u>\$ 13,505,904</u>	<u>\$ -</u>	<u>\$ 18,378,383</u>

The totals above do not include certain amounts as they are not measured on a recurring basis at fair value. The table below reconciles total investments:

	2013	2012
Total Investments	<u>\$ 21,454,398</u>	<u>\$ 18,458,048</u>
Investments Not Measured at Fair Value on a Recurring Basis:		
Cash and Cash Equivalents	<u>(84,609)</u>	<u>(79,665)</u>
Total Investments Measured at Fair Value on a Recurring Basis	<u>\$ 21,369,789</u>	<u>\$ 18,378,383</u>

The Organization provided funding to the plan of \$1,200,000 during fiscal year 2013. Additional funding of \$1,200,000 annually is expected.

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

NOTE 5 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (CONTINUED)

**Investment Allocation/Basis Used to Determine Expected Long-Term Rate of Return
(Continued)**

Estimated future benefit payments, which reflect expected future services, are as follows:

<u>Year Ending September 30,</u>	<u>Amount</u>
2014	\$ 1,692,443
2015	1,701,149
2016	1,745,765
2017	1,786,733
2018	1,852,258
2019-2023	9,463,353

Other Post Retirement Benefits

The Organization also has a defined contribution 403(b) retirement savings plan that covers substantially all employees. Employees can elect to contribute a portion of their pretax earnings to the plan. Employees are eligible for participation in the plan upon employment. In 2013 and 2012, the Organization matched participant contributions by 50% up to the first 4% of eligible compensation. The plan was amended in fiscal 2005 to allow for Employer discretionary contributions to be determined annually by the Organization's management. The discretionary contribution in 2013 and 2012 was 2% of eligible compensation. Employees become fully vested in the Employer match and discretionary contribution after five years of service. Expenses charged to the Organization's financial statements for this plan was \$1,336,716 and \$1,808,613 for the years ended September 30, 2013 and 2012, respectively.

NOTE 6 BENEFICIAL INTEREST IN PERPETUAL TRUST

The Anderson Trust, a perpetual trust in the amount of \$2,645,229 and \$2,574,870 at September 30, 2013 and 2012, respectively, is included in permanently restricted net assets. The Organization has the irrevocable right to receive the income on these trust assets, subject to certain limitations, but will never receive the assets held in trust. The unrealized gains and the undistributed earnings on the trusts are reported as additions to the permanently restricted net asset balance. The distributed income from these trusts is to be used for children and adults with disabilities within a 50 mile radius of the old VASA home. Income distributions from the trust were \$164,208 for the years ended September 30, 2013 and 2012.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 7 SELF-INSURED BENEFIT LIABILITIES

In 1992, a benefit fund was established for the Organization's self-funded employee medical, dental, and short-term disability plans. Under the plans, which are administered by the trust, contributions are made by the Organization and employees to pay claims, administrative costs, and commercial insurance premiums. The commercial insurance premiums (stop-loss insurance) cover individual medical claims in excess of \$200,000 and aggregate claims over 120% of annual expected claims or \$7,039,078. The self-insured medical, dental, and short-term disability expense recorded in the Organization's financial statements was \$6,015,073. and \$5,666,224 in 2013 and 2012, respectively. The Organization has recorded liabilities of \$1,125,000 and \$1,554,856 for claims incurred but not yet paid as of September 30, 2013 and 2012, respectively. The trust is a separate entity which is excluded from the Organization's consolidated financial statements

The Organization became self-insured for workers' compensation on April 1, 1994. As of September 30, 2013 and 2012, the Organization has recorded liabilities of \$541,597 and \$329,150, respectively, for claims incurred but not yet reported. In addition, the Organization has a \$1,291,953 surety bond to secure amounts potentially required to be paid for workers' compensation. Consulting actuaries assist the Organization in determining its liability for self-insured claims.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT

Description	Security	2013		2012	
		Face Value	Current Value	Face Value	Current Value
4.31% to 4.5% City of Grand Rapids, Minnesota, Tax-Exempt Series 2003A and B Bonds, Due through 2015	Houses, Computer and Motor Vehicles	\$ 114,204	\$ 114,204	\$ 167,389	\$ 167,389
4.92% to 5.70% City of Brainerd, Minnesota, Tax-Exempt Series 2001A, B and C Bonds, Due through 2016	Houses, Computer and Motor Vehicles	156,750	156,750	196,158	196,158
4.91% to 6.41% Minnesota Agricultural and Economic Development Board, Tax-Exempt Series, 1999A Bonds, Due through 2014	Houses, Computer and Motor Vehicles	21,946	21,946	64,107	64,107
Note Payable to American National Bank of Minnesota, Interest at 5%, Due through March 21, 2018.	Land and Buildings	168,975	168,975	195,279	195,279
Note Payable to Minnesota Housing Finance Agency, Non-Interest Bearing, Forgivable in 2020*	Safe House Land and Building	40,439	12,635	40,439	14,657
Thrivent PRI Loan, 2% Interest; Due through July 31, 2014		266,667	266,667	533,334	533,334
Lutheran Community Foundation PRI Loan, 2% Interest; Due through October 31, 2014		33,333	33,333	66,666	66,666
US Bank Short-Term Bank Note, Interest at 3.19%, Due April 30, 2014	Accounts Receivable and Inventory	114,604	114,604	135,604	135,605
Note Payable to Hennepin County Housing and Redevelopment Authority Affordable Housing Incentive Fund, Non-Interest Bearing, Forgivable in 2037*	Land and Building	600,000	481,668	600,000	501,668
Capital Leases	Vehicles	574,072	574,072	760,423	760,426
Subtotal for Lutheran Social Service of Minnesota		2,090,990	1,944,854	2,759,399	2,635,289

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT (CONTINUED)

Description	Security	2013		2012	
		Face Value	Current Value	Face Value	Current Value
Note Payable to Minnesota Housing Finance Agency, Non-Interest Bearing, Forgivable in 2020*	Land and Building	521,674	165,197	521,674	191,281
Note Payable to City of St. Paul Housing and Redevelopment Authority, Interest at 2%, Principal and Interest due through December 31, 2026	Land and Building	384,500	240,098	372,500	228,664
Subtotal for Rezek House LLC		906,174	405,295	894,174	419,945
Note Payable to Minnesota Housing Finance Agency, Non-Interest Bearing, Forgivable May 16, 2033 *	Land and Buildings	1,720,580	1,141,423	1,720,580	1,199,339
Note Payable to Minnesota Housing Finance Agency, Non-Interest Bearing, Due May 16, 2033	Land and Buildings	119,420	66,120	119,420	64,194
Note Payable to Family Housing Fund, Non-Interest Bearing, Due May 16, 2033	Land and Buildings	130,000	72,774	130,000	70,654
Note Payable to Minnesota Community Development Authority, Interest at 1%, Principal and Interest due May 16, 2033	Land and Buildings	331,000	217,859	328,000	211,514
Subtotal for LSS Townhomes LLC		2,301,000	1,498,176	2,298,000	1,545,701
Note Payable to Family Housing Fund, Non-Interest Bearing, Due May 19, 2034	Land and Buildings	126,000	65,154	126,000	63,103
Note Payable to Hennepin County Housing and Redevelopment Authority, Interest at 1%, Principal and Interest due May 19, 2034	Land and Buildings	291,644	174,730	281,778	169,229
Note Payable to City of Minneapolis, Interest at 1%, Principal and Interest due May 19, 2034	Land and Buildings	283,094	171,081	275,814	165,695

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NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT (CONTINUED)

Description	Security	2013		2012	
		Face Value	Current Value	Face Value	Current Value
Note Payable to Minnesota Housing Finance Agency, Non-Interest Bearing, Due May 19, 2034	Land and Buildings	600,000	310,256	600,000	300,489
Note Payable to City of Minneapolis, Non-Interest Bearing, Forgivable May 19, 2034 *	Land and Buildings	100,000	68,612	100,000	71,945
Total for LSS Supportive Housing LLC		1,400,738	789,833	1,383,592	770,461
Note Payable to Wells Fargo, N.A.; Interest at 1.9 plus LIBOR Rate, Due through December 31, 2017	Center For Changing Lives Building and improvements	2,651,664	2,651,664	2,815,853	2,815,853
Note Payable to New Markets Investment XXVIII, LLC, Interest at 5.81%, Principal payments from 2014 through January 24, 2038 **	Changing Lives Building and improvements	13,717,365	11,051,142	13,717,365	11,514,834
Total for LSS Center for Changing Lives		16,369,029	13,702,806	16,533,218	14,330,687
Note Payable to Hennepin County AHTF, Interest at 5.50%, Principal and Interest due January 24, 2038	Park Avenue Apartments	694,161	694,161	649,397	649,397
Note Payable to City of Minneapolis AHIF, Interest at 1%, Principal and Interest due November 15, 2037	Park Avenue Apartments	426,963	426,963	419,504	419,504
Total for Park Avenue Apartments		1,121,124	1,121,124	1,068,901	1,068,901
Note Payable to Sunrise Bank N.A., Interest at 3.125%, Due March 20, 2045	Rolling Hills Apartments	2,721,329	2,721,329	-	-
Note Payable to Lake Energy Investment, Inc, Interest at 7%, Due June 20, 2034	Rolling Hills Apartments	415,436	415,436	-	-
Note Payable to St. Paul City HRA (CDBG), Interest at 3%, Due December 1, 2045	Rolling Hills Apartments	48,940	48,940	-	-

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT (CONTINUED)

<u>Description</u>	<u>Security</u>	<u>2013</u>		<u>2012</u>	
		<u>Face Value</u>	<u>Current Value</u>	<u>Face Value</u>	<u>Current Value</u>
Note Payable to Housing & Redevelopment Authority of St. Paul (Home Loan), Interest at 1%, Due June 20, 2045	Rolling Hills Apartments	843,592	155,107	-	-
Total for Rolling Hills Apartments		<u>4,029,297</u>	<u>3,340,812</u>	-	-
Total Long-Term Debt and Conditional Grants		\$ 28,218,352	\$ 22,802,900	\$ 24,937,284	\$ 20,770,984
Less: Conditional Grants		<u>2,982,693</u>	<u>1,869,535</u>	<u>2,982,693</u>	<u>1,978,890</u>
Total Debt		25,235,659	20,933,365	21,954,591	18,792,094
Less: Current Maturities of Long-Term Debt		<u>879,705</u>	<u>879,705</u>	<u>808,489</u>	<u>808,489</u>
Maturities and Conditional Grants		<u>\$ 24,355,954</u>	<u>\$ 20,053,660</u>	<u>\$ 21,146,102</u>	<u>\$ 17,983,605</u>

* Conditional Grants

** There is a loan receivable in the amount of \$10,471,529 with an interest rate of 7.4% associated with the Center for Changing Lives project. Interest payments received from this loan offset interest expense paid on the Note Payable, in the amount of \$11,051,142, to New Markets XXVIII LLC. The loan will be acquired by the Organization when NEF exercises its call option in March 2014.

For below market loans the present value discount is imputed using rates between 3% and 5% depending on the year the loan was initiated.

Principal maturities for long-term debt are as follows:

<u>Year Ending September 30,</u>	<u>Amount</u>
2014	\$ 879,705
2015	718,196
2016	575,352
2017	469,024
2018	2,347,300
Thereafter	<u>15,943,788</u>
Total	<u>\$ 20,933,365</u>

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT (CONTINUED)

Land and buildings with a net book value of \$28,798,986 and \$11,217,194 are pledged as collateral at September 30, 2013 and 2012, respectively, primarily on MHFA mortgage notes. The increase from 2012 to 2013 was attributable to the permanent financing of the Center for Changing Lives Building in Minneapolis and the new Rolling Hills Apartments project.

At September 30, 2013, the Organization was not in compliance with the liabilities to net assets ratio for its Brainerd Series 2001 bonds and received a waiver subsequent to year-end. The Organization received a waiver dated December 24, 2013. The balance is scheduled to be paid in full by December 31, 2016.

Line of Credit

The Organization has a total of \$3,000,000 of working capital lines of credit with U.S. Bank. The lines bear interest on outstanding borrowings at the bank's reference rate (3.25% at September 30, 2013) and mature on April 30, 2014. At September 30, 2013 and 2012, the amount outstanding was \$-0-. In addition, there is a short-term loan of \$210,000 that will be renewed on April 30, 2014. The interest rate is 30 day LIBOR + 290 basis points, and \$1,750 in principal is paid each month. The balance outstanding at end of the year ended September 30, 2013 and 2012 was \$114,603 and \$135,604, respectively.

On July 10, 2012, the Organization entered into a line of credit with Sunrise Bank for \$3,000,000. This line bears interest on outstanding borrowings at the bank's reference rate (3.25% at September 30, 2013) and matures on April 30, 2014. At September 30, 2013, the amount outstanding was \$2,051,885.

Center for Changing Lives

The Organization established a construction loan of up to \$6.4 million for the Center for Changing Lives Project. The balance outstanding at end of the year ended September 30, 2013 and 2012 was \$2,651,663 and \$2,815,853, respectively. For the first four years, quarterly payments of interest were required at a rate equal to LIBOR plus 1.9%.

The schedule of principal amortization during this four year period provided that the outstanding principal at the end of each year may not exceed a specified maximum amount:

December 31, 2008	\$ 6,800,000
December 31, 2009	5,600,000
December 31, 2010	4,400,000
December 31, 2011	3,200,000
2012 - 2017	15 Year Amortization of 2011 Balance
December 31, 2017	Balance Due in Full

**LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 8 LONG-TERM DEBT AND LINE OF CREDIT (CONTINUED)

Center for Changing Lives (Continued)

At the end of the four year initial period (January 24, 2012), the loan (a maximum of \$3,200,000) converted to a fixed rate based on the five-year treasury rate plus 1.05%. The loan matures December 31, 2017.

There is a loan receivable from CFCL Investment Fund, LLC in the amount of \$10,471,529 and a loan payable to the New Market Investment XXVIII, LLC in the amount of \$13,717,365 from the Center for Changing Lives Project. There will be quarterly interest payments due on these amounts until 2014. The loan has provisions of a put and a call option which LSS intends to exercise in 2014 which will negate any principal payments on either of these loans.

Rolling Hills

During 2013, RH-St. Paul Apartments LP established a construction loan at Sunrise Bank of up to \$9.476 million for the Rolling Hills Project.

RH-St. Paul Apartments is a limited partnership consisting of the following general partners:

- LSS Rolling Hills LLC - a single member LLC of Lutheran Social Service of MN.
- RH Developer LLC - a for-profit company engaged in leasing and property management.

The balance outstanding on the loan as of September 30, 2013 was \$2,721,329 with interest accruing at 3.125% during the construction phase. The loan will convert to permanent financing on March 20, 2015. Interest will accrue at 4.5% (updated to LIBOR plus 2.5% every 5 years) and principal payments will commence until maturity on March 20, 2045.

The note is secured by real property owned by the partnership. As of September 30, 2013, Sunrise Bank also held in certificates of deposit a sum of \$243,529 in RH Developer LLC and LSS Rolling Hills LLC equity contributions to the partnership and the project as collateral against the debt.

NOTE 9 LEASES

The Organization has operating lease agreements for office space, residential facilities and vehicles. The majority of these leases expire throughout the next five years. In most instances, office space lease terms are renewable.

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 9 LEASES (CONTINUED)

As of September 30, 2013, future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year were:

<u>Year Ending September 30,</u>	<u>Amount</u>
2014	\$ 2,412,867
2015	1,827,259
2016	1,298,261
2017	935,231
2018	548,828
Thereafter	737,284
Total	<u>\$ 7,759,730</u>

Rental expense for all operating leases was \$3,420,244 and \$2,690,305 for the years ended September 30, 2013 and 2012, respectively.

The Organization leases certain vehicles under long-term lease agreements. The leases, which are accounted for as capital leases, expire at various dates. The cost of vehicles recorded under capital leases was \$1,320,896 at September 30, 2013 and 2012. Accumulated depreciation was \$765,203 and \$576,504 at September 30, 2013 and 2012, respectively.

Future minimum lease payments are as follows:

<u>Year Ending September 30,</u>	<u>Amount</u>
2014	\$ 220,742
2015	176,147
2016	131,407
2017	80,371
2018	25,954
Total Lease Payments	<u>634,621</u>
Less Interest Expense	<u>(60,549)</u>
Total Minimum Lease Payments	<u>\$ 574,072</u>

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 10 NET ASSETS

Temporarily Restricted

Temporarily restricted net assets are available for the following purposes at September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Split Interest Deferred Gifts / Trusts	\$ 1,541,302	\$ 1,558,650
Donations and Forgivable Loan Interest for Property	18,726,226	13,653,176
Cash Restricted by Donors for Specific Program Use	3,444,284	3,520,493
Total	<u>\$ 23,711,812</u>	<u>\$ 18,732,319</u>

Permanently Restricted

Permanently restricted net assets with investment return restricted for the following purposes at September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Perpetual Trust for VASA Lutheran Home	\$ 2,645,229	\$ 2,574,870
Endowment Investments	1,084,454	1,084,240
Camp Knutson	209,200	208,822
Other	44,767	44,768
Total	<u>\$ 3,983,650</u>	<u>\$ 3,912,700</u>

Net Assets Released from Restrictions

The net assets released from restrictions as of September 30, 2013 and 2012 consist of the following:

	<u>2013</u>	<u>2012</u>
Time and Purpose Releases	\$ 3,084,896	\$ 2,804,212
Building Releases	700,574	959,030
Total	<u>\$ 3,785,470</u>	<u>\$ 3,763,242</u>

NOTE 11 COMMITMENTS AND CONTINGENCIES

A land lease between Luther Seminary and the organization commenced in 1992 at the site of the new administrative office facility. The lease term is 50 years, with the option to extend the lease for an additional 25 years. Annual rent is \$13,911 adjusted every five years for the percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers.

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NOTE 11 COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Organization provides Guardianship and Conservatorship services for vulnerable adults throughout the state of Minnesota. For these services, the court orders the appointment of a person or agency to act as a substitute decision maker for a person. The Organization follows the National Guardianship Association and the Minnesota Association for Guardianship Conservatorship standards. As of September 30, 2013 and 2012, the Organization was the guardianship or conservator of estates totaling \$30,660,039 and \$32,470,519, respectively.

The Organization is involved in legal action in regards to normal business activities. Management does not feel that these actions are material and pose a financial threat to the organization and, accordingly, no liability is accrued at September 30, 2013 and 2012.

NOTE 12 ENDOWMENTS

The Organization has donor restricted endowment funds established for the purpose of securing the Organization's long-term financial viability and continuing to meet the needs of the Organization. As required by GAAP, net assets of the endowment fund are classified and reported based on the existence or absence of donor-imposed restrictions. The Board of Directors of the Organization has interpreted the state's Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair 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 the gifts to the permanent endowment and the value of subsequent gifts to the permanent endowment. The remaining portion of the donor restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

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. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$-0- as of September 30, 2013 and 2012.

The Organization's Foundation Board of Directors has adopted an Investment and Distribution Policy for its endowments assets. The policy seeks to maintain the purchasing power of the endowment assets while providing a predictable funding stream to its programs. In addition, the organization has hired an outside investment manager to oversee the investment of the endowment funds. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity or for a donor-specified period(s).

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

NOTE 12 ENDOWMENTS (CONTINUED)

Return Objectives and Risk Parameters, Investment and Spending Policies for the Organization's Foundation

The investment policy provides a targeted mix of equity and income investments. Investment performance is benchmarked quarterly against the performance of the S&P 500 and the applicable bond fund indexes.

Annual distributions from the Endowment funds are targeted at 5% of its endowment fund's average fair value over the prior 12 quarters through the calendar year-end based upon the preceding the fiscal year in which the distribution is planned. In addition, actual investment performance is considered in the distribution decision.

Endowment net asset composition by type and changes in endowment net assets for the years ended September 30 is as follows:

	2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Fund Balance, September 30, 2012	\$ -	\$ 8,079	\$ 1,329,610	\$ 1,337,689
Change in Value of Perpetual Trusts	-	-	215	215
Investment Return:				
Investment Income	-	42,576	-	42,576
Investment Expenses	-	(13,027)	-	(13,027)
Realized Gains (Losses)	-	9,084	-	9,084
Unrealized Gains (Losses)	-	106,036	-	106,036
Total Investment Return	-	144,670	-	144,670
Endowment Fund Balance, September 30, 2013	<u>\$ -</u>	<u>\$ 152,749</u>	<u>\$ 1,329,825</u>	<u>\$ 1,482,574</u>
	2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Fund Balance, September 30, 2011	\$ (202,367)	\$ -	\$ 1,329,460	\$ 1,127,093
Contributions	-	-	150	150
Investment Return:				
Investment Income	27,948	-	-	27,948
Investment Expenses	(11,359)	-	-	(11,359)
Realized Gains (Losses)	(11,759)	-	-	(11,759)
Unrealized Gains (Losses)	197,537	8,079	-	205,616
Total Investment Return	202,367	8,079	-	210,446
Endowment Fund Balance, September 30, 2012	<u>\$ -</u>	<u>\$ 8,079</u>	<u>\$ 1,329,610</u>	<u>\$ 1,337,689</u>

LUTHERAN SOCIAL SERVICE OF MINNESOTA AND AFFILIATES
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NOTE 13 AGREEMENT WITH CHILDREN'S HOME SOCIETY OF MINNESOTA

Effective July 1, 2012, the Organization entered into a management services agreement with Children's Home Society of Minnesota (CHS). The agreement continues through June 30, 2018 and automatically renews for additional one-year terms thereafter unless terminated pursuant to terms of the agreement. The President/CEO of the Organization will serve concurrently as the chief executive officer of CHS and report to the Board of Directors of CHS. Under this agreement, the Organization provides management and administrative services for CHS in exchange for a management fee which is calculated based on the operating revenues of CHS. At September 30, 2013, the Organization had a receivable from CHS totaling \$2,315,275 for management fees and other expenditures paid on behalf of CHS. These expenditures were primarily related the closure of its Ethiopia operations.

Principal repayment from CHS to the Organization shall be made to the extent funds are available in the timing and amount determined by the Organization. The loan is secured by a mortgage on real property owned by CHS. In conjunction with this management agreement, the Organization and CHS also signed a lease whereby the Organization will lease space from CHS from July 1, 2012, through June 30, 2018. The lease provides for annual rental payments to CHS of approximately \$240,000.

NOTE 14 RESTATEMENT

The September 30, 2012 financial statements were restated to properly record grant revenue and receivables for two multi-year unconditional grants. The impact of restating this error was to increase pledges receivable at September 30, 2012 by \$420,000 and to increase nongovernmental grant revenue by \$420,000.