

**Second Harvest Food Bank of Santa Clara and
San Mateo Counties**

Financial Statements
and Single Audit Reports and Schedules

June 30, 2017
(With Comparative Totals for 2016)



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Second Harvest Food Bank of Santa Clara and San Mateo Counties
San Jose, California

We have audited the accompanying financial statements of Second Harvest Food Bank of Santa Clara and San Mateo Counties (a California nonprofit corporation) (the "Food Bank"), which comprise the statement of financial position as of June 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 (the "U.S."); 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S. 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 Second Harvest Food Bank of Santa Clara and San Mateo Counties as of June 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 U.S.

Other Matter

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 and other governmental 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 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 U.S. 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 November 21, 2017, on our consideration of the Food Bank'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 the Food Bank's internal control over financial reporting and compliance.

Report on Summarized Comparative Information

We have previously audited Second Harvest Food Bank of Santa Clara and San Mateo Counties' 2016 financial statements, and our report dated October 5, 2016 expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.



Armanino^{LLP}
San Jose, California

November 21, 2017

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Statement of Financial Position
June 30, 2017
(With Comparative Totals for 2016)

	Unrestricted	Temporarily Restricted	2017 Total	2016 Total
ASSETS				
Cash and cash equivalents	\$ 15,000,167	\$ 2,032,171	\$ 17,032,338	\$ 14,446,680
Accounts receivable	22,078	-	22,078	14,949
Grants receivable	493,705	-	493,705	610,980
Pledges receivable (Note 3)	265,450	6,914,907	7,180,357	5,340,931
Inventory (Note 4)	3,098,507	-	3,098,507	3,557,758
Prepaid expenses and other assets	759,645	-	759,645	732,323
Investments - board-designated endowment (Notes 5 and 6)	7,152,977	-	7,152,977	5,404,985
Investments - other (Notes 5 and 6)	20,071,660	-	20,071,660	18,467,110
Land, buildings, and equipment, net (Note 7)	24,345,420	-	24,345,420	23,630,429
Total assets	\$ 71,209,609	\$ 8,947,078	\$ 80,156,687	\$ 72,206,145
LIABILITIES AND NET ASSETS				
Liabilities				
Accounts payable	\$ 2,470,436	\$ -	\$ 2,470,436	\$ 1,395,245
Accrued expenses	1,241,878	-	1,241,878	1,035,673
Deferred revenue	-	-	-	3,000
Total liabilities	3,712,314	-	3,712,314	2,433,918
Net assets				
Unrestricted				
Undesignated	500,000	-	500,000	500,000
Board designated (Note 11)	42,651,875	-	42,651,875	38,157,806
Land, building, and equipment fund	24,345,420	-	24,345,420	23,630,429
Total unrestricted	67,497,295	-	67,497,295	62,288,235
Temporarily restricted (Note 13)	-	8,947,078	8,947,078	7,483,992
Total net assets	67,497,295	8,947,078	76,444,373	69,772,227
Total liabilities and net assets	\$ 71,209,609	\$ 8,947,078	\$ 80,156,687	\$ 72,206,145

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

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Statement of Activities
For the Year Ended June 30, 2017
(With Comparative Totals for 2016)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>2017 Total</u>	<u>2016 Total</u>
Support and revenue				
Support				
Contributions	\$ 34,258,514	\$ 7,609,828	\$ 41,868,342	\$ 39,524,797
Contributions - capital campaign	-	-	-	24,745
Contributions in-kind - non-government (Note 14)	78,900,975	-	78,900,975	76,496,786
United Way support	117,195	-	117,195	185,001
Total support	<u>113,276,684</u>	<u>7,609,828</u>	<u>120,886,512</u>	<u>116,231,329</u>
Revenue				
Government assistance - cash	1,762,913	150,000	1,912,913	1,998,555
Government assistance - in-kind (Note 14)	6,676,459	-	6,676,459	9,236,486
Net investment income (Note 5)	2,208,003	-	2,208,003	87,585
Other gains (losses)	(46,262)	-	(46,262)	67,903
Total revenue	<u>10,601,113</u>	<u>150,000</u>	<u>10,751,113</u>	<u>11,390,529</u>
Total support and revenue	123,877,797	7,759,828	131,637,625	127,621,858
Net assets released from restriction (Note 13)	<u>6,296,742</u>	<u>(6,296,742)</u>	-	-
Total support, revenue, and net assets released from restriction	<u>130,174,539</u>	<u>1,463,086</u>	<u>131,637,625</u>	<u>127,621,858</u>
Functional expenses				
Program services	<u>118,332,491</u>	-	<u>118,332,491</u>	<u>116,194,917</u>
Support services				
Management and general	2,694,649	-	2,694,649	2,390,707
Fundraising	3,938,339	-	3,938,339	3,353,098
Total support services	<u>6,632,988</u>	-	<u>6,632,988</u>	<u>5,743,805</u>
Total functional expenses	<u>124,965,479</u>	-	<u>124,965,479</u>	<u>121,938,722</u>
Change in net assets	5,209,060	1,463,086	6,672,146	5,683,136
Net assets, beginning of year	<u>62,288,235</u>	<u>7,483,992</u>	<u>69,772,227</u>	<u>64,089,091</u>
Net assets, end of year	<u>\$ 67,497,295</u>	<u>\$ 8,947,078</u>	<u>\$ 76,444,373</u>	<u>\$ 69,772,227</u>

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

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Statement of Functional Expenses
For the Year Ended June 30, 2017
(With Comparative Totals for 2016)

	Program services	Support services		Total support services	2017 Total	2016 Total
		Management and general	Fundraising			
Personnel expenses						
Salaries and wages	\$ 8,286,286	\$ 1,367,818	\$ 1,367,226	\$ 2,735,044	\$ 11,021,330	\$ 9,964,509
Employee benefits	1,737,444	286,800	286,676	573,476	2,310,920	2,041,138
Payroll taxes	653,020	107,794	107,748	215,542	868,562	712,422
Worker's compensation insurance	198,361	32,743	32,730	65,473	263,834	225,711
Total personnel expenses	10,875,111	1,795,155	1,794,380	3,589,535	14,464,646	12,943,780
Donated food and supplies distributed	86,170,016	-	-	-	86,170,016	84,419,887
Purchased food and supplies distributed	13,976,542	-	-	-	13,976,542	14,205,345
Depreciation	1,373,912	148,621	148,962	297,583	1,671,495	1,683,856
Occupancy	1,032,627	97,002	96,966	193,968	1,226,595	1,112,469
Freight and storage	997,893	-	-	-	997,893	986,746
Outside services	805,881	3,946	150,106	154,052	959,933	876,779
Professional services	362,400	190,698	249,575	440,273	802,673	962,276
Direct mailing costs	-	-	698,011	698,011	698,011	646,481
Supplies, including in-kind	570,023	26,463	42,119	68,582	638,605	678,532
Vehicle operating costs	494,136	-	-	-	494,136	447,978
Advertising and media, including in-kind	34,962	-	370,227	370,227	405,189	565,427
Equipment rental and maintenance	325,000	37,945	37,930	75,875	400,875	339,156
Postage and printing	149,532	3,553	211,945	215,498	365,030	374,621
Building demolition - Curtner remodeling	319,382	-	-	-	319,382	-
Bank and payroll charges	185	261,395	-	261,395	261,580	237,315
Insurance	193,184	29,671	1,747	31,418	224,602	220,030
Equipment for agency infrastructure	218,508	-	-	-	218,508	756,759
Telephone	152,824	25,227	25,216	50,443	203,267	192,124
Conferences, conventions, and meetings	119,895	18,452	36,236	54,688	174,583	112,907
Recruitment expenses	40,555	25,231	50,502	75,733	116,288	21,887
Dues and subscriptions	28,235	15,609	15,689	31,298	59,533	64,163
Travel	35,965	3,339	8,728	12,067	48,032	39,732
Volunteer expenses	37,196	230	-	230	37,426	31,494
Affiliation fees (Note 15)	18,527	-	-	-	18,527	18,978
Bad debt expense	-	12,112	-	12,112	12,112	-
	<u>\$ 118,332,491</u>	<u>\$ 2,694,649</u>	<u>\$ 3,938,339</u>	<u>\$ 6,632,988</u>	<u>\$ 124,965,479</u>	<u>\$ 121,938,722</u>
Percentage of total	<u>94.7 %</u>	<u>2.2 %</u>	<u>3.1 %</u>	<u>5.3 %</u>	<u>100.0 %</u>	

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

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Statement of Cash Flows
For the Year Ended June 30, 2017
(With Comparative Totals for 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Changes in net assets	\$ 6,672,146	\$ 5,683,136
Adjustments to reconcile changes in net assets to net cash provided by operating activities		
Depreciation	1,671,495	1,683,856
Loss on sale and disposal of equipment	159,618	1,337
Donated vehicles and equipment	(27,707)	(13,794)
Net present value amortization adjustment	(49,976)	250,889
In-kind contributions of food and non-food (including USDA)	(85,563,156)	(85,616,010)
Distribution of food and non-food received in-kind	86,170,016	84,419,887
Net realized and unrealized (gains) losses on investments	(1,763,128)	391,397
Changes in operating assets and liabilities		
Accounts receivable	(7,130)	(715)
Grants receivable	117,275	(14,461)
Pledges receivable	(1,789,450)	(4,695,468)
Purchased inventory (food)	(147,608)	(167,961)
Prepaid expenses and other assets	(27,321)	(43,576)
Accounts payable	927,864	87,629
Accrued expenses	206,205	(99,170)
Deferred revenue	(3,000)	3,000
Net cash provided by operating activities	<u>6,546,143</u>	<u>1,869,976</u>
Cash flows from investing activities		
Purchase of land, buildings and equipment	(2,391,835)	(2,049,197)
Proceeds from sale of equipment	20,764	4,400
Purchase of investments	(3,290,729)	(9,020,714)
Proceeds from sale of investments	1,701,315	8,015,375
Net cash used in investing activities	<u>(3,960,485)</u>	<u>(3,050,136)</u>
Net increase (decrease) in cash and cash equivalents	2,585,658	(1,180,160)
Cash and cash equivalents, beginning of year	<u>14,446,680</u>	<u>15,626,840</u>
Cash and cash equivalents, end of year	<u>\$ 17,032,338</u>	<u>\$ 14,446,680</u>

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

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

1. ORGANIZATION

High Need Continues with Hunger Paradox

Second Harvest Food Bank of Santa Clara and San Mateo Counties, a nonprofit 501(c)(3) organization founded in 1979, realized significant progress in achieving its strategic goals during its 2016-2017 fiscal year. Also known as the "Food Bank" or "Second Harvest," the organization continued to enhance its traditional food-banking operations while pursuing innovative solutions to address the Silicon Valley hunger paradox. Despite the enormous wealth in what is considered the epicenter of technology, Second Harvest continues to face a growing hunger problem due to this hunger paradox.

The recent tech boom has created immense wealth for some, but it has also caused the cost of housing to soar. Rents in neighborhoods near Google, Facebook, and other tech giants have seen double-digit increases in just the last few years. But astronomical rents are not confined to these areas as every neighborhood in Silicon Valley has experienced steep increases in the cost of housing. From 2011 to 2016, the median apartment rent rose 45 percent while the median income increased only 14 percent. That leaves many local families without enough money to pay rent and put food on the table. Today, more kids, families, and seniors depend on Second Harvest than ever before. That's the new hunger paradox: as the economy grows, so does the number of people who need food.

This continues to create challenges for Second Harvest. Many who work jobs critical to the local economy can no longer afford to live here. They are moving to less-expensive areas and commuting long hours, making them harder to reach with services. High rents are forcing families to crowd into cramped apartments and live in unconventional spaces like recreational vehicles, garages, and sheds, often with no access to cooking facilities. The lack of access to nutrient-rich foods is hurting those who can't afford them. The people Second Harvest serves have higher rates of malnutrition, diabetes, hypertension, and other diet-fueled ailments.

The current political climate poses another challenge as local fears around immigration policy may impact who turns to Second Harvest for food, making it harder to predict future demand for services. In addition, funding for many of the federal nutrition programs that local families depend on are facing proposed budget cuts, which could force more people to seek food from Second Harvest.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

1. ORGANIZATION (continued)

Expanding Second Harvest's Reach

Second Harvest continued to enhance its operations to meet the rising need, enabling the Food Bank to increase the number of meals it provided by more than 1 million this fiscal year for a total of 55.5 million meals. The Food Bank served an average of 257,465 people each month, nearly 4,700 more than the previous fiscal year and more than ever before. During the fiscal year, Second Harvest began expansion efforts at its Curtner Center facility to increase storage, staging, and loading areas to support the expected 30 percent increase in shelf-stable, cold and frozen food pounds over the next five years and accommodate potential growth in office space. The Food Bank also continued to invest in mission-critical equipment and infrastructure for its distribution partners – \$218,508 this fiscal year – to strengthen the local nutritional safety-net. Nearly 40 percent of those investments went to enhance school pantries.

Second Harvest also remained one of the few food banks in the Feeding America network of 200 regional food banks to provide food to its distribution partners free of charge. During the fiscal year, the number of distribution sites operated by the Food Bank and its 300 partners increased by 5 percent to 905 sites. This included an impressive jump in school pantries. Schools are an ideal place to reach kids and families with services. In addition to providing food at these sites, Second Harvest offered nutrition education and connected families to other food-assistance programs like CalFresh (food stamps). The Food Bank added 21 new K-12 schools – a 25 percent jump – increasing the number of people served through the school pantry program by 30 percent. It grew the number of pantries at community colleges and universities by 67 percent, increasing the number of people served through the program by 115 percent. Second Harvest also added seven low-income housing complexes to its distribution sites, reaching an additional 1,000 people with services.

Second Harvest was able to raise significant dollars to support these efforts and effectively manage the funds to make the most impact on local hunger. Charity Navigator, the nation's largest and most-used evaluator of charities, has ranked Second Harvest among the top 50 charities in the United States based on accountability, transparency, and financial health. The Food Bank's impressive donor base – more than 46,100 donors – made more than 91,300 gifts totaling nearly \$37.9 million this fiscal year. The Food Bank was also able to leverage significant volunteer hours to help accomplish its mission. Volunteer hours totaled 338,291, up 9 percent over the previous fiscal year. Valued at nearly \$7.1 million, that is equivalent to 162 full-time employees.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

1. ORGANIZATION (continued)

Improving Community Health

Second Harvest continued its groundbreaking work to ensure that kids get the nutrients they need to grow up strong and healthy, and to address the high rates of diabetes and other diet-fueled conditions among the adults it serves. During the fiscal year, the Food Bank began implementing its ambitious Healthy Food and Beverage Policy, a model for the rest of the country. Already providing more fresh produce than any other food bank in the nation, Second Harvest formalized its commitment to healthy food by adopting the policy. It sets three-year goals for increasing the amount of healthy foods Second Harvest provides like whole grains and lean protein items, and reducing the amount of unhealthy items like high-sugar foods and beverages. The Food Bank exceeded its goal of having protein and dairy make up at least 22 percent of the food mix, providing nearly 25 percent.

Second Harvest sharpened its focus on nutrition education during the fiscal year. In addition to providing nutrition education to more than 30,000 clients, the Food Bank piloted higher-impact education methods, including 10 six-week workshops for families that use evidence-based curricula to teach them about nutrition, mindful eating, stress management, and healthy recipes. To expand its reach, Second Harvest bolstered its innovative Health Ambassador program, with 65 trained volunteer ambassadors who work out in the community to promote healthy eating. The Food Bank also opened its second Food Pharmacy at a local free clinic where low-income diabetes patients fill "prescriptions" for healthy food and receive nutrition education to help them eat healthier.

Building a Hunger-Free Community

While Second Harvest is making notable gains against local hunger, the reality is hunger in Silicon Valley is just too big to solve with traditional food-banking alone. During the fiscal year, the Food Bank conducted a comprehensive market research study to determine the size and scope of local hunger. The data revealed that an estimated 700,000 Silicon Valley residents – 1 in 4 – are food insecure, meaning they are at risk of hunger. The Food Bank would need to triple in size to meet this need.

The most effective and efficient way to provide more food to our hungry neighbors is to continue to grow Second Harvest's capacity to distribute food while intensifying efforts to connect more people to food by leveraging public programs and collaborating with other organizations. For example, the Food Bank launched a school breakfast initiative during the fiscal year to encourage more schools to provide federally funded school breakfasts so that kids have the nutritious food they need to power them through the school day. Second Harvest worked with 28 schools in high-need areas, providing meal carts and other support. Thanks to this effort, more than 311,000 additional meals were provided to local kids.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

1. ORGANIZATION (continued)

Building a Hunger-Free Community (continued)

Second Harvest will continue to lead efforts to build a hunger-free community by focusing on its core strengths while transforming the way people access food. Although this is an ambitious effort, the Food Bank is well-positioned to overcome some of the challenges it faces with the hunger paradox and accomplish its mission. Second Harvest is more committed than ever before to working harder and smarter to end hunger in Silicon Valley.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements of Second Harvest Food Bank of Santa Clara and San Mateo Counties have been prepared on the accrual basis of accounting.

Financial statement presentation

In accordance with accounting principles generally accepted in the United States of America, the Food Bank reports its financial position and operating activities in three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

- *Unrestricted net assets* - include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Food Bank. Under this category, the Food Bank maintains an operating fund, any net assets designated by the Board for specific purposes and the unrestricted land, building and equipment fund.
- *Temporarily restricted net assets* - include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.
- *Permanently restricted net assets* - include those assets which are subject to a nonexpiring donor restriction, such as endowments. There are currently no permanently restricted net assets.
- Land, building and equipment fund is designated for equipment acquisitions and for recording the cost of the land, building, equipment and accumulated depreciation. The net asset value of those items that are temporarily or permanently restricted are included in the appropriate net asset category, otherwise the net asset value is included in unrestricted net assets.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of support, revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Comparative financial information

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

Cash and cash equivalents

Cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. The Food Bank maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Food Bank has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Accounts, grants, and pledges receivable

The Food Bank considers all accounts, grants, and pledges receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary.

Inventory

Inventory consists of donated food and non-food items, purchased food, and United States Department of Agriculture (USDA) commodities received from the government. Donated non-government products were valued at \$1.73 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. Donated government food was valued at \$1.52 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. This valuation is based on a cost study conducted for Feeding America. Purchased food is valued utilizing first in, first out (FIFO) method.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments

Investments in marketable securities 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.

Fair value measurements

Fair value is defined 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."

A hierarchy has been established to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). Observable inputs are those that market participants would use in pricing the asset based on market data obtained from sources independent of the Food Bank. Unobservable inputs reflect the Food Bank's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

- *Level 1* - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.
- *Level 2* - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.
- *Level 3* - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Food Bank's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Land, buildings and equipment

Land, buildings and equipment are recorded at cost or estimated fair value for donated items. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 30 years. Equipment purchases over \$5,000 are capitalized. Depreciation is recorded as a decrease in unrestricted net assets and the expense is charged to the activity benefiting from the use of the facilities or equipment. Amounts expended for maintenance and repairs are charged to operations as incurred.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accrued flexible time off (FTO)

Accrued FTO represents vacation and sick time earned, but not taken as of June 30, 2017 and 2016. The maximum FTO that can be accrued and carried over to the next year is 300 hours for employees hired prior to March 10, 2008 and 240 hours for employees hired after March 10, 2008. The accrued FTO balance as of June 30, 2017 and 2016 was \$753,633 and \$684,761, respectively, and is included in accrued expenses.

Revenue recognition

The Food Bank recognizes support and revenue on the accrual basis of accounting. Revenue from grants which have been classified as "exchange transactions" and program fees are recognized as revenue in the period in which the service is provided.

Contributions

Contributions are recognized when the donor makes a pledge to give that is, in substance, an unconditional promise. Second Harvest will not recognize a conditional promise to give until the conditions on which the promise depends are substantially met. A promise that calls for specific outcomes to be achieved will be treated as a conditional promise to give. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted depending on the nature of donor restrictions. Restricted contributions are reported as increases in restricted net assets. When the restriction is met the amount is shown as a reclassification of restricted net assets to unrestricted net assets.

Contributions in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. Contributed services, which require a specialized skill and which the Food Bank would have paid for if not donated, are recorded at the estimated fair value at the time the services are rendered. The Food Bank also receives donated services that do not require specific expertise but which are nonetheless central to the Food Bank's operations. While these contributed services are not reflected in the financial statements the estimated value of these services is disclosed in Note 14.

Functional expense allocations

Management estimates Second Harvest's indirect salary expense allocation based on individual employees estimated time spent by function or time studies. Management's estimate of other indirect costs are based on salary expense, poundage, or actual food distribution by counties.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax status

Second Harvest Food Bank of Santa Clara and San Mateo Counties is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements.

Accounting principles generally accepted in the United States of America provide accounting and disclosure guidance about positions taken by an organization in its tax returns that might be uncertain. Management has considered its tax positions and believes that all of the positions taken by the Food Bank in its federal and state exempt organization tax returns are more-likely-than-not to be sustained upon examination.

The Food Bank's federal returns for the years ended June 30, 2016, 2015, and 2014 could be subject to examination by federal taxing authorities, generally for 3 years after they are filed. The Food Bank's state returns for the years ended June 30, 2016, 2015, 2014, and 2013 could be subject to examination by state taxing authorities, generally for 4 years after they are filed.

Advertising costs

Advertising costs are charged to operations when incurred. Advertising costs for the years ended June 30, 2017 and 2016 totaled \$405,189 and \$565,427, respectively. Of these costs, \$26,934 and \$46,498, respectively were in-kind contributions.

Subsequent events

Management of the Food Bank has evaluated events and transactions subsequent to June 30, 2017 for potential recognition or disclosure in the financial statements. The Food Bank did not have subsequent events that required recognition or disclosure in the financial statements for the fiscal year ended June 30, 2017. Subsequent events have been evaluated through the date the financial statements became available to be issued, November 21, 2017.

Reclassifications

Certain amounts in the prior year have been reclassified in order to be consistent with the current year presentation.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

3. PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	2017	2016
Pledges receivable in less than one year	\$ 3,852,950	\$ 1,823,500
Pledges receivable in one to five years	3,560,000	3,800,000
	7,412,950	5,623,500
Less discounts to net present value	(232,593)	(282,569)
	\$ 7,180,357	\$ 5,340,931

4. INVENTORY

Inventory consists of donated food and non-food items, purchased food and United States Department of Agriculture (USDA) commodities received from the government. Donated non-government products were valued at \$1.73 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. Donated government food was valued at \$1.52 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. This valuation is based on a cost study conducted for Feeding America. Purchased food is valued utilizing first in, first out (FIFO) method. All donated food, non-food items and USDA commodities inventory are classified as Level 2 assets and all purchased food inventory is classified as a Level 1 asset (see Note 2).

Inventory consists of the following:

	2017	2016
Donated non-government food and non-food	\$ 1,623,899	\$ 2,137,579
Purchased food	825,024	677,416
USDA food commodities	644,126	742,763
FEMA food	5,458	-
	\$ 3,098,507	\$ 3,557,758

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

5. INVESTMENTS

Investments consist of the following:

	2017	2016
Investments - board designated endowment (Note 11)	\$ 7,152,977	\$ 5,404,985
Investments - other	20,071,660	18,467,110
	\$ 27,224,637	\$ 23,872,095

Investment earnings (losses) consist of the following:

	2017	2016
Interest and dividends	\$ 635,546	\$ 659,334
Net realized and unrealized gains (losses)	1,763,128	(391,397)
	2,398,674	267,937
Investment fees	(190,671)	(180,352)
	\$ 2,208,003	\$ 87,585

6. FAIR VALUE MEASUREMENTS

The Food Bank's investment policy is to maintain a moderately conservative but balanced portfolio, with the primary investment objectives being the preservation of purchasing power and the preservation of capital. The Food Bank's investment portfolio is structured and maintained with the overall objective of providing the resources and liquidity for the Food Bank to fulfill its mission statement.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
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(With Comparative Totals for 2016)

6. FAIR VALUE MEASUREMENTS (continued)

The following table sets forth by level, within the fair value hierarchy, the Food Bank's assets at fair value as of June 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity investments	\$ 13,366,192	\$ -	\$ -	\$ 13,366,192
Corporate bonds and notes	-	7,930,233	-	7,930,233
U.S. government securities and agency obligations	2,766,301	-	-	2,766,301
Money market investments	1,212,893	-	-	1,212,893
Mutual funds	887,777	-	-	887,777
Real estate investment trusts	-	714,009	-	714,009
Master limited partnership	-	347,232	-	347,232
	<u>\$ 18,233,163</u>	<u>\$ 8,991,474</u>	<u>\$ -</u>	<u>\$ 27,224,637</u>

The following table sets forth by level, within the fair value hierarchy, the Food Bank's assets at fair value as of June 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity investments	\$ 11,018,324	\$ -	\$ -	\$ 11,018,324
Corporate bonds and notes	-	6,979,454	-	6,979,454
U.S. government securities and agency obligations	3,138,638	-	-	3,138,638
Money market investments	1,070,054	-	-	1,070,054
Mutual funds	914,565	-	-	914,565
Real estate investment trusts	-	638,324	-	638,324
Master limited partnerships	-	112,736	-	112,736
	<u>\$ 16,141,581</u>	<u>\$ 7,730,514</u>	<u>\$ -</u>	<u>\$ 23,872,095</u>

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
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(With Comparative Totals for 2016)

7. LAND, BUILDINGS, AND EQUIPMENT

Land, buildings, and equipment consist of the following:

	2017	2016
Land	\$ 3,865,858	\$ 3,865,858
Buildings and improvements	23,730,570	23,553,013
Equipment	11,269,975	10,673,321
Construction-in-progress	1,080,317	449,653
	39,946,720	38,541,845
Accumulated depreciation	(15,601,300)	(14,911,416)
	\$ 24,345,420	\$ 23,630,429

Depreciation expense for the years ended June 30, 2017 and 2016 totaled \$1,671,495 and \$1,683,856, respectively.

8. LINE OF CREDIT

The Food Bank established a revolving line of credit with Wells Fargo Bank to meet short-term working capital borrowing needs. Borrowings under the line of credit for the fiscal years ended June 30, 2017 and 2016 were limited to a maximum of \$4,000,000. Interest on outstanding funds is payable monthly at the bank's prime rate and has a floor rate of 4.0%. The maturity date was May 10, 2017 and has been extended to May 10, 2018. The credit line is secured by certain assets owned by the Food Bank and contains a covenant clause that requires \$8,000,000 of liquidity in cash and investments. There was no balance outstanding or related interest expense on this line of credit for either of the years ended June 30, 2017 and 2016.

9. COMMITMENTS AND CONTINGENCIES

Commitment for remodel

During the year ended June 30, 2017, the Food Bank entered into construction contracts for the Curtner warehouse remodel. The commitment liability as of June 30, 2017 was \$3,602,806.

Operating leases

The Food Bank leases from the County of Santa Clara the land on which the San Jose distribution center is located. The lease term is 50 years, commencing July 30, 1991, at the rate of \$1 per year, with three 10-year renewal options. In the event the premises cease to be used as a nonprofit food collection and distribution facility, the County of Santa Clara has the right to terminate the lease. Due to the impracticality of determining the fair value of the lease, the financial statements do not include an in-kind contribution for this amount.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

9. COMMITMENTS AND CONTINGENCIES (continued)

Contingencies

Grants and contracts awarded to Second Harvest Food Bank of Santa Clara and San Mateo Counties are subject to the funding agencies' criteria, contract terms and regulations under which expenditures may be charged and are subject to audit under such terms, regulations and criteria. Occasionally, such audits may determine that certain costs incurred against the grants do not comply with the established criteria that govern them. In such cases, the Food Bank could be held responsible for repayments to the funding agency for the costs or be subject to the reductions of future funding in the amount of the costs. Management does not anticipate any material questioned costs for the contracts and grants administered through the year ended June 30, 2017.

10. RETIREMENT PLAN

The Food Bank maintains a tax deferred 403(b) retirement plan (the "Plan") to provide retirement benefits for all eligible employees. The plan provides for Food Bank contributions of 5% of eligible employee compensation. Vesting is based on years of service, with 100% vesting of employer matching contributions upon eligibility. Food Bank contributions for the years ended June 30, 2017 and 2016 were \$437,947 and \$407,996, respectively. All of the Plan's administration costs were paid for by the Plan.

11. BOARD DESIGNATED NET ASSETS

As part of the Food Bank's annual review of designated assets, the Board adopted specific guidelines for establishing the level of each designation. Operating reserves include approximately six months of the coming year's annual budget, with adjustments for purchased inventory on hand and current liabilities. Current investment in inventory is reviewed on a monthly basis and is generally below one month's distribution. The designation for capital replacement fund is calculated as the present-value of a ten year asset replacement plan.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

11. BOARD DESIGNATED NET ASSETS (continued)

Board designated net assets consist of the following:

	2017	2016
Operating fund		
Designated for operating reserves	\$ 20,660,359	\$ 18,784,228
Urgent food and infrastructure fund	1,500,000	1,500,000
Inventory	3,098,507	3,557,758
Board-designated endowment fund (pledges)	-	900
Board-designated endowment fund (investment)	7,152,977	5,404,985
	32,411,843	29,247,871
Land, building and equipment fund		
Designated for capital replacement	10,240,032	8,909,935
	\$ 42,651,875	\$ 38,157,806

12. BOARD DESIGNATED ENDOWMENT FUND

Second Harvest Food Bank of Santa Clara and San Mateo Counties' Board Designated Endowment consists of unrestricted net assets which the Board of Directors has chosen to hold as a general endowment fund (the "Fund") to support the mission of the Food Bank.

Interpretation of relevant law

The Food Bank's Board of Directors has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Food Bank classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Food Bank in a manner consistent with the standard of prudence prescribed by UPMIFA.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

12. BOARD DESIGNATED ENDOWMENT FUND (continued)

Interpretation of relevant law (continued)

In accordance with UPMIFA, the Food Bank considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Food Bank and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Food Bank
- (7) The investment policies of the Food Bank

Return objectives and risk parameters

The Board Designated Endowment (the "Fund") was created to ensure a reasonable, predictable, and sustainable source of funds. The Food Bank will designate 90% of each unrestricted donor bequest to the endowment. The Fund will be used to produce a growing level of income in order to support future activities, programs and the capital needs of the Food Bank. The Food Bank's objective is to provide a predictable stream of funding while seeking to maintain the purchasing power of the Fund's assets and preserve capital. The primary goal is to seek a total return (net of fees and expenses) that equals at least 500 basis points over the inflation rate, as measured by the Consumer Price Index on an annualized basis. These objectives and goals are expected to be achieved over 6 - 10 years.

Strategies employed for achieving objectives

The Board has determined that the assets of the Fund will be professionally managed in a moderately conservative manner. Management of the Fund's portfolio should focus on satisfying these objectives through the optimal allocation of stocks and fixed income securities. Fixed income securities should be used to satisfy current income requirements and control total portfolio volatility. Common stocks should generate income and capital growth to preserve and enhance the purchasing power of the portfolio. The nature of the assets involved and the long-term objectives of the Fund suggest utilizing a "total return approach" to investment management.

The Equity portion of the Fund will consist of publicly traded common and preferred stocks and convertible debt. It is expected that 40% to 70% (with a target of 57%) of the Fund will be invested in equity and/or equity mutual funds. It is expected that 30% to 60% (with a target of 38%) of the Fund will be invested in fixed income securities. It is expected that 0% to 7% (with a target of 5%) of the Fund will be invested in alternative investments.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

12. BOARD DESIGNATED ENDOWMENT FUND (continued)

Spending policy and how investment objectives relate to spending policy

The Board's first objective was to grow the fund to \$1,000,000 which was achieved as of June 30, 2014. Starting July 1, 2014 the Fund's spending policy aims to ensure a prudent tradeoff between current program needs and long-term purchasing power. Therefore, the spending range of 4% to 5.75%, with a desired optimal target of 5%, is considered prudent.

The amount of funds allocated for expenditure ("Spending Allocation") will be calculated in April of each year and based on the rolling prior 12-quarter average. If less than 12 quarters are available then the available quarters will be used. The Spending Allocation will be transferred to the operations account between July and October in the fiscal year following the calculation.

Endowment composition

Changes in board-designated endowment net assets are as follows:

	2017	2016
Balance, beginning of year	\$ 5,405,885	\$ 4,939,017
Transfers to board designated endowment fund	1,669,160	407,245
Investment income	128,935	100,674
Investment fees	(51,003)	(41,051)
Balance, end of year	\$ 7,152,977	\$ 5,405,885

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
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(With Comparative Totals for 2016)

13. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following:

	2017	2016
Purpose restrictions		
Stand Up for Kids	\$ 1,552,250	\$ 347,065
Capacity building	1,000,000	1,454,592
School pantry	250,000	25,000
Brown bag program	50,000	-
Holiday food drive	30,000	310,000
Family harvest program	24,671	40,931
Capital campaign	2,500	508,614
Season of sharing	-	146,250
Food assistance	-	125,000
Produce mobile	-	2,500
	2,909,421	2,959,952
Time restrictions		
General support for future periods	5,887,657	4,394,040
Government - Sequoia (program)	150,000	130,000
	\$ 8,947,078	\$ 7,483,992

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

13. TEMPORARILY RESTRICTED NET ASSETS (continued)

Temporarily restricted net assets released from restriction during the year were as follows:

	<u>2017</u>	<u>2016</u>
Time restrictions	\$ 3,156,540	\$ 441,433
Stand Up for Kids	1,183,942	7,630,139
Capital campaign	506,258	135,758
Capacity building	454,592	-
Holiday food drive	310,000	26,090
School pantry	275,000	991,666
Season of sharing	146,250	84,000
Food assistance	125,000	189,278
Community nutrition	50,000	-
Food purchase	40,400	-
Family harvest program	16,260	69,069
Produce mobile	17,500	50,000
Volunteer program	10,000	-
Photo	5,000	-
CalFresh	-	170,000
Brown bag	-	50,000
Fuel	-	25,000
	<u>\$ 6,296,742</u>	<u>\$ 9,862,433</u>

14. CONTRIBUTIONS IN-KIND

The estimated fair value of donated food, gift certificates, property and equipment, advertisements, supplies and expert services received are recorded as contributions. Donated non-government products were valued at \$1.73 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. Donated government food was valued at \$1.52 and \$1.67 per pound for the years ended June 30, 2017 and 2016, respectively. This valuation is based on a cost study conducted for Feeding America.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Financial Statements
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(With Comparative Totals for 2016)

14. CONTRIBUTIONS IN-KIND (continued)

In-kind contributions received during the year were as follows:

	2017	2016
Contributions in-kind - non-government		
Food and non-food inventory	\$ 78,374,071	\$ 75,889,014
Supplies and minor equipment	450,463	518,866
Vehicles and equipment	27,707	13,794
Media	26,934	46,498
Gift certificates	20,425	28,114
Services	1,375	500
	78,900,975	76,496,786
 Government assistance - in-kind		
Food - government	6,676,459	9,236,486
	\$ 85,577,434	\$ 85,733,272

The Food Bank also receives donated services that do not require specific expertise but which are nonetheless central to the Food Bank's operations. For the years ended June 30, 2017 and 2016 the estimated value of these services, based on the estimated dollar value of volunteer time calculated by average rate by job category, totaled \$7,075,916 and \$6,646,180, respectively. The value of these services are not reflected in the financial statements.

15. PAYMENTS TO AFFILIATES

In accordance with the affiliation agreement between Feeding America and the Food Bank, the Food Bank pays fees based on total poundage of food received from Feeding America. Affiliation payments for the years ended June 30, 2017 and 2016 were \$18,527 and \$18,978, respectively.

16. CONFLICT OF INTEREST POLICY

Included among the Food Bank's Board of Directors and Officers are volunteers from the community who provide valuable assistance to the Food Bank in the development of policies and programs and in the evaluation of business transactions. The Food Bank has adopted a conflict of interest policy whereby board members are disqualified from participation in the final decisions regarding any action affecting their related company or organization.

SINGLE AUDIT REPORTS AND SCHEDULES

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
Second Harvest Food Bank of Santa Clara and San Mateo Counties
San Jose, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America (the "U.S.") 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 Second Harvest Food Bank of Santa Clara and San Mateo Counties (a California nonprofit corporation) (the "Food Bank"), which comprise the statement of financial position as of June 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 November 21, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Food Bank'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 the Food Bank's internal control. Accordingly, we do not express an opinion on the effectiveness of the Food Bank's internal control.

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 the Food Bank'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 Food Bank'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 Food Bank's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Armanino^{LLP}
San Jose, California

November 21, 2017



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
Second Harvest Food Bank of Santa Clara and San Mateo Counties
San Jose, California

Report on Compliance for Each Major Federal Program

We have audited Second Harvest Food Bank of Santa Clara and San Mateo Counties' (a California nonprofit corporation) (the "Food Bank") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Food Bank's major federal programs for the year ended June 30, 2017. The Food Bank'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.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Food Bank'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 "U.S."); the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S.; 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* (the "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 the Food Bank'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 the Food Bank's compliance.

Opinion on Each Major Federal Program

In our opinion, the Food Bank 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 June 30, 2017.

Report on Internal Control Over Compliance

Management of the Food Bank 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 the Food Bank'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 the Food Bank'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 weakness 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.



Armanino^{LLP}
San Jose, California

November 21, 2017

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Schedule of Expenditures of Federal and Other Governmental Awards
For the Year Ended June 30, 2017

Federal Grantor/Pass-Through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Total Federal Expenditures
<u>Expenditures of Federal Awards</u>			
U.S. Department of Agriculture			
Passed through			
California Department of Social Services			
Food Distribution Cluster			
Emergency Food Assistance Program (Food Commodities)	10.569	N/A	\$ 6,676,459
Emergency Food Assistance Program (Administrative Costs)	10.568	MOU#10-6060	239,730
Emergency Food Assistance Program (Supplemental Costs)	10.568	MOU#10-6060	82,354
Total Food Distribution Cluster			<u>6,998,543</u>
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561	N/A	<u>269,888</u>
Total U.S. Department of Agriculture			<u>7,268,431</u>
U.S. Department of Homeland Security Federal Emergency Management Agency (FEMA)			
Direct awards			
Emergency Food and Shelter National Board Program	97.024	N/A	<u>113,748</u>
Total U.S. Department of Homeland Security Federal Emergency Management Agency (FEMA)			<u>113,748</u>
Total Expenditures of Federal Awards			<u>7,382,179</u>
<u>Expenditures of Other Governmental Awards</u>			
Santa Clara County - Department of Social Services	N/A	N/A	768,576
San Mateo County - Sequoia Healthcare district	N/A	N/A	150,000
San Mateo County - Measure A	N/A	N/A	150,000
San Mateo County - Food Assistance	N/A	N/A	68,427
San Mateo County - Food Stamp Outreach	N/A	N/A	30,000
State of California Department of Social Services			
Passed through - Emergency Food Assistance Program (Tax Check Off)	N/A	N/A	<u>40,190</u>
Total Expenditures of Other Governmental Awards			<u>1,207,193</u>
Total Expenditures of Federal and Other Governmental Awards			<u>\$ 8,589,372</u>

The accompanying notes to the Schedule of Expenditures of Federal and Other Governmental Awards are an integral part of this schedule.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Notes to Schedule of Expenditures of Federal and Other Governmental Awards
June 30, 2017

1. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal and other governmental awards (the "Schedule") includes the federal and other governmental award activity of Second Harvest Food Bank of Santa Clara and San Mateo Counties (the "Food Bank") under programs of the federal, state and local governments for the year ended June 30, 2017. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* (CFR), *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 Food Bank, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Food Bank.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This Schedule is presented on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or limited as to reimbursement.

3. SUBRECIPIENTS

Of the federal expenditures presented in the Schedule, Second Harvest Food Bank of Santa Clara and San Mateo Counties provided federal awards to Subrecipients as follows:

<u>CFDA Number</u>	<u>Program Name</u>	<u>Amount Provided to Subrecipients</u>
10.569	Emergency Food Assistance Program (Food Commodities)	\$6,998,543

4. FOOD DISTRIBUTION

Nonmonetary assistance for commodities received are reported in the Schedule based on a cost study conducted for Feeding America. At June 30, 2017, the Food Bank had food commodities totaling \$644,126 in inventory.

5. INDIRECT COST RATE

Second Harvest Food Bank of Santa Clara and San Mateo Counties has not elected to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance.

Second Harvest Food Bank of Santa Clara and San Mateo Counties
 Schedule of Findings and Questioned Costs
 For the Year Ended June 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?	No
Significant deficiency(ies) identified that are not considered to be material weaknesses?	None reported
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major programs:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weaknesses?	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 2 CFR 200.516(a)?	No
Identification of major programs:	

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Emergency Food Assistance Program (Administrative Costs)	10.568
Emergency Food Assistance Program (Food Commodities)	10.569
Dollar threshold used to distinguish between Type A and Type B programs	\$750,000
Auditee qualified as low-risk auditee?	Yes

Second Harvest Food Bank of Santa Clara and San Mateo Counties
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2017

SECTION II - SUMMARY OF FINANCIAL STATEMENT FINDINGS

There are no financial statement findings to be reported.

SECTION III - SUMMARY OF FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

There are no federal award findings to be reported.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS

There were no prior year findings.

SECTION V - CORRECTIVE ACTION PLAN

There is no corrective action plan required.