

# Levi, Ray & Shoup, Inc. and Subsidiaries

Consolidated Financial Report  
(with Independent Auditor's Report Thereon)  
July 31, 2018

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## Independent Auditor's Report

To the Stockholders  
Levi, Ray & Shoup, Inc. and Subsidiaries

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Levi, Ray & Shoup, Inc. and Subsidiaries (Company), which comprise the consolidated balance sheets as of July 31, 2018 and 2017, the related consolidated statements of comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, 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.

### Auditor's Responsibility

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

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

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

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Levi, Ray & Shoup, Inc. and Subsidiaries as of July 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***RSN US LLP***

Springfield, Illinois


October 30, 2018

Levi, Ray & Shoup, Inc. and Subsidiaries

Consolidated Balance Sheets  
July 31, 2018 and 2017

	2018	2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 36,825,932	\$ 37,979,480
Marketable securities - trading	3,608,290	-
Marketable securities - available-for-sale	5,945,053	6,262,457
Accounts receivable	61,851,327	49,984,852
Prepaid expenses and other assets	6,274,195	5,560,535
<b>Total current assets</b>	<b>114,504,797</b>	<b>99,787,324</b>
Property and equipment, net	30,456,696	32,175,999
Marketable securities - available-for-sale	73,189,884	73,735,376
Other assets	9,581,176	9,299,879
Amortizable intangible assets, net	380,000	760,000
Goodwill, net	7,296,516	9,883,559
<b>Total assets</b>	<b>\$ 235,409,069</b>	<b>\$ 225,642,137</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 9,196,909	\$ 7,892,323
Accrued income taxes	947,892	1,115,809
Accrued expenses and other current liabilities	15,243,650	15,477,840
Current portion of deferred gain	91,079	218,585
Deferred revenue	79,524,480	75,236,298
<b>Total current liabilities</b>	<b>105,004,010</b>	<b>99,940,855</b>
Long-term liabilities:		
Deferred gain, less current portion	-	91,079
Deferred revenue, less current portion	8,615,989	3,078,982
<b>Total long-term liabilities</b>	<b>8,615,989</b>	<b>3,170,061</b>
<b>Total liabilities</b>	<b>113,619,999</b>	<b>103,110,916</b>
Commitments and contingencies (Notes 5, 9, 12 and 14)		
Stockholders' equity:		
Common stock:		
Voting, no par value; 100 shares authorized, 50 shares issued and outstanding	25	25
Non-voting, no par value; 1900 shares authorized, 950 shares issued and outstanding	475	475
Additional paid-in capital	978,295	978,295
Undistributed Subchapter S earnings	120,248,531	119,478,075
Accumulated other comprehensive income	561,744	2,074,351
<b>Total stockholders' equity</b>	<b>121,789,070</b>	<b>122,531,221</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 235,409,069</b>	<b>\$ 225,642,137</b>

See notes to consolidated financial statements.

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**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Consolidated Statements of Comprehensive Income  
Years Ended July 31, 2018 and 2017**

	2018	2017
Revenue:		
Software sales	\$ 99,383,561	\$ 94,042,487
Software maintenance	43,859,484	41,431,219
Hardware sales	41,012,670	36,170,254
Consulting services	52,252,153	47,050,959
Other operating revenue	10,641,427	9,138,059
<b>Total revenue</b>	<b>247,149,295</b>	<b>227,832,978</b>
Costs and expenses:		
Compensation and related expenses	94,568,085	87,241,334
Cost of hardware sold	32,394,047	28,595,247
Depreciation and amortization	5,628,426	5,161,993
Other operating expenses	59,416,244	53,806,844
<b>Total costs and expenses</b>	<b>192,006,802</b>	<b>174,805,418</b>
<b>Income before other income and income taxes</b>	<b>55,142,493</b>	<b>53,027,560</b>
Other income, net	2,675,158	3,488,344
<b>Income before income taxes</b>	<b>57,817,651</b>	<b>56,515,904</b>
Provision for income taxes	3,047,195	2,603,959
<b>Net income</b>	<b>54,770,456</b>	<b>53,911,945</b>
Other comprehensive loss:		
Unrealized loss on marketable securities arising during the year	(1,512,607)	(2,034,784)
<b>Comprehensive income</b>	<b>\$ 53,257,849</b>	<b>\$ 51,877,161</b>

See notes to consolidated financial statements.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Consolidated Statements of Stockholders' Equity  
Years Ended July 31, 2018 and 2017**

	Shares		Common Stock			Additional Paid-In Capital	Undistributed Subchapter S Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Amount	Shares	Voting Amount	Non-voting Shares	Amount				
Balance, July 31, 2016	50	\$ 500	-	\$ -	-	\$ 978,295	\$ 109,566,130	\$ 4,109,135	\$ 114,654,060
Conversion of common stock to voting and non-voting common stock (Note 1)	(50)	(500)	50	25	950	475	-	-	-
Net income	-	-	-	-	-	-	53,911,945	-	53,911,945
Other comprehensive loss	-	-	-	-	-	-	-	(2,034,784)	(2,034,784)
Cash dividends	-	-	-	-	-	-	(44,000,000)	-	(44,000,000)
Balance, July 31, 2017	-	-	50	25	950	475	119,478,075	2,074,351	122,531,221
Net income	-	-	-	-	-	-	54,770,456	-	54,770,456
Other comprehensive loss	-	-	-	-	-	-	-	(1,512,607)	(1,512,607)
Cash dividends	-	-	-	-	-	-	(54,000,000)	-	(54,000,000)
<b>Balance, July 31, 2018</b>	<b>-</b>	<b>\$ -</b>	<b>50</b>	<b>\$ 25</b>	<b>950</b>	<b>\$ 475</b>	<b>\$ 978,295</b>	<b>\$ 120,248,531</b>	<b>\$ 561,744</b>
									<b>\$ 121,789,070</b>

See notes to consolidated financial statements.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Consolidated Statements of Cash Flows**  
**Years Ended July 31, 2018 and 2017**

	2018	2017
<b>Cash flows from operating activities:</b>		
Net income	\$ 54,770,456	\$ 53,911,945
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,628,426	5,161,993
Amortization of premiums on investments in marketable securities	698,470	688,071
Loss (gain) on disposal of property and equipment, net	3,529	(11,682)
Accretion of deferred gain	(218,585)	(218,585)
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Accounts receivable	(11,866,475)	(280,858)
Marketable trading securities	(3,608,290)	-
Prepaid expenses and other current assets	(713,660)	(1,649,287)
Other assets	(281,297)	(851,127)
Increase (decrease) in liabilities:		
Accounts payable	964,230	1,758,519
Accrued expenses and other current liabilities	(402,107)	906,980
Deferred revenue	9,825,189	1,568,492
<b>Net cash provided by operating activities</b>	<b>54,799,886</b>	<b>60,984,461</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(605,255)	(1,801,385)
Proceeds from sale of property and equipment	-	20,900
Proceeds from maturities of marketable securities	5,730,000	10,240,000
Investment in marketable securities	(7,078,179)	(12,284,898)
Purchase of Cirrato (Note 14)	-	(6,195,397)
Purchase of Central Illinois Security, Inc. (Note 14)	-	(3,000,000)
<b>Net cash used in investing activities</b>	<b>(1,953,434)</b>	<b>(13,020,780)</b>
<b>Cash flows from financing activities:</b>		
Dividends paid	(54,000,000)	(44,000,000)
<b>Net cash used in financing activities</b>	<b>(54,000,000)</b>	<b>(44,000,000)</b>
<b>Change in cash and cash equivalents</b>	<b>(1,153,548)</b>	<b>3,963,681</b>
<b>Cash and cash equivalents:</b>		
Beginning of year	37,979,480	34,015,799
End of year	\$ 36,825,932	\$ 37,979,480

(Continued)



**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Consolidated Statements of Cash Flows (Continued)**  
**Years Ended July 31, 2018 and 2017**

	2018	2017
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest	\$ 2,373	\$ 4,781
Income taxes	\$ 3,215,112	\$ 2,880,587
Purchase of capital assets included in accounts payable	\$ 340,356	\$ -
Supplemental disclosure of other investing activities:		
Acquisition of Cirrato and CIS (see Note 14)		
Assets acquired:		
Accounts receivable	\$ -	\$ 60,236
Inventory	-	64,768
Furniture and equipment	-	100,599
Identifiable intangible assets	-	600,000
Goodwill	-	10,699,000
Liabilities assumed:		
Accounts payable and accrued expenses	-	(244,868)
Deferred revenue	-	(2,084,338)
Net cash paid for business acquisitions	\$ -	\$ 9,195,397

See notes to consolidated financial statements.

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies

**Business:** Levi, Ray & Shoup, Inc. (LRS) develops, sells, and maintains proprietary output management software in mainframe and open system markets that are sold in approximately 120 countries around the world. In addition, LRS provides information technology solutions, consulting and mainframe computer processing services, and resells IBM computer hardware.

LRS operates a marina business in Fort Myers, Florida, through its wholly-owned subsidiary, Diversified Yacht Services, Inc. (DYS) and a commercial and residential security business in Springfield, Illinois through its wholly-owned subsidiary Central Illinois Security, Inc. (CIS).

LRS, DYS and CIS are collectively referred to as the Company.

**Principles of consolidation:** The financial statements include the accounts of LRS and its wholly-owned subsidiaries, DYS and CIS. All significant intercompany accounts and transactions have been eliminated in the consolidation.

**Presentation:** Certain amounts reported for 2017 have been reclassified to conform to the 2018 presentation, with no effect on previously reported net income, comprehensive income, or stockholders' equity.

**Use of estimates:** The preparation of the 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 amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and their reported amounts of revenue and expenses during the reporting periods. Such estimates relate to useful lives of property and equipment, as well as intangible assets, accounts receivable, contract accounting, and deferred revenue. Actual results could differ from such estimates.

**Revenue recognition:** The Company enters into contractual arrangements with the end-users of its products to sell software licenses, software maintenance, consulting and processing services and hardware, either separately or combined into multiple-element arrangements. For each arrangement, revenues are recognized when persuasive evidence of an arrangement exists, the fees to be paid by the customer are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, the vendor-specific objective evidence (VSOE) of the fair value of any undelivered elements exists, and no other significant obligations on the part of the Company remain. The Company's software products are licensed to customers under both perpetual and time-based license arrangements. The Company also sells customized software under the product name Pension Gold.

**Perpetual license revenue:** Customers that purchase licenses under a perpetual license agreement generally enter into renewable one-year maintenance agreements that entitle the customer to receive unspecified updates on licensed software, technical corrections and support, generally for a fixed fee. The Company has established the VSOE of fair value for the maintenance element of its perpetual license arrangements by reference to the renewal rate paid by customers. For arrangements that include perpetual licenses and maintenance elements, the arrangement fee is allocated to separate elements using the residual method. Under the residual method, the VSOE of fair value is allocated to the maintenance element, and the remaining arrangement fee is allocated to the license element. The amount allocated to the license element is recognized on delivery of the software if collection of the fees is probable, the fees are fixed or determinable, and an agreement is signed. Maintenance revenue is recognized ratably over the maintenance period, which is generally 12 months. Revenue from sales through marketing agents is recorded as revenue, net of fees withheld by agents, upon receipt of a signed perpetual license arrangement, delivery of the software license to the end-user customer and determination that the fees are fixed or determinable as well as collectible.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 1. Summary of Significant Accounting Policies (Continued)**

**Term license revenue:** The Company also licenses its software under multiyear, time-based license agreements and on a month-to-month basis under various operating lease-type rental plans. Revenue under time-based license arrangements is recognized ratably over the term of the arrangement. The Company has a history of successfully collecting substantially all amounts due under the original terms of multiyear, time-based license arrangements without making concessions on payments. Unbilled and unearned future amounts due under multiyear noncancellable, time-based license arrangements totaled \$148,077,000 and \$139,165,000 at July 31, 2018 and 2017, respectively. Revenue related to unbilled future amounts as of July 31, 2018, will be recognized during the periods in which earned and are due in future years as follows:

Year Ending July 31,	Amount
2019	\$ 48,903,000
2020	48,213,000
2021	28,876,000
2022	15,441,000
2023	4,211,000
Thereafter	2,433,000
	<u>\$148,077,000</u>

**Software maintenance revenue:** Revenue from annual maintenance contracts for which customers pay a fee up front in order to receive software maintenance is recognized on a straight-line basis over the periods in which the support is provided.

**Consulting services revenue:** Consulting and processing services revenue is generally sold on a time and material basis, and the related revenue is recognized as the specific services are performed. Consulting and services revenue includes general consulting, processing services, training and other related services.

**Hardware revenue:** In some cases, the Company resells third-party hardware to its customers. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is considered probable. The Company considers delivery to occur when the product is shipped and title and risk of loss have passed to the customer.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 1. Summary of Significant Accounting Policies (Continued)**

**Pension Gold license revenue:** The Company undertakes projects for implementation of Pension Gold software, which requires significant production, modification or customization of software, and the related revenue is recognized in accordance with contract accounting. Under contract accounting, the Company utilizes the percentage-of-completion method for revenue recognition. The Company estimates the profit on a contract as the difference between the total estimated revenue and the total estimated costs of a contract and recognizes that profit over the contract term. The Company determines progress toward completion on production contracts based on input measures (labor hours incurred). The Company reviews its long-term contracts periodically to assess revisions in contract values and estimated project costs at completion. The Company applies the effect of any changes in estimates resulting from these assessments in the period of change so that the consolidated balance sheet at the end of the period of change and the accounting in subsequent periods are as they would have been if the revised estimates had been the original estimates. The Company charges any anticipated losses on contracts to earnings as soon as they are identified. Accounts receivable associated with long-term contracts consist of billed and unbilled amounts. Billed amounts include invoices presented to customers that have not been paid. Unbilled amounts relate to revenues that have been recorded and billings that have not been presented to customers. Unbilled amounts at July 31, 2018 and 2017, were \$2,730,018 and \$1,554,932, respectively, and are included in accounts receivable.

**Other revenue:** The Company also provides other miscellaneous services, such as technical education training, which are recognized as other operating revenue as services are performed.

**Deferred revenue:** Deferred revenue represents amounts received from customers under certain license, maintenance and service agreements for which the revenue earning process has not been completed.

**Research and development costs:** Research and development costs are expensed as incurred and amounted to approximately \$829,000 and \$806,000, respectively, during the years ended July 31, 2018 and 2017. Included in those amounts are costs pertaining to development of software to be sold, which the Company expenses as incurred as such amounts are not significant.

**Charitable contributions:** Charitable contributions are recognized as an expense when committed to be paid by the Company and are included in other operating expenses in the consolidated statements of comprehensive income. Charitable contributions during the years ended July 31, 2018 and 2017, were approximately \$1,016,000 and \$1,015,000, respectively.

**Cash equivalents:** Cash equivalents consist of money market funds, a portion of which is on deposit with related parties (see Note 10).

**Concentration of credit risk:** The Company maintains its cash, cash equivalents, and certain investments in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and management believes they are not exposed to any significant credit risk on cash and cash equivalents.

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

**Marketable securities – trading:** The Company's investment in marketable securities classified as trading securities includes certain equity-based securities. Trading securities are stated at fair value, with realized and unrealized gains and losses reported in other income in the consolidated statements of comprehensive income. A realized gain related to the appreciation in fair value of trading securities of \$169,331 and \$0 is included in other income for the years ended July 31, 2018 and 2017, respectively. The entirety of the gain recognized during the year ended July 31, 2018 relates to securities still held at July 31, 2018.

**Marketable securities – available-for-sale:** The Company's investment in marketable securities classified as available-for-sale securities includes corporate debt securities and municipal revenue bonds. All corporate and municipal debt securities are classified as available-for-sale as the Company intends to hold these securities for an indefinite period of time, but not necessarily to maturity. Available-for-sale securities are stated at fair value, with the unrealized gains and losses reported as a separate component of accumulated other comprehensive income in stockholders' equity. Realized gains and losses are included in the consolidated statements of comprehensive income as other income.

The cost of securities sold is based on the specific identification method. Where applicable, discounts and premiums on investments are accreted and amortized into interest income using the effective yield method over the estimated remaining life of the assets. Declines in the fair value of available-for-sale securities below their amortized cost basis, if any, that are deemed to be other-than-temporary impairment losses are reflected as realized losses.

**Trade receivables:** Trade receivables are carried at original invoice amount less an estimate for uncollectible trade receivables. The Company performs ongoing credit evaluations of its customers and provisions are made for estimated uncollectible trade receivables. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. There was no allowance for doubtful accounts recorded at July 31, 2018 and 2017.

Trade accounts receivable are considered to be past due if any portion of the receivable balance is outstanding for more than 30 days. Interest may be charged on accounts that are outstanding for more than 45 days and is recognized when charged.

**Foreign currency translation:** The monetary assets and liabilities of the foreign branches, whose functional currency is the U.S. dollar, are translated at year-end exchange rates and nonmonetary items are translated at historical rates. Income and expense accounts are translated each month at the rate in effect at the beginning of the month, except for nonmonetary assets and liabilities, which are translated at historical rates. The effects of changes in exchange rates are included in income during the period of change. Foreign currency (losses)/gains included in other income were \$(521,252) and \$613,916 for the years ended July 31, 2018 and 2017, respectively, and arose primarily from fluctuations in the value of the Australian dollar, Euro, British pound sterling, and Swedish Krona against the U.S. dollar.

**Property and equipment:** Property and equipment is stated at cost. Depreciation is recorded over the estimated useful lives of the assets using principally the straight-line method as follows:

	Years
Buildings	40 - 50
Computer equipment and software	3 - 5
Other equipment, furniture, and fixtures	5 - 10
Aircraft	10

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 1. Summary of Significant Accounting Policies (Continued)**

**Other assets:** Other assets include a Section 444 deposit to the Internal Revenue Service (IRS). This Section 444 deposit, held by the IRS in connection with the Internal Revenue Code (Code) requirements for a Subchapter S Corporation with a tax year ending July 31, was \$9,581,176 and \$9,299,879 at July 31, 2018 and 2017, respectively.

**Goodwill and amortizable intangible assets:** The Company records as goodwill the excess of the purchase price over the fair value of identifiable net assets acquired in a business combination. In January 2014, the Financial Accounting Standards Board (FASB) issued guidance related to private companies and the subsequent accounting for goodwill. The revised guidance allows an entity to amortize goodwill over a 10-year period, or less than 10 years if the entity demonstrates that another useful life is more appropriate, and perform impairment analysis only when a triggering event occurs. The Company is amortizing goodwill using the straight-line method over an estimated useful life of 5 years for goodwill recognized in connection with technology company-related acquisitions. A useful life of 10 years is used for all other acquisitions. The Company has elected to evaluate goodwill impairment at the entity level. As of July 31, 2018, the Company has determined that there was no occurrence of an event or circumstance that may indicate the fair value of the entity is less than its carrying value.

Amortizable intangible assets include the fair value of proprietary software and customer relationships acquired. Amortizable intangible assets are being amortized using the straight-line method over an estimated useful life of 5 years.

**Recoverability of long-lived assets:** All long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset.

**Income taxes:** Deferred taxes are provided on a liability method, whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits, if any, are classified as provision for income taxes in the consolidated statements of comprehensive income.

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

**Stockholders' equity:** During the year ended July 31, 2017, the Company amended its articles of incorporation to increase the aggregate number of shares of common stock the Company may issue to 2,000. The common stock has no par value and has been designated into two classes – 100 shares were designated as Class A voting common stock and 1,900 shares were designated as Class B non-voting common stock. The existing 50 shares of common stock outstanding at the time of the amendment to the articles of incorporation were surrendered and exchanged for 50 shares of Class A voting common stock and 950 shares of Class B non-voting common stock. Other than voting rights, Class A and Class B shares are identical in all respects.

#### Note 2. Marketable Securities – Available-for-Sale

The amortized cost and fair values of available-or-sale marketable securities as of July 31, 2018 and 2017, are summarized as follows:

	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-term marketable securities:				
Available-for-sale:				
Corporate debt securities	\$ 1,004,597	\$ 7,993	\$ -	\$ 1,012,590
Municipal revenue bonds	4,911,806	20,657	-	4,932,463
Short-term marketable securities	<u>\$ 5,916,403</u>	<u>\$ 28,650</u>	<u>\$ -</u>	<u>\$ 5,945,053</u>
Long-term marketable securities:				
Available-for-sale:				
Corporate debt securities	\$ 4,052,112	\$ 153,388	\$ -	\$ 4,205,500
Municipal revenue bonds	68,604,678	1,005,615	(625,909)	68,984,384
Long-term marketable securities	<u>\$ 72,656,790</u>	<u>\$ 1,159,003</u>	<u>\$ (625,909)</u>	<u>\$ 73,189,884</u>
	2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-term marketable securities:				
Available-for-sale:				
Corporate debt securities	\$ 1,004,672	\$ 12,768	\$ -	\$ 1,017,440
Municipal revenue bonds	5,208,035	37,907	(925)	5,245,017
Short-term marketable securities	<u>\$ 6,212,707</u>	<u>\$ 50,675</u>	<u>\$ (925)</u>	<u>\$ 6,262,457</u>
Long-term marketable securities:				
Available-for-sale:				
Corporate debt securities	\$ 5,092,027	\$ 399,491	\$ -	\$ 5,491,518
Municipal revenue bonds	66,618,748	2,030,647	(405,537)	68,243,858
Long-term marketable securities	<u>\$ 71,710,775</u>	<u>\$ 2,430,138</u>	<u>\$ (405,537)</u>	<u>\$ 73,735,376</u>

# Levi, Ray & Shoup, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

### Note 2. Marketable Securities – Available-for-Sale (Continued)

Gross unrealized losses on investments and the fair value of the related investments, aggregated by the length of time that individual securities have been in a continuous unrealized loss position, at July 31, 2018 and 2017, were as follows:

		2018					
		Less than 12 Months		12 Months or More		Total	
		Unrealized	Fair	Unrealized	Fair	Unrealized	Fair
		Losses	Value	Losses	Value	Losses	Value
Available-for-sale:							
Municipal revenue bonds	\$	(150,428)	\$ 8,312,650	\$ (475,481)	\$ 18,259,352	\$ (625,909)	\$ 26,572,002
		2017					
		Less than 12 Months		12 Months or More		Total	
		Unrealized	Fair	Unrealized	Fair	Unrealized	Fair
		Losses	Value	Losses	Value	Losses	Value
Available-for-sale:							
Municipal revenue bonds	\$	(330,935)	\$ 16,355,433	\$ (75,527)	\$ 3,337,953	\$ (406,462)	\$ 19,693,386

The table above represents 26 investment securities at July 31, 2018 compared to 18 at July 31, 2017 that, due to the current interest rate environment and other factors, have declined in value but do not presently represent realized losses. Management evaluates securities for other-than-temporary impairment at least on an annual basis, and more frequently when economic or market concerns warrant such evaluation. In estimating other-than-temporary impairment losses on investment securities, management considers many factors which include: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. To determine if an other-than-temporary impairment exists on a debt security, the Company first determines if (a) it intends to sell the security or (b) it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of the conditions is met, the Company will recognize an other-than-temporary impairment in earnings equal to the difference between the security's fair value and its adjusted cost basis. If neither of the conditions is met, the Company determines (a) the amount of the impairment related to credit loss and (b) the amount of the impairment due to all other factors. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of total impairment related to all other factors is included in other comprehensive income (loss). Management has deemed all declines in the values of investment securities held at July 31, 2018 and 2017 to be temporary.

In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports.

Securities with maturity dates within one year are classified as short-term marketable securities. Securities with maturity dates greater than one year are classified as long-term marketable securities. At July 31, 2018, the maturity dates of long-term marketable securities, based on current contractual maturities, extend to December 2029. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties.



**Levi, Ray & Shoup, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****Note 3. Property and Equipment**

Property and equipment at July 31, 2018 and 2017, consists of the following:

	2018	2017
Land	\$ 5,560,324	\$ 5,560,324
Buildings	17,777,667	17,695,894
Computer equipment and software	5,370,286	5,683,683
Other equipment, furniture, and fixtures	12,004,239	11,987,386
Aircraft	33,172,528	33,172,528
	73,885,044	74,099,815
Less accumulated depreciation	43,428,348	41,923,816
	<u>\$ 30,456,696</u>	<u>\$ 32,175,999</u>

Depreciation expense was \$2,661,383 and \$2,524,269 for the years ended July 31, 2018 and 2017, respectively.

**Note 4. Goodwill and Amortizable Intangible Assets**

Goodwill and amortizable intangible assets as of July 31, 2018 and 2017, consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	2018		
Goodwill	<u>\$ 14,354,708</u>	<u>\$ 7,058,192</u>	<u>\$ 7,296,516</u>
Amortizable intangible assets:			
Software	\$ 1,400,000	\$ 1,020,000	\$ 380,000
Customer relationships	500,000	500,000	-
	<u>\$ 1,900,000</u>	<u>\$ 1,520,000</u>	<u>\$ 380,000</u>
	2017		
Goodwill	<u>\$ 14,354,708</u>	<u>\$ 4,471,149</u>	<u>\$ 9,883,559</u>
Amortizable intangible assets:			
Software	\$ 1,400,000	\$ 740,000	\$ 660,000
Customer relationships	500,000	400,000	100,000
	<u>\$ 1,900,000</u>	<u>\$ 1,140,000</u>	<u>\$ 760,000</u>

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Note 4. Goodwill and Amortizable Intangible Assets (Continued)**

The changes in the net carrying amount of goodwill and amortizable intangible assets for the years ended July 31, 2018 and 2017, were as follows:

	Goodwill	Customer Relationships	Software
	2018		
Balance, beginning	\$ 9,883,559	\$ 100,000	\$ 660,000
Amortization	(2,587,043)	(100,000)	(280,000)
Balance, ending	\$ 7,296,516	\$ -	\$ 380,000
	2017		
Balance, beginning	\$ 1,462,283	\$ 200,000	\$ 320,000
Additions (Note 14)	10,699,000	-	600,000
Amortization	(2,277,724)	(100,000)	(260,000)
Balance, ending	\$ 9,883,559	\$ 100,000	\$ 660,000

Estimated aggregate annual amortization expense on goodwill and amortizable intangible assets as of July 31, 2018, in future years, is as follows:

Year Ending July 31,	Goodwill	Amortizable Intangible Assets	Total
2019	\$ 1,855,900	\$ 120,000	\$ 1,975,900
2020	1,855,900	120,000	1,975,900
2021	1,855,900	120,000	1,975,900
2022	545,900	20,000	565,900
2023	283,900	-	283,900
Thereafter	899,016	-	899,016
	\$ 7,296,516	\$ 380,000	\$ 7,676,516

**Note 5. Sale and Leaseback Transaction, Lease Commitments and Total Rent Expense**

During the year ended July 31, 2009, the Company sold its Springfield, Illinois, office facilities (Springfield Campus) to a related party at a gain of \$2,149,421. Simultaneous with the sale, the Company entered into an operating lease agreement with the related party to lease back the Springfield Campus for an initial term of nine years and ten months. Annual rental payments due under the original lease totaled \$1,058,250. The gain resulting from the sale has been recorded as deferred income and is being amortized to income over the lease term. Included as a deferred item in current and noncurrent liabilities on the consolidated balance sheets as of July 31, 2018 and 2017, is the unamortized balance of \$91,079 and \$309,664, respectively. The lease was amended effective July 1, 2017 to increase annual rental payments to \$1,814,684 and amend the termination date to coincide with the expected completion date of a new office building subject to the lease agreement, which has been estimated as November of 2018. The Company will then occupy the new office building under a new lease.

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 5. Sale and Leaseback Transaction, Lease Commitments and Total Rent Expense (Continued)

Rent expense incurred under facilities leases for the years ended July 31, 2018 and 2017, was \$3,919,171 and \$3,087,424, respectively.

In addition to the lease of the Springfield compass, the Company has entered into leases of facilities which range from \$4,000 to \$223,000 per year and which generally have expiration dates between 2019 to 2025.

The total approximate rental commitments as of July 31, 2018, are due in future years as follows:

Year Ending July 31,	Amount
2019	\$ 1,393,741
2020	1,227,623
2021	900,761
2022	601,396
2023	451,647
Thereafter	718,216
	<u>\$ 5,293,384</u>

The Company also leases from non-related parties certain other facilities under non-cancelable operating leases.

#### Note 6. International Operations

The Company operates eight branches with offices in the United Kingdom, Germany, Spain, Italy, France, Sweden, Australia, and Singapore. The U.S. dollar is used as the functional currency for all international operations. The following is a summary of certain significant financial information of the Company's international operations included in the accompanying financial statements:

	2018	2017
Assets	\$ 32,657,472	\$ 29,885,969
Liabilities and deferred revenue	34,669,336	29,850,933
Revenue	44,801,789	41,348,322
Foreign income tax expense	2,350,515	1,953,362
Net income	3,679,025	5,372,513

#### Note 7. Income Taxes

Since July 31, 1987, the Company has operated under the provisions of Subchapter S of the Internal Revenue Code. As such, the Company's net income is recognized by the stockholders of the Company for federal income tax purposes as if the Company were a partnership. Accordingly, the Company is not liable for any federal income tax. The Company files its income tax returns using the accrual basis method of accounting.

The Company also files various state and local income tax returns. State and local income taxes were approximately \$697,000 and \$651,000 for the years ended July 31, 2018 and 2017, respectively.

## **Levi, Ray & Shoup, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements**

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#### **Note 7. Income Taxes (Continued)**

The Company's eight foreign branches file income tax returns in their respective countries. Foreign income tax expense was approximately \$2,351,000 and \$1,953,000 for the years ended July 31, 2018 and 2017, respectively.

The deferred tax benefit arising from net operating losses (NOLs) in foreign branches totaled approximately \$2,274,000 and \$1,926,000 at July 31, 2018 and 2017, respectively. At July 31, 2018 and 2017, the Company does not believe any of its NOLs will be utilized and, therefore, a full valuation allowance has been provided against all NOLs. The NOLs arise in foreign jurisdictions and can be carried forward indefinitely.

The Company has adopted the FASB issued guidance on accounting for uncertainty in income taxes. Management has evaluated the Company's tax positions and concluded that the Company has taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance. With few exceptions, the Company is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for fiscal years ended before 2015.

#### **Note 8. Retirement Plan**

Effective January 1, 2005, the Company adopted a 401(k) matching contribution plan covering substantially all domestic salaried employees of the Company and eligible hourly employees of its subsidiaries. The Company matches 100 percent of employee contributions up to a maximum of 5 percent of eligible employee compensation. Employer matching contributions to the plan totaled \$2,074,057 and \$1,986,017 for the years ended July 31, 2018 and 2017, respectively.

#### **Note 9. Self-Insurance**

The Company is self-insured for medical claims up to predetermined amounts. The Company has stop-loss insurance for individual claims in excess of \$185,000 and \$150,000 for the policy years ended December 31, 2018 and 2017, respectively. As of July 31, 2018 and 2017, the Company reserved \$324,000 and \$281,000, respectively, for medical claims payable and incurred but not yet reported as of year-end. The expenses under the Company's self-insured medical program for the years ended July 31, 2018 and 2017, were \$5,577,000 and \$4,426,000, respectively.

#### **Note 10. Related-Party Transactions**

The Company enters into certain transactions with two financial institutions in which the sole shareholder of the Company owns an equity interest. Cash balances on deposit were \$20,539,182 and \$20,021,234 as of July 31, 2018 and 2017, respectively. Interest income derived from cash balances on deposit with both financial institutions totaled \$72,115 and \$32,381 for the years ended July 31, 2018 and 2017, respectively. Revenue for services provided to the financial institutions totaled \$161,911 and \$234,504 for the years ended July 31, 2018 and 2017, respectively. Bank service fees expense totaled \$29,577 and \$31,765 for the years ended July 31, 2018 and 2017, respectively. The Company has also entered into a sale and leaseback transaction with a related party (see Note 5).

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 11. Fair Value Disclosures

##### Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value because of the short-term maturity of these instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of judgment and, therefore, cannot be determined with precision.

##### Fair Value Measurements

The FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, provides a framework for measuring fair value under generally accepted accounting principles. FASB ASC 820 applies to all financial and non-financial instruments that are being measured and reported on a fair value basis.

FASB ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. *Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:*

- Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.
- Level 3 - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of July 31, 2018 and 2017.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 11. Fair Value Disclosures (Continued)**

**Marketable securities:** The fair value of trading and available-for-sale securities is determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. At this time, all of the Company's investments in trading securities fall within the level one hierarchies for pricing. If quoted market prices are not available, then fair values are estimated by using pricing models or quoted prices of securities with similar characteristics. For these investments, the pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing to prepare evaluations. They also use model processes, such as the Option Adjusted Spread model to assess interest rate impact and develop prepayment scenarios. In the case of municipal securities, information on the Bloomberg terminal such as credit ratings, credit support, and call features are used to set the matrix values for the issues, which will be used to determine the yields from which the market values are calculated each month. Because they are not price quote valuations, the pricing methods are considered Level 2 inputs. At this time, all of the Company's available-for-sale securities fall within the Level 2 hierarchies for pricing. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Company currently has no securities classified within Level 3.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement as of the reporting date.

To assess the appropriate classification of investments within the fair value hierarchy, the availability of market data is monitored. Changes in economic conditions or valuation techniques may require the transfer of investments from one fair value level to another. In such instances, the transfer is reported at the end of the reporting period.

The Company evaluates the significance of transfers between levels based upon the nature of the investment and size of the transfer relative to total investments. There were no transfers in or out of Level 3 during the year ended July 31, 2018.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Note 11. Fair Value Disclosures (Continued)**

*Assets Measured at Fair Value on a Recurring Basis*

The following table presents the Company's assets that are measured at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of July 31, 2018 and 2017:

	Level 1	Level 2	Level 3	Total
	2018			
<b>Assets:</b>				
Marketable securities:				
Equity based securities	\$ 3,608,290	\$ -	\$ -	\$ 3,608,290
Corporate debt securities:				
A- credit rating	-	1,012,590	-	1,012,590
BBB credit rating	-	822,216	-	822,216
BBB+ credit rating	-	2,315,964	-	2,315,964
Not Rated	-	1,067,320	-	1,067,320
Municipal revenue bonds:				
A credit rating	-	12,896,406	-	12,896,406
A- credit rating	-	988,950	-	988,950
A+ credit rating	-	6,281,444	-	6,281,444
AA credit rating	-	22,004,004	-	22,004,004
AA- credit rating	-	1,946,982	-	1,946,982
AA+ credit rating	-	2,891,554	-	2,891,554
AAA credit rating	-	1,649,180	-	1,649,180
BBB credit rating	-	989,610	-	989,610
BBB- credit rating	-	4,715,587	-	4,715,587
BBB+ credit rating	-	5,653,241	-	5,653,241
Not Rated	-	13,899,889	-	13,899,889
	\$ 3,608,290	\$ 79,134,937	\$ -	\$ 82,743,227
	Level 1	Level 2	Level 3	Total
	2017			
<b>Assets:</b>				
Marketable securities:				
Corporate debt securities:				
A- credit rating	\$ -	\$ 1,134,380	\$ -	\$ 1,134,380
BBB+ credit rating	-	5,374,578	-	5,374,578
Municipal revenue bonds:				
A credit rating	-	11,470,263	-	11,470,263
A- credit rating	-	4,717,584	-	4,717,584
A+ credit rating	-	4,711,696	-	4,711,696
AA credit rating	-	24,536,610	-	24,536,610
AA- credit rating	-	4,689,717	-	4,689,717
AA+ credit rating	-	1,888,284	-	1,888,284
AAA credit rating	-	1,708,413	-	1,708,413
BBB+ credit rating	-	4,724,315	-	4,724,315
Not Rated	-	15,041,993	-	15,041,993
	\$ -	\$ 79,997,833	\$ -	\$ 79,997,833

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 12. Commitments and Contingencies**

Under the terms of substantially all of the Company's license agreements, the Company has agreed to indemnify customers from all damages awarded against them and all reasonable expenses incurred by them as the result of any claim of trade secret, patent, or copyright infringement asserted against them by virtue of their use of the Company's software products. In the event of an infringement claim, in the vast majority of the license agreements, the Company retains the right to (a) procure for the customer the right to continue to use the software products or (b) replace or modify the software products to make their use non-infringing.

In the majority of the license agreements, if neither option is readily available, the Company may terminate the license agreement and refund a pro rata portion of the license fees paid. Such indemnification provisions are accounted for as contingent liabilities. The likelihood that the Company would be required to make refunds to customers under any such provisions is considered remote. The amount of the indemnification is limited to the amount paid by the customer in substantially all of the license agreements, while in some arrangements the Company's liability could extend up to unlimited amounts.

The Company's standard license agreements include a product warranty provision for all products. Such warranties are accounted for as contingent liabilities. The likelihood that the Company would be required to make refunds to customers under such provisions is considered remote. The amount of refund is typically limited to the actual license fees paid by the customer; however, in some arrangements, the Company's liability could extend up to unlimited amounts.

In the ordinary course of its business activities, the Company experiences certain disputed matters which give rise to claims that may result in litigation. Management vigorously pursues appropriate resolutions to such claims, but at any point in time, some claims, which could result in lawsuits by and against the Company, remain outstanding. In the opinion of management, no outstanding claims have the potential to result in judgments which, in the aggregate, would have a material adverse effect on the Company's financial statements.

**Note 13. New Accounting Pronouncements**

In March 2017, the FASB issued Accounting Standards Update (ASU) 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, which shortens the amortization period of certain callable debt securities held at a premium. This ASU is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which addresses eight specific cash-flow presentation and classification issues with the objective of reducing existing diversity in practice. This ASU is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.



## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 13. New Accounting Pronouncements (Continued)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which sets forth “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2020. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The ASU is expected to impact the Company's financial statements as the Company has certain operating lease arrangements for which it is the lessee. This ASU is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. A practicability exception will be available for equity investments that do not have readily determinable fair values, however, the exception requires the Company to adjust the carrying amount for impairment and observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance also changes certain disclosure requirements and other aspects of current U.S. GAAP. This ASU is effective for fiscal years beginning after December 15, 2018. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*. This ASU eliminates the requirement to retrospectively account for changes to provisional amounts initially recorded in a business combination. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustments are determined, including the effect of the change in provisional amount as if the accounting had been completed at the acquisition date. The guidance was adopted by the Company effective August 1, 2017. The adoption did not have a material effect on the consolidated financial statements.

**Levi, Ray & Shoup, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

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**Note 13. New Accounting Pronouncements (Continued)**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which affects narrow aspects of Topic 606 related to assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which affects aspects of Topic 606 related to identifying performance obligations and licensing. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies the implementation guidance in ASU 2014-09 related to principal versus agent considerations. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2018. The Company has not yet selected a transition method and is currently evaluating the effect that the standard will have on its consolidated financial statements.

**Note 14. Acquisitions**

On September 19, 2016, the Company acquired substantially all of the operations of Cirrato Technologies AB, Cirrato Technologies, Inc. and Cirrato Technologies, Ltd. (collectively, Cirrato), a privately owned group headquartered in Stockholm, Sweden. Cirrato is an output management software provider with products complementary to the Company's software solutions, with a "channel-ready" print management offering which will be compelling for customer segments beyond the Company's current markets. In addition, Cirrato brings well-established partnerships with major third parties which are expected to offer the Company new ways to promote its software solutions to organizations of all sizes.

As a result of the acquisition, the Company acquired Cirrato operations including the customer network, application software, intellectual property and other assets used in the Cirrato business. Purchase consideration totaled \$8,500,000, which consisted of \$6,195,397 in cash paid to the owners of Cirrato and the assumption of liabilities totaling \$2,304,603.

The Company is required to allocate the purchase price to tangible and certain non-customer related identifiable intangible assets acquired and liabilities assumed based on their fair values. The fair value of the identifiable intangible assets was determined by discounting the estimated net future cash flows of these intangible assets. The excess of purchase price over those fair values is recorded as goodwill. The Company's fair market valuation of acquired assets and liabilities is summarized below:

Furniture and equipment	\$ 40,000
Identifiable intangible assets	600,000
Goodwill	7,860,000
Liabilities assumed	(2,304,603)
	<u>\$ 6,195,397</u>

## Levi, Ray & Shoup, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 14. Acquisitions (Continued)

The Company's estimated useful life of the identifiable intangible assets acquired is five years. Goodwill associated with the acquisition was \$7,860,000. The factors that contribute to the recognition of goodwill included securing synergies that are specific to the Company's business and not available to other market participants, which are expected to increase revenues and profits, and the acquisition of a talented workforce. The goodwill is expected to be deductible for tax purposes.

The Cirrato acquisition agreement provides for earn-out payments totaling up to \$7,500,000 contingent upon the achievement of certain pretax earnings targets through the fifth anniversary of the acquisition date. Under the terms of the earn-out arrangement, the first \$850,000 of pretax earnings from Cirrato products or LRS products through Cirrato channels will be due to LRS. Further, if the cumulative net loss from the sale of Cirrato products or LRS products through Cirrato channels reaches \$2,000,000 at any time during the earn-out period, the earn-out will be deemed null and void. As of the acquisition date, it was estimated that no contingent payments would be due related to the earn-out. Such contingent payments, if necessary, will be recorded as expense in the period in which they are incurred. At July 31, 2018, it is estimated that no contingent payments will be due.

On September 30, 2016, the Company entered into an agreement to purchase all of the outstanding shares of common stock of Central Illinois Security, Inc. (CIS). CIS provides security system services specializing in fire detection and burglar alarm systems, including the installation of electrical apparatus and equipment. Cash consideration for the purchase totaled \$3,000,000.

The Company is required to allocate the purchase price to tangible and certain non-customer related identifiable intangible assets acquired and liabilities assumed based on their fair values. The excess of purchase price over those fair values is recorded as goodwill. The Company's fair market valuation of acquired assets and liabilities is summarized below:

Accounts receivable	\$ 60,236
Inventory	64,768
Furniture and equipment	60,599
Goodwill	2,839,000
Liabilities assumed	(24,603)
	<u>\$ 3,000,000</u>

#### Note 15. Subsequent Events

All of the effects of subsequent events that provide additional evidence about conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. The Company does not recognize subsequent events that provide evidence about conditions that did not exist at the balance sheet date but arose after, but before the financial statements are available to be issued. In some cases, non-recognized subsequent events are disclosed to keep the financial statements from being misleading.

The Company has evaluated events occurring subsequent to July 31, 2018, as to their potential impact to the financial statements through October 30, 2018, which is the date the financial statements were available to be issued.