

**NORTHEAST SOUTH DAKOTA
ECONOMIC CORPORATION
dba GROW South Dakota**

**FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT
WITH SUPPLEMENTARY INFORMATION**

SEPTEMBER 30, 2017

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

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*Wahlenberg
Ritzman & Co., LLC*
certified public accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Northeast South Dakota Economic Corporation
dba GROW South Dakota
Sisseton, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of **Northeast South Dakota Economic Corporation dba GROW South Dakota (a nonprofit organization, hereafter referred to as NESDEC)**, which comprise the statement of financial position as of September 30, 2017, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NESDEC as of September 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited NESDEC's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 23, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements.

The information has been subjected to the auditing procedures applied in the audit of the of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 27, 2017, on our consideration of NESDEC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering NESDEC's internal control over financial reporting and compliance.

Wohlschlag Ritzman + Co., LLC

Yankton, South Dakota
December 27, 2017

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

STATEMENT OF FINANCIAL POSITION
SEPTEMBER 30, 2017
WITH COMPARATIVE TOTALS FOR SEPTEMBER 30, 2016

	2017			2016
	Unrestricted	Temporarily Restricted	Total	
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 1,417,532	\$ 3,588,017	\$ 5,005,549	\$ 5,992,439
Certificates of deposit	1,643,067	1,057,500	2,700,567	3,200,558
Accrued interest receivable	32,415	32,210	64,625	57,209
Other receivables	850	5,467	6,317	754
Due from other governments	-	12,275	12,275	54,493
Current portion of notes receivable, net of allowance for loan losses of \$144,920 in 2017 and \$144,274 in 2016	882,729	1,741,014	2,623,743	2,241,590
Total current assets	3,976,593	6,436,483	10,413,076	11,547,043
LONG-TERM RECEIVABLES:				
Loan guarantees - certificates of deposit, less allowance for loan losses of \$12,015 in 2017 and \$11,290 in 2016	147,085	-	147,085	81,660
Notes receivable, less allowance for loan losses of \$664,005 in 2017 and \$677,021 in 2016 and less current maturities	5,485,850	7,234,572	12,720,422	11,966,835
Total long-term receivables	5,632,935	7,234,572	12,867,507	12,048,495
OTHER ASSETS:				
Investments	1,109,028	-	1,109,028	1,112,778
Other real estate owned	40,238	54,688	94,926	176,964
Property and equipment, net	777,674	-	777,674	795,165
Total other assets	1,926,940	54,688	1,981,628	2,084,907
TOTAL ASSETS	\$ 11,536,468	\$ 13,725,743	\$ 25,262,211	\$ 25,680,445
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Current portion of long-term debt	\$ 20,356	\$ 381,052	\$ 401,408	\$ 437,374
Accounts payable	3,166	1,352	4,518	4,890
Accrued expenses	882	14,597	15,479	5,375
Accrued interest	7,590	30,474	38,064	45,306
Due to affiliate	27,985	27,394	55,379	46,615
Unearned revenue	-	602,954	602,954	2,514
Other current liabilities	-	27,066	27,066	27,066
Total current liabilities	59,979	1,084,889	1,144,868	569,140
LONG-TERM DEBT				
Notes payable, less current maturities	3,489,975	6,546,840	10,036,815	11,455,214
TOTAL LIABILITIES	3,549,954	7,631,729	11,181,683	12,024,354
NET ASSETS				
Temporarily restricted	-	6,094,014	6,094,014	6,431,184
Unrestricted	7,986,514	-	7,986,514	7,224,907
TOTAL NET ASSETS	7,986,514	6,094,014	14,080,528	13,656,091
TOTAL LIABILITIES AND NET ASSETS	\$ 11,536,468	\$ 13,725,743	\$ 25,262,211	\$ 25,680,445

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

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

STATEMENT OF ACTIVITIES
YEAR ENDED SEPTEMBER 30, 2017
WITH COMPARATIVE TOTALS FOR SEPTEMBER 30, 2016

	2017			
	Unrestricted	Temporarily Restricted	Total	2016
REVENUE AND OTHER SUPPORT				
Interest income - notes receivable	241,291	457,874	699,165	727,926
Grant income	11,450	415,665	427,115	514,479
Interest income - checking and CD's	13,259	12,020	25,279	23,014
Rent income	29,000	-	29,000	32,600
Miscellaneous income	63,554	13,146	76,700	60,619
Marketable securities (loss) income	-	-	-	4,475
Gain (loss) on investments	(3,750)	-	(3,750)	(47,110)
Net assets released from restrictions				
Restrictions satisfied by payments	1,235,875	(1,235,875)	-	-
 Total revenue and other support	1,590,679	(337,170)	1,253,509	1,316,003
EXPENSES				
PROGRAM SERVICES:				
Loan programs	505,660	-	505,660	468,148
Regional programs	4,200	-	4,200	4,514
Housing programs	39,172	-	39,172	40,891
	549,032	-	549,032	513,553
SUPPORTING SERVICES:				
General and administrative	280,040	-	280,040	269,505
	829,072	-	829,072	783,058
 Change in Net Assets	761,607	(337,170)	424,437	532,945
Net Assets, Beginning of Year	7,224,907	6,431,184	13,656,091	13,123,146
Net Assets, End of Year	\$ 7,986,514	\$ 6,094,014	\$ 14,080,528	\$ 13,656,091

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

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED SEPTEMBER 30, 2017
WITH COMPARATIVE TOTALS FOR SEPTEMBER 30, 2016

Program Services

	<u>Loan Program</u>	<u>Regional Programs</u>	<u>Housing Programs</u>	<u>Program Services Total</u>	<u>General and Administrative</u>	<u>2017 Totals</u>	<u>2016 Totals</u>
Salaries and taxes	\$ 148,979	\$ -	\$ 3,925	\$ 152,904	\$ 181,511	\$ 334,415	\$ 317,858
Interest expense	170,422	-	20,000	190,422	-	190,422	222,815
Employee benefits	70,417	-	257	70,674	38,946	109,620	98,128
Targeted program expense	920	4,200	23,771	28,891	-	28,891	4,368
Bad debt expense	19,959	-	6,398	26,357	-	26,357	4,621
Professional fees	7,547	-	-	7,547	17,803	25,350	29,143
Depreciation	-	-	-	-	23,510	23,510	23,163
Travel and conferences	10,546	-	69	10,615	9,866	20,481	22,102
Filing fee expense	15,530	-	-	15,530	-	15,530	11,366
OREO Expense	32,267	-	(19,991)	12,276	-	12,276	(1,616)
Repairs and maintenance	6,533	-	934	7,467	851	8,318	17,114
Education and training	6,573	-	-	6,573	1,658	8,231	2,986
Marketing	7,811	-	65	7,876	-	7,876	6,478
Insurance	1,826	-	270	2,096	5,190	7,286	13,023
Office supplies	6,315	-	-	6,315	605	6,920	5,476
Property taxes	-	-	1,869	1,869	-	1,869	4,225
Miscellaneous	15	-	1,605	1,620	100	1,720	1,808
Total expenses	<u>\$ 505,660</u>	<u>\$ 4,200</u>	<u>\$ 39,172</u>	<u>\$ 549,032</u>	<u>\$ 280,040</u>	<u>\$ 829,072</u>	<u>\$ 783,058</u>

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

STATEMENT OF CASH FLOWS
YEAR ENDED SEPTEMBER 30, 2017
WITH COMPARATIVE TOTALS FOR SEPTEMBER 30, 2016

	2017	2016
Cash Flows From Operating Activities		
Net increase in net assets	\$ 424,437	\$ 532,945
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Depreciation	23,510	23,163
Bad Debt Expense	26,357	4,621
Realized loss (gain) on marketable securities	-	30,338
Unrealized loss (gain) on investment	3,750	15,333
Changes in operating assets and liabilities		
(Increase) decrease in:		
Interest receivable	(7,416)	7,380
Other receivables	(5,563)	(754)
Due from other governments	42,218	(17,886)
Increase (decrease) in:		
Interest payable	(7,242)	(4)
Unearned revenue	600,440	2,514
Accounts payable and accrued expenses	18,496	(9,892)
Other current liabilities	-	(14,987)
Net cash provided by operating activities	<u>1,118,987</u>	<u>572,771</u>
Cash Flows From Investing Activities		
Net decrease (increase) in certificates of deposits	499,991	514,992
Purchase of marketable securities	-	(72,223)
Redemption of marketable securities	-	217,541
Purchase of property and equipment	(6,019)	(10,765)
Decrease (Increase) in other real estate owned	82,038	16,125
Net decrease (increase) in notes receivable	(1,162,097)	985,450
Net decrease in loan guarantee - certificates of deposit	(65,425)	23,040
Net cash (used in) provided by investing activities	<u>(651,512)</u>	<u>1,674,160</u>
Cash Flows From Financing Activities		
Proceeds received on notes payable	325,000	275,000
Principal payments on notes payable	(1,779,365)	(1,364,687)
Net cash (used in) financing activities	<u>(1,454,365)</u>	<u>(1,089,687)</u>
(Decrease) increase in cash, cash equivalents and restricted cash	(986,890)	1,157,244
Cash, Cash Equivalents and Restricted Cash		
Beginning	<u>5,992,439</u>	<u>4,835,195</u>
Ending	<u>\$ 5,005,549</u>	<u>\$ 5,992,439</u>
Supplemental Disclosures		
Cash payments for:		
Interest	<u>\$ 197,664</u>	<u>\$ 222,819</u>
Reconciliation of Cash to the Balance Sheet		
Cash and cash equivalents	\$ 1,417,532	\$ 2,747,464
Restricted cash	3,588,017	3,244,975
	<u>\$ 5,005,549</u>	<u>\$ 5,992,439</u>

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

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principal Business Activity

The Northeast South Dakota Economic Corporation (NESDEC) was incorporated in 1978 as a not-for-profit corporation. In 2012, NESDEC underwent a branding campaign and is now doing business as GROW South Dakota in combination with the Northeast South Dakota Community Action Program (NESDCAP) and GROW South Dakota.

NESDEC operates under a Board of Directors selected from a twenty-two county geographical area. NESDEC's mission is to stimulate economic opportunities through loans, technical assistance and partnerships.

The primary purpose of NESDEC is to provide financing to small- and medium-sized businesses in its geographical area. NESDEC maintains a variety of revolving loan funds funded through various grant and loan programs. In addition, NESDEC also funds housing and other programs.

Financial Statement Presentation

NESDEC is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Comparative Financial Information

The financial statements include certain prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with NESDEC's financial statements for the year ended September 30, 2016, from which the summarized information was derived.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted net assets depending on the existence or nature of any donor restrictions.

Cash and Cash Equivalents

For purposes of the statement of cash flows, NESDEC considers all highly liquid securities with an initial maturity date of three months or less to be cash equivalents. Certificates of deposits, regardless of maturity, are not considered to be cash and cash equivalents. Loan guarantee - certificates of deposit are not considered cash or cash equivalents.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Receivables and Credit Policies

Notes receivable are stated at principal amounts plus accrued interest and are collateralized. Payments on notes receivable that are received after a 10-day grace period are assessed a delinquency fee between \$7.50 and 10% of the loan payment. Due to the uncertainty regarding collection, delinquency fees are recognized as income when received.

A note receivable is considered delinquent when the debtor has missed two or more payments. Loans placed on non-accrual status are determined by the board of directors. Interest resumes when principal on non-accrual status loans has been paid current. Management reviews the status of the past due notes and collection proceedings begin as management deems necessary.

Payments of notes receivable are allocated first to accrued and unpaid interest with the remainder to the outstanding principal balance. Interest income is recognized when due.

The carrying amount of loan receivables is reduced by a valuation allowance that reflects management's best estimate of the amounts that will not be collected. Management reviews all notes receivable and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. Additionally, management applies a risk rating calculation based upon various factors including collectability, collateral and ability to make payments to the aggregate remaining loan receivables to estimate a general allowance covering those amounts. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. It is at least reasonably possible this estimate will change within the next year.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the un-collectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Department of Agriculture requires a reserve for loan loss of 6% on the outstanding Intermediary Relending Program (IRP) loan balances and 5% on the outstanding Rural Microentrepreneur Assistance Program (RMAP) loan balances. The Small Business Administration requires a reserve for loan loss of 15% of microloan loan balances.

A loan is considered to be impaired when, based on current information and events, it is probable that NESDEC will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Guarantees - Certificates of Deposit

NESDEC pledges certificates of deposit to lending institutions as security for loans to individuals and businesses who otherwise would not acquire the loans due to their financial condition. When the loans are fully paid back, the lending institution releases the certificates of deposit back to NESDEC. Interest earned on the certificates of deposit is not part of the security agreement and is paid to NESDEC.

Property and Equipment

Purchased property and equipment in excess of \$5,000 are recorded at cost. Donated property and equipment is valued at estimated fair value on the date donated and are reported as unrestricted contributions when placed in service unless the donor has restricted the use for the asset to a specific purpose or time period. Contributions of cash or other assets that must be used to acquire property and equipment are reported as increases in temporarily restricted net assets until the assets are acquired and placed in service as instructed by the donor, unless the donor has also required that the acquired asset be used for a specific purpose or time period. If the donor requires property and equipment to be used for a specific purpose, restrictions on net assets are released as the asset is depreciated. If the donor requires property and equipment to be used for a specific time period, restrictions on net assets are released evenly over the period required.

Costs in excess of \$5,000 for renewals and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Costs for maintenance and repairs are charged to expense currently. When depreciable properties are retired or sold, the cost and related accumulated depreciation are eliminated from the accounts and the resultant gain or loss is reflected in income.

Depreciation is provided for over the estimated useful lives of the individual assets using the straight-line method. The estimated useful lives used in the computation of depreciation are as follows:

	<u>Years</u>
Buildings	7-40
Equipment	5-7
Vehicles	5

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Investments with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets. Investment income and gains restricted by a donor are reported as increases in unrestricted net assets if the restrictions are met (either by passage of time or by use) in the reporting period in which the income and gains are recognized.

Inputs to the fair value methodology include:

- | | |
|---------|---|
| Level 1 | Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date |
| Level 2 | Inputs other than quoted prices included within Level 1 that are observable for the asset either directly or indirectly. Level 2 Inputs include the following: <ul style="list-style-type: none">• Quoted prices for similar Assets or Liabilities in active markets;• Quoted prices for similar Assets or Liabilities in markets that are not active;• Inputs other than quoted prices that are observable for the asset or liability;• Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs) If the asset or liability has a specified (or contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability |
| Level 3 | Inputs are unobservable inputs for the asset or liability. |

Investments in equity securities without readily determinable fair value are stated at cost, net of a valuation allowance. NESDEC periodically reviews these securities for possible impairment to determine the level of the valuation allowance.

Foreclosed Property and Other Real Estate Owned

Real estate and other properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Impairment losses on property to be held and used are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. The portion of interest costs relating to development of real estate is capitalized. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates

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

Restricted and Unrestricted Revenue and Support

Federal grant awards received for specific purposes are recognized as support to the extent of related expenses incurred in compliance with the specific restrictions. The unexpended funds are reported as deferred revenue on the statement of financial position. It is policy of NESDEC to record restricted grants whose restrictions are met in the same reporting period as unrestricted grants.

Fund Raising Activity

NESDEC does not maintain a formal fund raising or solicitation department. Currently, it does not conduct fund raising campaigns, door-to-door solicitations, telethons, mass mailings or special fund raising events. The program directors do, however, compile data and applications necessary to renew and obtain new grants. NESDEC does not track costs associated with this activity, but believes the time and cost for this activity represents a very small percentage of the program directors' time. Accordingly, fund raising expense is not segregated and presented in the financial statements.

Salaries and Benefits

NESDEC does not incur payroll, but reimburses affiliate for wages and benefits paid for common employees.

Advertising

NESDEC expenses the costs of advertising as incurred.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 1 - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

NESDEC is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. In addition, NESDEC qualifies for the charitable contribution deduction under Section 170(b)(10)(A) and has been classified as an organization other than a private foundation under Section 509(a)(2).

NOTE 2 – CUSTODIAL CREDIT RISK - DEPOSITS

NESDEC maintains cash balances at several financial institutions located in South Dakota. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. In addition, certain financial institutions obtained additional bank deposit guaranty bonds to cover balances not insured by FDIC. As of September 30, 2017, NESDEC had no uninsured cash balances.

NOTE 3 - TEMPORARILY RESTRICTED ASSETS AND LIABILITIES

a. Temporarily Restricted Cash

Temporary restricted cash is comprised of balances that are restricted for certain types of loans and related loan losses as follows:

	<u>2017</u>	<u>2016</u>
Rural Development	\$ 2,046,666	\$ 2,249,558
Other	<u>1,541,351</u>	<u>995,417</u>
	<u>\$ 3,588,017</u>	<u>\$ 3,244,975</u>

b. Temporarily Restricted Certificates of deposits

Rural Development	\$ 1,057,500	\$ 1,907,500
Other	<u>-</u>	<u>150,000</u>
	<u>\$ 1,057,500</u>	<u>\$ 2,057,500</u>

c. Temporarily Restricted Accrued Interest Receivable

Rural Development	\$ 27,313	\$ 25,838
Other	<u>4,897</u>	<u>5,403</u>
	<u>\$ 32,210</u>	<u>\$ 31,241</u>

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota

NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 3 - TEMPORARILY RESTRICTED ASSETS AND LIABILITIES (Continued)

	<u>2017</u>	<u>2016</u>
d. Temporarily Restricted Other Receivables		
Rural Development	\$ -	\$ -
Other	<u>5,467</u>	<u>-</u>
	<u>\$ 5,467</u>	<u>\$ -</u>
e. Temporarily Restricted Due From Other Governments		
Rural Development	\$ -	\$ 1,421
Other	<u>12,275</u>	<u>53,072</u>
	<u>\$ 12,275</u>	<u>\$ 54,493</u>
f. Temporarily Restricted Notes Receivable		
Rural Development	\$ 7,880,845	\$ 8,229,184
Other	1,687,123	1,766,197
Allowance for loan losses	<u>(592,382)</u>	<u>(633,196)</u>
	<u>\$ 8,975,586</u>	<u>\$ 9,362,185</u>
g. Temporarily Restricted Other Real Estate Owned		
Rural Development	\$ 54,688	\$ 51,115
Other	<u>-</u>	<u>85,611</u>
	<u>\$ 54,688</u>	<u>\$ 136,726</u>
h. Temporarily Restricted Current Liabilities (excluding current portion of long-term debt)		
Rural Development	\$ 81,525	\$ 88,219
Other	<u>622,312</u>	<u>7,684</u>
	<u>\$ 703,837</u>	<u>\$ 95,903</u>
i. Temporarily Restricted Notes Payable		
Rural Development	\$ 4,901,400	\$ 5,886,760
Other	<u>2,026,492</u>	<u>2,473,273</u>
	<u>\$ 6,927,892</u>	<u>\$ 8,360,033</u>

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE

NESDEC has 309 notes receivable totaling \$15,344,165. Interest rates range from 0% to 8.25%. Each note has its own repayment schedule and interest rate. The notes permit principal repayment at any time without penalty. Approximately 90% of the notes receivable portfolio serves as collateral for debt (See Note 9).

The purpose of the loan fund is to provide flexible and accessible loans primarily gap financing that will strengthen, create, or save businesses and job opportunities. A summary of notes receivable by portfolio category as of September 30, 2017 and 2016 follows:

	<u>2017</u>	<u>2016</u>
Commercial Loans	\$ 14,084,562	\$ 13,089,154
Housing Loans	<u>2,068,528</u>	<u>1,940,566</u>
Total Loans	\$ 16,153,090	\$ 15,029,720
Less allowance for loan losses	<u>(808,925)</u>	<u>(821,295)</u>
Total Notes Receivable, net of Allowances	<u>\$ 15,344,165</u>	<u>\$ 14,208,425</u>

Allowance for Loan Losses

The following table presents the activity in the allowance for loan losses for the year ended September 30, 2017, by portfolio segment.

Year Ended September 30, 2017	Commercial	Housing	Total
Allowance for Loan Losses			
Balance, beginning of year	\$ 735,557	\$ 97,028	\$ 832,585
Provision for loan losses	19,959	6,398	26,357
Net recoveries (charge offs)	<u>(38,002)</u>	<u>-</u>	<u>(38,002)</u>
Balance, end of year	<u>\$ 717,514</u>	<u>\$ 103,426</u>	<u>\$ 820,940</u>

NESDEC individually reviews each loan where all or a portion of the balance exceeds 90 days past due. Based on the assessment of the borrower's current creditworthiness, NESDEC adjusts the borrower's risk category which is used to calculate the portion, if any, of the balance that will not be collected. Additionally, on the aggregate remaining loan receivables, NESDEC estimates an allowance covering those amounts not specifically identified based on the risk category assigned at the borrower's last loan update.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE (Continued)

The ending balance in the allowance for loan loss is attributed to loans evaluated individually and loans evaluated collectively as follows:

Year Ended September 30, 2017	Allowance for Loan Losses		
	Commercial	Housing	Total
Individually evaluated for impairment	\$ 90,615	\$ -	\$ 90,615
Collectively evaluated for impairment	<u>626,899</u>	<u>103,426</u>	<u>730,325</u>
Balance, end of year	<u>\$ 717,514</u>	<u>\$ 103,426</u>	<u>\$ 820,940</u>

The balance of loans evaluated individually and loans evaluated collectively are as follows:

Year Ended September 30, 2017	Notes Receivable Balances		
	Commercial	Housing	Total
Individually evaluated for impairment	\$ 303,146	\$ -	\$ 303,146
Collectively evaluated for impairment	<u>13,781,416</u>	<u>2,068,528</u>	<u>15,849,944</u>
Balance, end of year	<u>\$ 14,084,562</u>	<u>\$ 2,068,528</u>	<u>\$ 16,153,090</u>

Credit Quality Indicators

NESDEC categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt including current financial information, historical payment experience, collateral adequacy, credit documentation, public information, current economic trends, and other factors. NESDEC analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger loans such as business loans. This analysis is performed on an ongoing basis as new information is obtained. NESDEC uses the following definitions for risk ratings for business loans:

Prime - Loans with a rating of prime are very low risk. The borrower is in a strong financial position and able to withstand adversity to the business. The business owner typically has a very high credit score, a track record of proven management ability, strong character and there is adequate collateral for the loan or loans. Repayment ability is proven by borrower's financial history and there is adequate cash flow to show a margin for adversity.

Desirable - Loans with this rating present a lower risk to NESDEC than many other loans but they are not as strong as loans rated prime. Losses from loans in this category would be rare. These loans are generally strong in all areas but are more subject to adversity than prime loans. There may be one or more areas with some minor weakness or vulnerabilities.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE (Continued)

Satisfactory - These are average loans for NESDEC's portfolio. They are strong enough to show repayment and collateral coverage but typically show one or more weaknesses. There may be narrow margins for repayment and collateral coverage. The credit scores for the principals may be average or slightly below average. Adversity can quickly affect this type of loan and result in a lower risk rating when updated.

Watch - These loans have one or more definite weaknesses, which may include factors such as a lack of sufficient collateral, weaker cash flows, management weaknesses, poor credit ratings of the principal owners/managers or other risks. Loans with this initial risk rating should not be made unless there are ways identified to reduce NESDEC's risk such as additional collateral, other supporting income or a strong guarantor.

Doubtful - New applications with this rating should not be approved. Existing loans with this rating have proven to be high risk by their performance. They are past due or cannot reasonably demonstrate the ability to repay the loan. Collateral is often inadequate, deteriorated or missing. Loans with this risk rating assigned are typically already having problems with repayment. A loan rated doubtful has a reasonable chance for at least partial repayment.

Projected Loss - A loan designated as projected loss means our best estimate shows NESDEC will experience a partial or total loss of its loan funds. These loans have similar risk characteristics as the Doubtful category. The primary difference is that loan officers are able to make a reasonable estimate of what the expected loss will be. Projected loss loans should be presented to the board for partial or complete charge off.

NESDEC categorizes housing loans into the satisfactory risk category because of the first mortgage collateral position on residential loans. Satisfactory rated loans require the minimum 5% reserve.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE (Continued)

Based on the most recent analysis performed, the risk category of loans by class of loans as of September 30, 2017 is as follows:

Credit Risk Profile by Internally Assigned Grade

Year Ended September 30, 2017	<u>2017</u>		
	Commercial	Housing	Total
Prime	\$ 1,325,128	\$ -	\$ 1,325,128
Desirable	5,934,989	-	5,934,989
Satisfactory	5,118,954	2,068,528	7,187,482
Watch	1,569,089	-	1,569,089
Doubtful	136,402	-	136,402
Projected Loss	-	-	-
Total	\$ 14,084,562	\$ 2,068,528	\$ 16,153,090

Credit Risk Profile by Class Based on Payment Activity

Commercial and housing loans are managed on an individual basis. Loans that are delinquent 90 days or more or are not accruing interest are considered nonperforming. The following table presents the recorded investments in loans by class based on payment activity as of September 30, 2017.

Year Ended September 30, 2017	Performing	Nonperforming	Total
Commercial	\$ 13,928,882	\$ 155,680	\$ 14,084,562
Housing	2,068,528	-	2,068,528
Total	\$ 15,997,410	\$ 155,680	\$ 16,153,090

The following table summarizes the aging of the past due loans by loan class within the portfolio segments as of September 30, 2017.

Year Ended September 30, 2017	Current	Still Accruing		Nonaccrual Balance
		30-89 Days Past Due	Over 90 Days Past Due	
		Commercial	\$ 13,845,364	
Housing	2,051,396	17,132	-	-
Total	\$ 15,896,760	\$ 100,650	\$ 55,675	\$ 100,005

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE (Continued)

Impaired loans are loans assigned to a risk category of “doubtful” or “projected loss”. The following table summarizes individually impaired loans by class of loans as of September 30, 2017:

Year Ended September 30, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With an allowance recorded:				
Commercial	\$ 136,402	\$ 136,402	\$ 75,145	\$ 3,331
Housing	-	-	-	-
Total	<u><u>\$ 136,402</u></u>	<u><u>\$ 136,402</u></u>	<u><u>\$ 75,145</u></u>	<u><u>\$ 3,331</u></u>

There are no impaired loans without an allowance recorded.

The following table presents NESDEC’s impaired and nonaccrual loans as of September 30, 2017 and 2016:

	2017	2016
Impaired loans with a valuation allowance	\$ 136,402	\$ 242,760
Total impaired loans	136,402	242,760
Valuation allowance related to impaired loans	75,145	129,356
Total nonaccrual loans	100,005	111,679
Total loans 90 days or more past due and still accruing	55,675	139,637
Average investment in impaired loans	27,280	27,379
Interest income recognized on impaired loans	3,331	6,777

Loan Modifications and Troubled Debt Restructuring

Modifications of terms for loans and their inclusion as troubled debt restructurings are based on individual facts and circumstances. Loan modifications that are included as troubled debt restructurings may involve reduction of the interest rate or renewing at an interest rate below current market rates, extension of the term of the loan and/or forgiveness of principal, regardless of the period of modification.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 4 - NOTES RECEIVABLE (Continued)

Loan Modifications and Troubled Debt Restructuring, continued

The following table represents the effects of the troubled debt restructuring during the year ended September 30, 2017:

Year Ended September 30, 2017	Number of Contracts	Outstanding Recorded Investment	
		Pre-Modification	Post-Modification
Troubled debt restructurings:			
Commercial	6	\$ 357,834	\$ 357,834
Housing	-	-	-
Troubled debt restructurings that subsequently defaulted:			
Commercial	6	57,049	57,049
Housing	-	-	-

During the year ended September 30, 2017, the concessions granted to certain borrowers included extending the payment due dates and lowering the contractual interest rate and did not include reducing accrued interest or reducing the debt's face or maturity amount.

At the time of the restructuring, the loan is evaluated for an asset-specific allowance for credit losses. NESDEC continues to specifically reevaluate the loan in subsequent periods, regardless of the borrower's performance under the modified terms. If the loan defaults after restructuring it is written off with board approval.

NOTE 5 - OTHER REAL ESTATE OWNED

Other real estate owned consists of the following as of September 30, 2017 and 2016:

	<u>2017</u>		<u>2016</u>	
	<u>Number of Properties</u>	<u>Carrying Amount</u>	<u>Number of Properties</u>	<u>Carrying Amount</u>
Commercial Property	2	\$ 54,688	3	\$ 89,467
Residential Property	<u>1</u>	<u>40,238</u>	<u>2</u>	<u>87,497</u>
Total	<u>3</u>	<u>\$ 94,926</u>	<u>5</u>	<u>\$ 176,964</u>

Properties are carried at fair value, less estimated costs to sell. If the value decreases during the holding period, the property is written down with a charge to loan program expense. All properties are being actively marketed for sale and management monitors these properties to minimize any losses.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 6 - LOAN GUARANTEES – CERTIFICATES OF DEPOSIT

NESDEC pledges certificates of deposit to lending institutions as security for loans to individuals and businesses who otherwise would not acquire the loans due to their financial condition. When the loans are fully paid back, the lending institution releases the certificates of deposit back to NESDEC. Interest earned on the certificates of deposit is not part of the security agreement and is paid to NESDEC.

CD pledge guarantees as of September 30, 2017 and 2016, is as follows:

	<u>2017</u>	<u>2016</u>
CD pledge guarantees	\$ 159,100	\$ 92,950
Allowance for loan losses	<u>(12,015)</u>	<u>(11,290)</u>
	<u>\$ 147,085</u>	<u>\$ 81,660</u>

Changes in the allowance for loan losses are as follows:

	<u>2017</u>	<u>2016</u>
Balance, beginning of the year	\$ 11,290	\$ 11,450
Provision for loan losses	<u>725</u>	<u>(160)</u>
	<u>\$ 12,015</u>	<u>\$ 11,290</u>

NOTE 7 - PROPERTY AND EQUIPMENT

Property and equipment is as follows:

	<u>2017</u>	<u>2016</u>
Buildings	\$ 818,477	\$ 812,458
Land	142,506	142,506
Office equipment	22,771	30,771
Vehicles	<u>14,050</u>	<u>14,050</u>
	997,804	999,785
Less: accumulated depreciation	<u>(220,130)</u>	<u>(204,620)</u>
	<u>\$ 777,674</u>	<u>\$ 795,165</u>

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 8 - INVESTMENTS

Securities With Readily Determinable Fair Value

Fair value of investments measured on a recurring basis at September 30, 2017, are as follows:

	<u>Fair Value Measurements at Reporting Date Using</u>			
	Fair Value Balance at 9/30/2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
CDC Bancshares, Inc.	<u>908,660</u>	<u>-</u>	<u>908,660</u>	<u>-</u>
	<u>\$ 908,660</u>	<u>\$ -</u>	<u>\$ 908,660</u>	<u>\$ -</u>

NESDEC owns a 19% interest in CDC Bancshares, Inc. at a total cost of \$908,660. The entity is a bank holding company organized under the laws of the state of Minnesota. The holding company owns Community Development Bank, including Community Development Insurance, which had assets of approximately \$83.5 million at September 30, 2017. At September 30, 2017 and 2016, CDB Bancshares, Inc. consisted of the following:

	<u>2017</u>	<u>2016</u>
CDC Bancshares, Inc.	\$ 545,095	\$ 545,095
Cumulative unrealized gain (loss)	<u>363,565</u>	<u>363,565</u>
	<u>\$ 908,660</u>	<u>\$ 908,660</u>

Securities Without Readily Determinable Fair Value

NESDEC has an investment in Great Opportunities, LLC, a South Dakota Limited Liability Company, formed in 2007. Great Opportunities selectively provides seed funding for start-up companies in need of equity capital. This investment is carried at cost, net of the valuation allowance.

At September 30, 2017 and 2016, Great Opportunities LLC, Securities Investment, consisted of the following:

	<u>2017</u>	<u>2016</u>
Great Opportunities LLC - cost	\$ 75,000	\$ 75,000
Valuation allowance	<u>(43,387)</u>	<u>(39,637)</u>
	<u>\$ 31,613</u>	<u>\$ 35,363</u>

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 8 – INVESTMENTS (Continued)

Investment return is summarized as follows:

Interest and dividend income	\$ -	\$ -
(Increase) in valuation allowance	<u>(3,750)</u>	<u>(3,150)</u>
	<u>\$ (3,750)</u>	<u>\$ (3,150)</u>

NESDEC has made minor Venture Capital Investments in two entities that promote economic development for a total cost of \$168,755 at September 30, 2017.

NOTE 9 - NOTES PAYABLE

Notes payable as of September 30, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Bank of America, unsecured, quarterly interest only payments, 3% interest, annual principal payments begin in 2020 with final payment due September 20, 2022	\$ 1,500,000	\$ 1,500,000
Community Development Financial Institutions, Financial Assistance, semi-annual interest only payments, 1.95% interest, principal due in three annual payments beginning on December 31, 2025, with final payment due April 16, 2028.	1,389,975	1,389,975
Wells Fargo Community Development Corporation - subordinated loan, quarterly interest payments only, 2.0% interest, principal due July 8, 2024, uncollateralized	750,000	750,000
Rural Development, collateralized by security interest in loans made with proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due on June 25, 2040	651,174	676,250

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 9 - NOTES PAYABLE (Continued)	<u>2017</u>	<u>2016</u>
Rural Development, collateralized by security interest in loans made with proceeds of this loan, annual interest payment to October 10, 2011, annual installments of \$31,838 start October 10, 2012, 1% interest, final payment due October 10, 2039	\$ 625,849	\$ 651,176
Rural Development, collateralized by security interest in loans made with proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due on March 14, 2037	574,433	600,268
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due June 7, 2035	522,334	548,685
Dakota Resources, quarterly interest payments only of \$4,500, 3.6% interest, final payment due December 1, 2018	500,000	500,000
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$42,450, (interest payments only for first three years), 1% interest, final payment due October 8, 2028	477,654	514,954
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$31,838 (interest payments only for first three years), 1% interest, final payment due August 14, 2033	468,483	495,368

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
 SEPTEMBER 30, 2017

NOTE 9 - NOTES PAYABLE (Continued)	<u>2017</u>	<u>2016</u>
SBA, collateralized by security interest in loans made with the proceeds of this loan, monthly installments begin in month 13 and are calculated based on current balance, 1.625%, final payment due October 14, 2025, with \$325,000 in funds remaining to draw	\$ 463,363	\$ 175,000
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due February 15, 2031	413,895	441,319
Rural Development, Rural Microentrepreneur Assistance Program (RMAP), collateralized by security interest in loans made with the proceeds of this loan, monthly principal and interest payments of \$2,842, 2% interest, final payment due December 20, 2030	394,446	420,412
Rural Development, collateralized by security interest in loans made with proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due on October 1, 2042	386,924	399,721
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$31,838, (interest payments only for first three years), 1% interest, final payment due February 10, 2030	386,208	413,907
Small Business Lending Fund, Community Development Financial Institutions, EQ2 Securities - subordinated loan, quarterly interest only payments, 2% interest, principal due September 21, 2019	325,000	1,000,000

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 9 - NOTES PAYABLE (Continued)	<u>2017</u>	<u>2016</u>
Wells Fargo Community Investment Holdings – Subordinated loan, quarterly interest payments only 2.0% interest, principal due July 27, 2020, uncollateralized	\$ 250,000	\$ 250,000
SBA, collateralized by security interest in loans made with the proceeds of this loan, monthly installments of \$5,230, 2.125%, final payment due May 12, 2021, all funds were drawn	238,129	298,273
Venture Communications Cooperative, annual interest only payments, 1% interest, due February 1 st ; principal due at maturity on February 1, 2026.	100,000	100,000
Rural Electric Economic Development (REED), (Whetstone Valley Electric), 0% interest, monthly principal payments of \$1,852, due August 16, 2018, collateralized by real estate mortgage	20,356	42,580
Rural Development, collateralized by security interest in loans made with the proceeds of this loan, annual installments of \$84,900, 1% interest, final payment due December 8, 2024.	-	<u>724,700</u>
Total	\$ 10,438,223	\$ 11,892,588
Less: Current portion	<u>(401,408)</u>	<u>(437,374)</u>
	<u>\$ 10,036,815</u>	<u>\$ 11,455,214</u>

Interest expense for the year ending September 30, 2017 and 2016, respectively, was \$190,422 and \$222,815.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 9 - NOTES PAYABLE (Continued)

The estimated minimum principal payments due in the next five years are as follows:

2018	\$ 401,408
2019	1,209,700
2020	1,138,463
2021	883,947
2022	832,993
Thereafter	<u>5,971,712</u>
	<u>\$ 10,438,223</u>

NOTE 10 - COMMITMENTS, CONTINGENT LIABILITIES AND CONCENTRATION OF CREDIT RISK

NESDEC participates in a number of federal and private grant programs. These programs are subject to program compliance audits by the grantors or their representatives. Compliance with applicable grant requirements for grants whose grant periods have not expired will be established at some future date. In the opinion of management, the amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although they expect such amounts, if any, to be immaterial.

NESDEC pledges certificates of deposit as security to guarantee loans of others (see Note 6). The amount of the certificates pledged approximate the Organization's exposure to liability in the event of loan defaults. The carrying amount of NESDEC's liability obligations under the guarantees is zero. As of September 30, 2017, the terms of the CD pledge guarantees range from one year renewable guarantees to ten years, with the average term being approximately six years. Should any of the parties default on their loan, NESDEC would be responsible for any shortfall after liquidation of all collateral, limited to the amount of the CD pledged. NESDEC requires assignment of bank security and collateral to support financial instruments subject to credit risk.

NESDEC, as part of its normal business operations, grants credit in the form of notes receivable to businesses located primarily in the northeastern South Dakota area. The maximum amount of loss due to credit risk is equal to the outstanding balance on the notes. Risk ratings are reviewed annually on all notes, which include assessment of collateral and financial condition of the business. Allowances for loan losses are calculated from the risk ratings. NESDEC's policy is to review collateral and financial statements of the businesses on an annual basis. Collateral is required on all loans, typically a first lien or shared first lien on assets. NESDEC seeks to obtain the most secure position possible, including collateral such as inventory, equipment, accounts receivable, mortgages, vehicle liens and personal guarantees.

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 10 - COMMITMENTS, CONTINGENT LIABILITIES AND CONCENTRATION OF CREDIT RISK (Continued)

Other current liabilities is a Loan Loss Reserve that was transferred to NESDEC by USDA Rural Development when NESDEC acquired another intermediary's loans. The liability will remain for the term of the loans acquired. If no losses occur, funds will be returned to Rural Development. If a loss occurs, NESDEC will reduce the amount of the liability.

NOTE 11 - RELATED PARTY TRANSACTIONS

Northeast South Dakota Community Action Program (NESDCAP) is a nonprofit organization that promotes health, education and social and economic welfare to low-income, minority and disadvantage persons. NESDEC employees are also employed by NESDCAP. NESDEC reimburses NESDCAP for salaries, employee benefits and various administrative costs which amounted to approximately \$478,418 for the year ended September 30, 2017.

NESDEC has deposits with banks that employ some of the members of the Board of Directors. The lending expertise of these board members is utilized in assessing NESDEC's loan portfolio. NESDEC has deposits totaling \$337,620 at financial institutions employing NESDEC board members.

NESDEC also has a direct loan receivable totaling \$1,000,000 with Grow South Dakota, an affiliate.

During 2012, NESDEC entered into an agreement with Venture Communications to administer their Revolving Loan Fund. A NESDEC board member is a key employee of Venture Communications.

NOTE 12 - RETIREMENT PLAN

NESDCAP, an affiliate of NESDEC, maintains a defined contribution Simplified Employee Pension Plan. Substantially, all employees meeting certain eligibility requirements are covered by this plan. NESDCAP may contribute up to 15% of total employee compensation to the plan. However, the Board has set the percentage at 10%. Total employer contributions to this plan were \$128,463 for the fiscal year ended September 30, 2017, of which NESDEC paid \$70,492.

NOTE 13 - SUBSEQUENT EVENTS

Events occurring after September 30, 2017, were evaluated by management on December 27, 2017, the date the financial statements were available to be issued, to ensure that any subsequent events that met the criteria for recognition and/or disclosure in these financial statements have been included.

The following events and transactions occurred subsequent to December 27, 2017:

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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NOTES TO FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2017

NOTE 13 - SUBSEQUENT EVENTS (Continued)

In October 2017, NESDEC made a \$758,000 investment into CDC Bancshares Inc. for the purchase of a bank branch in St. Michaels, Minnesota. The commitment for this purchase was approved by the Board of Directors at a meeting held on April 13, 2017. The acquisition maintains NESDEC's 19% interest in CDC Bancshares Inc.

SUPPLEMENTARY INFORMATION

NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED SEPTEMBER 30, 2017

<u>Federal Grantor/Pass-Through Grantor Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Disbursements/ Expenditures</u>
U.S. DEPARTMENT OF TREASURY Direct Funding Community Development Financial Institution Fund - Financial Assistance - Note 3	21.020	\$ <u>1,025,260</u>
Total U.S. Department of Treasury		<u>1,025,260</u>
U.S. SMALL BUSINESS ADMINISTRATION Direct Funding: Microloan Program - Project Grant	59.046	<u>47,384</u>
Total U.S. Small Business Administration		<u>47,384</u>
U.S. DEPARTMENT OF AGRICULTURE - RURAL DEVELOPMENT Direct Funding: Intermediary Relending Program - Note 3 Rural Microentrepreneur Assistance Program - Project Grant	10.767 10.870	5,466,348 <u>34,282</u>
Total U.S. Department of Agriculture - Rural Development		<u>5,500,630</u>
Total Federal Funding		<u>\$ 6,573,274</u>

Note 1: Basis of Presentation

This accompanying Schedule of Expenditures of Federal Awards includes the federal award activity of the Northeast South Dakota Economic Corporation under programs of the federal government for the year ended September 30, 2017. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Northeast South Dakota Economic Corporation, it is not intended to, and does not present the financial position, changes in net assets, or cash flows of the organization.

Note 2: Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance and/or OMB Circular A-122, Cost Principles for Non-profit Organizations, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

The Northeast South Dakota Economic Corporation has not elected to use the 10% de minimis cost rate.

<u>Note 3: Federal Loan Programs</u>	<u>Federal CFDA Number</u>	<u>Outstanding Balance</u>
The outstanding balances of federal loans at September 30, 2017 were as follows:		
U.S. Department of Agriculture - Intermediary Relending Program	10.767	\$ 4,506,954
U.S. Department of Agriculture - Rural Microentrepreneur Assistance Program	10.870	394,446
U.S. Department of Treasury - Small Business Lending Fund	21.020	325,000
U.S. Department of Treasury - Community Development Financial Institutions Program	21.020	1,389,975
U.S. Small Business Administration	59.046	<u>701,492</u>
		<u>\$ 7,317,867</u>

*Wahlenberg
Ritzman & Co., LLC*
certified public accountants

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

To the Board of Directors
Northeast South Dakota Economic Corporation
dba GROW South Dakota
Sisseton, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Northeast South Dakota Economic Corporation dba GROW South Dakota (a nonprofit organization, hereafter referred to as NESDEC), which comprise the statement of financial position as of September 30, 2017, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered NESDEC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of NESDEC's internal control. Accordingly, we do not express an opinion on the effectiveness of NESDEC's internal control.

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Yankton Office	207 Douglas Avenue	PO Box 1018	Yankton, SD 57078	605.665.4401
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Member of: Private Companies Practice Section American Institute of CPA's, South Dakota Society of CPA's



A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether NESDEC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

Wohlschlag Ritzman + Co., LLC

Yankton, South Dakota
December 27, 2017

*Wahlenberg
Ritzman & Co., LLC*
certified public accountants

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM
GUIDANCE

To the Board of Directors
Northeast South Dakota Economic Corporation
dba GROW South Dakota
Sisseton, South Dakota

Report on Compliance for Each Major Federal Program

We have audited Northeast South Dakota Economic Corporation dba GROW South Dakota's (a nonprofit organization, hereafter referred to as NESDEC) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of NESDEC's major federal programs for the year ended September 30, 2017. NESDEC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

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Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of NESDEC's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about NESDEC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of NESDEC's compliance.

Opinion on Each Major Federal Program

In our opinion, NESDEC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2017.

Report on Internal Control Over Compliance

Management of NESDEC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered NESDEC's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of NESDEC's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Wohlberg Ritzman + Co., LLC

Yankton, South Dakota
December 27, 2017

**NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota**

**SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS
SEPTEMBER 30, 2017**

SECTION II – FINANCIAL STATEMENT AUDIT

There were no prior audit financial statement audit findings reported.

SECTION III – MAJOR FEDERAL AWARD PROGRAMS AUDIT

There were no prior major federal award program findings reported.

**NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED SEPTEMBER 30, 2017**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unmodified

Internal Control over financial reporting:
Material weakness(es) identified? _____ yes X no
Significant deficiency(ies) identified? _____ yes X none reported

Noncompliance material to financial statements noted? _____ yes X no

Federal Awards

Internal Control over major programs:
Material weakness(es) identified? _____ yes X no
Significant deficiency(ies) identified? _____ yes X none reported

Type of auditor's report issued on compliance
for major programs: Unmodified

Any audit findings disclosed that are required to be
reported in accordance with the Uniform Guidance
2 CFR 200.516(a)? _____ yes X no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.767	Intermediary Relending Program

Dollar threshold used to distinguish
between Type A and Type B Programs: \$750,000

Auditee qualified as low-risk auditee? X yes _____ no

**NORTHEAST SOUTH DAKOTA ECONOMIC CORPORATION
dba GROW South Dakota**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – continued
YEAR ENDED SEPTEMBER 30, 2017

SECTION II – FINANCIAL STATEMENT AUDIT

There are no financial statement audit findings to report.

SECTION III – MAJOR FEDERAL AWARD PROGRAMS AUDIT

There are no federal award program findings to report.