

Consolidated financial statements of:

SECOND HARVEST HEARTLAND

Years ended
September 30, 2017 and 2016

	Page
Independent auditor's report	1
Consolidated financial statements:	
Statements of financial position	2
Statements of activities and changes in net assets	3
Statements of cash flows	4-5
Statements of functional expenses	6-7
Notes to consolidated financial statements	8-19



Suite 1600
100 Washington Avenue South
Minneapolis, MN 55401-2192

P 612.332.5500 F 612.332.1529
www.sdkcpa.com

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Second Harvest Heartland
1140 Gervais Ave.
Maplewood, MN 55109

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Second Harvest Heartland (the Organization) which comprise the consolidated statements of financial position as of September 30, 2017 and 2016, and the related consolidated statements of activities and changes in net assets, cash flows and functional expenses for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of September 30, 2017 and 2016, and the results of its activities and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Schechter Dokken Kanter
Andrews & Selzer Ltd.*

December 15, 2017

SECOND HARVEST HEARTLAND

	<u>2017</u>	<u>2016</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 2,563,917	\$ 2,539,192
Investments	6,700,372	5,075,466
Receivables:		
Trade, net	764,720	858,898
Grants	582,324	455,846
Pledges, current portion, net	1,213,329	531,433
Other	10,109	21,168
Inventory	4,442,531	4,852,048
Prepaid expense	377,873	314,073
	<u>16,655,175</u>	<u>14,648,124</u>
Property and equipment, net	<u>17,923,101</u>	<u>4,814,467</u>
Pledges receivable, net of current portion	2,139,127	1,229,960
Other assets	18,649	18,649
	<u>2,157,776</u>	<u>1,248,609</u>
Total assets	<u>\$ 36,736,052</u>	<u>\$ 20,711,200</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30

	2017	2016
<i>Liabilities and net assets:</i>		
Current liabilities:		
Line of credit		\$ 500,000
Accounts payable	\$ 1,413,769	942,635
Fiscal agent payable	12,368	14,361
Accrued expenses	807,390	978,565
Current portion of:		
Note payable	-	324,006
Capital leases	254,602	234,950
Deferred rent	14,554	22,220
	2,502,683	3,016,737
Long - term liabilities, net of current portions:		
Notes payable	13,400,000	221,933
Capital leases	1,183,634	1,327,542
Deferred rent	-	14,554
	14,583,634	1,564,029
	17,086,317	4,580,766
Net assets:		
Unrestricted:		
Operations	10,033,246	8,039,135
In-kind inventory	3,900,148	4,349,149
	13,933,394	12,388,284
Temporarily restricted	5,716,341	3,742,150
	19,649,735	16,130,434
	\$ 36,736,052	\$ 20,711,200

SECOND HARVEST HEARTLAND

	2017		
	Unrestricted	Temporarily restricted	Total
Revenues:			
Program services	\$ 2,975,329		\$ 2,975,329
Purchase program	6,502,698		6,502,698
Government contracts	2,629,488		2,629,488
Contributions	15,239,192	\$ 4,004,768	19,243,960
Special Events, net of expenses of \$288,475 and \$289,709 in 2017 and 2016, respectively	626,357		626,357
In-Kind donations:			
Product	109,268,679		109,268,679
Services	732,000		732,000
Investment income	323,973		323,973
Miscellaneous income	154,332		154,332
	<u>138,452,048</u>	<u>4,004,768</u>	<u>142,456,816</u>
Net assets released from restrictions	<u>2,030,577</u>	<u>(2,030,577)</u>	<u>-</u>
Total support and revenues	<u>140,482,625</u>	<u>1,974,191</u>	<u>142,456,816</u>
Expenses:			
Programs	131,016,073		131,016,073
General, administrative and marketing	3,649,842		3,649,842
Fundraising	4,271,600		4,271,600
	<u>138,937,515</u>		<u>138,937,515</u>
Total expenses	<u>138,937,515</u>		<u>138,937,515</u>
Change in net assets	1,545,110	1,974,191	3,519,301
Change in net assets, increase (decrease) from:			
Operations	1,994,111	1,974,191	3,968,302
In-kind inventory change	(449,001)	-	(449,001)
	<u>1,545,110</u>	<u>1,974,191</u>	<u>3,519,301</u>
Total change in net assets	<u>1,545,110</u>	<u>1,974,191</u>	<u>3,519,301</u>
Net assets, beginning	<u>12,388,284</u>	<u>3,742,150</u>	<u>16,130,434</u>
Net assets, ending	<u>\$ 13,933,394</u>	<u>\$ 5,716,341</u>	<u>\$ 19,649,735</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF ACTIVITIES
AND CHANGES IN NET ASSETS
YEARS ENDED SEPTEMBER 30

2016		
Unrestricted	Temporarily restricted	Total
\$ 2,495,987		\$ 2,495,987
6,523,992		6,523,992
2,550,101		2,550,101
13,943,874	\$ 4,043,224	17,987,098
749,915		749,915
113,939,820		113,939,820
196,324		196,324
205,065		205,065
<u>140,605,078</u>	<u>4,043,224</u>	<u>144,648,302</u>
974,304	(974,304)	
141,579,382	3,068,920	144,648,302
133,381,056		133,381,056
3,186,873		3,186,873
4,153,417		4,153,417
<u>140,721,346</u>		<u>140,721,346</u>
858,036	3,068,920	3,926,956
1,147,018	3,068,920	4,215,938
(288,982)	-	(288,982)
<u>858,036</u>	<u>3,068,920</u>	<u>3,926,956</u>
11,530,248	673,230	12,203,478
<u>\$ 12,388,284</u>	<u>\$ 3,742,150</u>	<u>\$ 16,130,434</u>

CONSOLIDATED STATEMENTS OF
CASH FLOWS
YEARS ENDED SEPTEMBER 30

SECOND HARVEST HEARTLAND

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ 3,519,301	\$ 3,926,956
Adjustments to reconcile change in net assets to cash provided by (used in) operating activities:		
Depreciation and amortization	1,206,412	1,389,276
Donated securities	(665,643)	(367,839)
Gain on disposal of equipment	1,351	(88,464)
Realized and unrealized gains	(319,304)	(191,940)
Temporarily restricted capital campaign cash contributions	(1,974,191)	(1,122,559)
Decrease (increase) in:		
Receivables, net	(1,612,304)	(1,440,930)
Prepaid expenses	(63,800)	(53,098)
Inventory	409,517	404,011
Decrease (increase) in:		
Accounts payable	471,134	169,810
Fiscal agent payable	(1,993)	(51,972)
Accrued expenses	(171,175)	(117,830)
Deferred:		
Revenue	-	(222,922)
Rent	(22,220)	(17,592)
	777,085	2,214,907
Net cash provided by operating activities		
Cash flows from investing activities:		
Purchase of:		
Property and equipment	(1,031,482)	(506,035)
Investments	(2,509,694)	(9,864,905)
Proceeds from sale of:		
Property and equipment	-	88,464
Investments	1,869,734	5,352,073
	(1,671,442)	(4,930,403)
Net cash used in investing activities		

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF
CASH FLOWS
YEARS ENDED SEPTEMBER 30

SECOND HARVEST HEARTLAND AND SUBSIDIARIES

	2017	2016
Cash flows from financing activities:		
Capital campaign cash contributions	\$ 1,974,191	\$ 1,122,559
Payments on:		
Capital leases	(246,017)	(211,184)
Notes payable	(545,939)	(311,567)
Net change in line of credit	(500,000)	500,000
Proceeds from notes payable	236,847	
Net cash provided by financing activities	919,082	1,099,808
Net increase (decrease) in cash and cash equivalents	24,725	(1,615,688)
Cash and cash equivalents, beginning	2,539,192	4,154,880
Cash and cash equivalents, ending	\$ 2,563,917	\$ 2,539,192
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 123,981	\$ 81,965
Purchase of building through debt financing	\$ 13,163,153	
Purchase of equipment through capital leases	\$ 121,761	\$ 432,997

See notes to consolidated financial statements.

SECOND HARVEST HEARTLAND

	Programs				
	CSFP	Food Bank	Food Rescue	Agency Relations	Community Outreach
Wages and temporary services	\$ 272,076	\$ 3,090,907	\$ 872,598	\$ 485,964	\$ 870,610
Fringe benefits and payroll taxes	60,179	776,337	197,998	148,536	209,878
Professional fees	-	4,320	-	10,100	182,959
In-kind professional fees		244,000			488,000
Occupancy	193,680	625,719	5,268	8,173	15,098
Vehicles operation	101,483	649,084	446,942	30	12,246
Procurement	76,336	2,255,422	-	-	6,877
Equipment	28,465	453,525	56,239	37,434	80,970
Supplies	24,473	67,909	5,980	3,942	26,954
Meeting, travel and staff development	8,366	48,646	19,202	40,485	76,227
Promotions and marketing	67	1,112	12	-	31,402
Special events	-	-	-	-	-
Direct mail	-	(11,385)	-	-	-
Cluster/network fees	-	-	-	-	-
Agency assistance	-	6,781	-	57,674	50,898
Subgrant awards - HFMN	-	-	-	-	-
In-kind distributed*	6,928,261	102,789,421	-	-	-
Cost of purchased product disbursed	-	6,487,992	-	-	200,317
Other	-	-	-	19,465	47
Depreciation and amortization	31,868	939,409	67,840	19,409	39,359
Bad debts	-	706	-	-	-
Interest	1,075	56,571	7,753	135	247
	7,726,329	118,486,476	1,679,832	831,347	2,292,089
Less:					
Special events					
	\$ 7,726,329	\$ 118,486,476	\$ 1,679,832	\$ 831,347	\$ 2,292,089

*Food Bank In-kind distributed includes Food Rescue product.

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED SEPTEMBER 30, 2017

(WITH COMPARATIVE TOTALS FOR 2016)

Programs total	Support services			Total	2016 Total
	G&A and marketing	Fundraising	Support total		
\$ 5,592,155	\$ 1,990,540	\$ 1,631,179	\$ 3,621,719	\$ 9,213,874	\$ 8,708,352
1,392,928	423,679	422,595	846,274	2,239,202	2,052,815
197,379	452,649	269,294	721,943	919,322	955,864
732,000			-	732,000	
847,938	136,338	23,362	159,700	1,007,638	922,864
1,209,785	5,815	1,939	7,754	1,217,539	978,831
2,338,635	-	53	53	2,338,688	1,960,542
656,633	96,902	102,990	199,892	856,525	646,451
129,258	22,516	160,376	182,892	312,150	279,944
192,926	95,471	42,507	137,978	330,904	247,313
32,593	182,813	176,464	359,277	391,870	298,088
-	-	288,475	288,475	288,475	289,709
(11,385)	3,707	1,375,682	1,379,389	1,368,004	1,366,035
-	29,762	-	29,762	29,762	30,002
115,353	-	-	-	115,353	54,761
-	-	-	-	-	-
109,717,682	-	-	-	109,717,682	114,228,801
6,688,309	2,798	-	2,798	6,691,107	6,511,652
19,512	104,683	-	104,683	124,195	5,235
1,097,885	43,720	64,807	108,527	1,206,412	1,389,276
706	601	-	601	1,307	2,555
65,781	57,848	352	58,200	123,981	81,965
131,016,073	3,649,842	4,560,075	8,209,917	139,225,990	141,011,055
		288,475	288,475	288,475	289,709
<u>\$ 131,016,073</u>	<u>\$ 3,649,842</u>	<u>\$ 4,271,600</u>	<u>\$ 7,921,442</u>	<u>\$ 138,937,515</u>	<u>\$ 140,721,346</u>

SECOND HARVEST HEARTLAND

	Programs				
	CSFP	Food Bank	Food Rescue	Agency Relations	Community Outreach
Wages and temporary services	\$ 267,975	\$ 3,136,332	\$ 778,916	\$ 438,996	\$ 670,603
Fringe benefits and payroll taxes	63,457	739,339	192,829	126,392	156,310
Professional fees	-	6,595	-	9,205	161,295
Occupancy	109,834	638,481	3,282	5,809	9,110
Vehicles operation	105,094	545,775	309,730	20	11,561
Procurement	58,334	1,900,414	86	25	1,683
Equipment	22,808	401,364	41,506	24,619	45,053
Supplies	24,516	55,826	5,364	9,876	19,753
Meeting, travel and staff development	4,769	28,951	16,030	33,328	77,042
Promotions and marketing	272	3,094	-	-	29,640
Special events	-	-	-	-	-
Direct mail	-	-	-	-	-
Cluster/network fees	-	-	-	-	-
Agency assistance	-	-	-	9,761	45,000
Subgrant awards - HFMN	-	-	-	-	-
In-kind distributed*	6,442,814	107,785,987	-	-	-
Cost of purchased product disbursed	80	6,336,014	-	-	175,558
Other	-	-	-	-	-
Depreciation and amortization	24,439	1,036,308	85,228	24,272	44,542
Bad debts	-	40	-	-	-
Interest	2,407	67,516	9,056	306	435
	<u>7,126,799</u>	<u>122,682,036</u>	<u>1,442,027</u>	<u>682,609</u>	<u>1,447,585</u>
Less:					
Special events	-	-	-	-	-
	<u>\$ 7,126,799</u>	<u>\$ 122,682,036</u>	<u>\$ 1,442,027</u>	<u>\$ 682,609</u>	<u>\$ 1,447,585</u>

*Food Bank In-kind distributed includes Food Rescue product.

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED SEPTEMBER 30, 2016

Programs total	Support services			Support total	Total
	G&A and marketing	Fundraising			
\$ 5,292,822	\$ 1,868,117	\$ 1,547,413	\$ 3,415,530	\$ 8,708,352	
1,278,327	421,875	352,613	774,488	2,052,815	
177,095	493,769	285,000	778,769	955,864	
766,516	98,661	57,687	156,348	922,864	
972,180	6,298	353	6,651	978,831	
1,960,542	-	-	-	1,960,542	
535,350	34,264	76,837	111,101	646,451	
115,335	17,128	147,481	164,609	279,944	
160,120	54,001	33,192	87,193	247,313	
33,006	88,008	177,074	265,082	298,088	
-	-	289,709	289,709	289,709	
-	3,515	1,362,520	1,366,035	1,366,035	
-	30,002	-	30,002	30,002	
54,761	-	-	-	54,761	
-	-	-	-	-	
114,228,801	-	-	-	114,228,801	
6,511,652	-	-	-	6,511,652	
-	5,235	-	5,235	5,235	
1,214,789	62,062	112,425	174,487	1,389,276	
40	2,515	-	2,515	2,555	
79,720	1,423	822	2,245	81,965	
133,381,056	3,186,873	4,443,126	7,629,999	141,011,055	
-	-	289,709	289,709	289,709	
<u>\$ 133,381,056</u>	<u>\$ 3,186,873</u>	<u>\$ 4,153,417</u>	<u>\$ 7,340,290</u>	<u>\$ 140,721,346</u>	

SECOND HARVEST HEARTLAND

1. Summary of significant accounting policies:

Nature of activities:

Second Harvest Heartland (the Organization) is a Minnesota not-for-profit organization dedicated to ending hunger through community partnerships and increasing public awareness of hunger. The Organization obtains, stores and distributes donated and purchased food to approximately 1,100 member agency programs and directly to low income individuals in Minnesota and Western Wisconsin. The Organization is a member of Feeding America, an association of more than 200 food banks serving the entire country. Through partnerships with public agencies and other nonprofit organizations, the Organization assists in the administration of two government programs: The Emergency Food Assistance Program (TEFAP) and the Commodity Supplemental Food Program (CSFP). The organization is engaged in a capital campaign for funding of capital expansion and improvements. Private and governmental funding was raised in 2017 and 2016 to pursue expansion of services in partnership with the Health care industry. The Organization also administers a food rescue program as well as provides food to member agencies (food bank program) and other programs that address hunger issues. Financial funding for the Organization comes from general contributions, grants, fees charged to member agencies and non-financial funding comes from donations and grants of food.

During fiscal year 2011, Second Harvest Heartland created a single member LLC called Hunger-Free Minnesota, LLC. Hunger-Free Minnesota has a strategic, three-year action plan to close the gap of 100 million missing meals every year across the state of Minnesota. In fiscal year 2015, after providing grants to more than 400 partner agencies, and sponsoring media to create hunger insecurity awareness statewide, Hunger-Free Minnesota LLC operations sunsetted. There was no activity for Hunger-Free Minnesota LLC in 2016 or 2017.

Principles of consolidation:

The consolidated financial statements include the accounts of Second Harvest Heartland and its wholly owned subsidiary, Hunger-Free Minnesota, LLC. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Use of estimates:

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America which requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. Significant estimates include in-kind donated food inventory, receipts and distributions and in-kind donated services.

Major source of revenue:

The Organization received approximately 11 % and 13% of total support and revenue from one governmental agency for the years ended September 30, 2017 and 2016, respectively.

Contributions and grants:

All contributions and grants are considered available for unrestricted use unless specifically restricted by the donor. Donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. If a restriction expires in the same fiscal year in which the contribution was recognized, the contribution is reported as an increase in unrestricted net assets. At the end of fiscal years 2017 and 2016, the Organization did not have any permanently restricted net assets.

SECOND HARVEST HEARTLAND

1. Summary of significant accounting policies (continued):

Unrestricted net assets:

The Organization presents its unrestricted net assets in two categories: operations and in-kind inventory. The in-kind inventory category is the accumulated effect that in-kind activity has on ending inventory, while the operations amount is the accumulated effect of change in net assets excluding the in-kind inventory activity.

Functional allocation of expenses:

The costs of providing various programs and other activities have been summarized on a functional basis in the statements of activities and change in net assets. Expenses that relate to more than one program or function have been allocated based on the best estimates of management.

Received product:

The Organization reports contributions of food over which it has control as unrestricted in-kind donations. Public donations of food and food obtained through USDA commodity programs (TEFAP and CSFP) are valued based on a weighted average wholesale value per pound. This valuation is determined using a report provided annually by Feeding America based on an annual study. During fiscal years 2017 and 2016, the Organization received 98,380,000 and 96,570,000 pounds of food, respectively. The Organization reported in-kind donations for donated food, along with purchased product valued at cost, as follows:

	<u>2017</u>	
	<u>Pounds</u>	<u>Dollars</u>
Donated product	68,325,000	\$ 94,487,000
TEFAP	4,923,000	8,120,000
CSFP	<u>3,479,000</u>	<u>6,662,000</u>
In-kind donations	76,727,000	109,269,000
Purchased	14,330,000	6,763,000
In-kind donations as agent	<u>7,323,000</u>	<u>17,514,000</u>
Total received	<u>98,380,000</u>	<u>\$ 133,546,000</u>

	<u>2016</u>	
	<u>Pounds</u>	<u>Dollars</u>
Donated product	64,663,000	\$ 95,706,000
TEFAP	7,030,000	11,719,000
CSFP	<u>3,812,000</u>	<u>6,515,000</u>
In-kind donations	75,505,000	113,940,000
Purchased	13,185,000	6,397,000
In-kind donations as agent	<u>7,880,000</u>	<u>15,711,000</u>
Total received	<u>96,570,000</u>	<u>\$ 136,048,000</u>

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 20161. Summary of significant accounting policies (continued):

The Organization acts as an agent for five other Feeding America Food Banks with locations in Minnesota. Per contractual arrangements, the Organization re-distributes certain products to these other Feeding America locations.

Distributed product:

During fiscal years 2017 and 2016, the Organization distributed 94,785,000 and 93,385,000 pounds of food, respectively, to member agencies and partners. The following reflects all of the Organization's distributions (including purchased product, but excluding waste) during fiscal years 2017 and 2016:

	2017	
	<u>Pounds</u>	<u>Dollars</u>
Donated product	64,558,000	\$ 90,528,000
TEFAP	4,936,000	8,076,000
CSFP	<u>3,677,000</u>	<u>6,956,000</u>
In-kind distributions	73,171,000	105,560,000
Purchased	14,269,000	6,708,000
In-kind distributions as agent	<u>7,345,000</u>	<u>17,625,000</u>
Total distributions	<u>94,785,000</u>	<u>\$ 129,893,000</u>

	2016	
	<u>Pounds</u>	<u>Dollars</u>
Donated product	61,360,000	\$ 91,610,000
TEFAP	7,137,000	11,876,000
CSFP	<u>3,783,000</u>	<u>6,460,000</u>
In-kind distributions	72,280,000	109,946,000
Purchased	13,255,000	6,506,000
In-kind distributions as agent	<u>7,850,000</u>	<u>\$ 15,729,000</u>
Total distributions	<u>93,385,000</u>	<u>\$ 132,181,000</u>

SECOND HARVEST HEARTLAND

1. Summary of significant accounting policies (continued):

Contributed services:

The Organization received donated in-kind professional business services in 2017 and 2016 which were recorded as revenue and expense at the fair value as established by the donor of \$732,000 and \$0, respectively.

Members of the Organization and volunteers have donated significant amounts of their time to enhancing the Organization's activities. The number of unique volunteers and hours of service totaled 31,175 and 128,200 in 2017, respectively. The number of unique volunteers and hours of service totaled 28,800 and 132,800 in 2016, respectively. The value of these donated services totaled \$1,218,546 and \$1,251,600 in 2017 and 2016, respectively, however the amount is not reflected in the accompanying financial statements as they are non-specialized services.

Cash and cash equivalents:

Cash and cash equivalents include interest bearing money market accounts and any investments with an original maturity of three months or less. The Organization maintains its cash and cash equivalents with various financial institutions. At times, these balances may exceed federally insured limits. The Organization has not experienced a loss as a result of these deposits.

Investments:

Investments in marketable securities with readily determinable fair value and all investments in debt securities are valued 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:

The Organization's investments are reported using a framework for measuring fair value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets, for which prices are available at the measurement date.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

SECOND HARVEST HEARTLAND

1. Summary of significant accounting policies (continued):

Fair value measurements (continued):

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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 used must maximize the use of observable inputs and minimize the use of unobservable inputs.

Inventory:

Inventory is valued on a first-in, first-out basis. Public donations of food and food obtained through USDA commodity programs (TEFAP and CFSP) are valued based on a weighted average wholesale price per pound. This valuation is determined using a report provided annually by Feeding America based on an annual study. Purchased food is valued based on actual cost. Inventory is shown net of any inventory on-hand that is allocated to Feeding America entities for which the Organization is only acting as an agent.

Property and equipment:

Property and equipment are stated at cost. Contributed property and equipment are recorded at fair value at the date of donation. Depreciation is provided over the estimated useful lives of the assets by the straight-line method. The capitalization policy of the Organization is to capitalize all property and equipment over \$5,000. Asset lives are as follows:

Buildings	40 years
Building improvements	10-25 years
Equipment	3-10 years
Autos and trucks	3-10 years

Computer software:

The Organization capitalizes the costs of obtaining or developing internal use software including directly related payroll costs and amortizes those costs over a period of three years, beginning when the software is ready for its intended use.

Trade receivable and bad debt:

Trade receivables are stated at original invoice amount less an estimate for doubtful receivables based on management's review of all outstanding amounts and historical experience. Accounts receivable are written-off when deemed uncollectible. Recoveries of accounts previously written-off are recorded when received. The allowance for doubtful accounts was \$32,109 as of September 30, 2017 and 2016. The Organization transacts with its member agencies on open credit and such accounts receivable are uncollateralized. The maximum loss that would be incurred if a member agency failed to pay amounts owed would be limited to the recorded amount due after any allowances provided.

An account is considered past due if the balance is outstanding for more than 90 days.

1. Summary of significant accounting policies (continued):**Grants receivable:**

Grants receivable are stated at the estimated net realizable value after provision for doubtful accounts. There was no allowance related to grants receivable at September 30, 2017 and 2016. Grants receivable at September 30, 2017 and 2016 are due in less than one year.

Pledges receivable:

Unconditional promises to give are recorded at net realizable value. The allowance for uncollectible pledges was \$95,024 and \$54,476 as of September 30, 2017 and 2016, respectively. Conditional promises to give are recognized when the conditions are met.

Income taxes:

The Organization is exempt, as a public charity, from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state statutes. However, income from certain activities not directly related to the Organization's tax-exempt purpose could result in taxable income.

The Organization has evaluated its tax positions for uncertainty and has no unrecognized tax matters that are required to be disclosed.

Advertising costs:

Advertising costs are expensed as incurred. Total advertising expense was \$1,690,582 and \$1,579,178 for the years ended September 30, 2017 and 2016, respectively.

Reclassifications:

Certain reclassifications have been made to the 2016 financial statements to conform to the 2017 presentation.

Subsequent events:

The Organization evaluated for subsequent events through December 15, 2017, the date the financial statements were available for issuance.

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 20162. Fair value measurements:

The following table presents the fair value hierarchy for the balances of the assets of the Organization measured at fair value on a recurring basis as of September 30, 2017 and 2016.

	2017			Total
	Level 1	Level 2	Level 3	
Equities:				
Large cap	\$ 609,207			\$ 609,207
Mid cap	30,237			30,237
Small cap	44,236			44,236
Emerging	56,634			56,634
Diversified	442,691			442,691
Other	215,429			215,429
Fixed income:				
Corporate bond	1,058,964			1,058,964
Fixed income fund	1,225,133			1,225,133
Core fixed income fund	2,369,246			2,369,246
High yield fund	291,496			291,496
US treasury bond	99,813			99,813
Other	257,286			257,282
	<u>\$ 6,700,372</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 6,700,372</u>
2016				
	Level 1	Level 2	Level 3	Total
Equities:				
Large value	\$ 179,764			\$ 179,764
Large blend	556,152			556,152
Foreign large blend	125,672			125,672
Other	329,844			329,844
Fixed income:				
Corporate bond	2,801,108			2,801,108
Foreign bond	150,732			150,732
Hedged bond	284,241			284,241
Short-term bond	267,391			267,391
Intermediate bond	319,345			319,345
Other	61,217			61,217
	<u>\$ 5,075,466</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 5,075,466</u>

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 2016**3. Inventory:**

Ending inventory is comprised of the following:

	<u>2017</u>	<u>2016</u>
Donated	\$ 1,920,261	\$ 2,148,633
TEFAP	801,047	755,292
CSFP	1,178,840	1,445,224
Purchased	<u>542,383</u>	<u>502,899</u>
	<u>\$ 4,442,531</u>	<u>\$ 4,852,048</u>

4. Pledges receivable:

Unconditional promises to give are recorded as pledges receivable and revenue of the appropriate net asset category.

Unconditional promises to give at September 30 are as follows:

	<u>2017</u>	<u>2016</u>
Unrestricted promises	\$ 85,304	\$ 202,393
Restricted promises	<u>3,267,152</u>	<u>1,559,000</u>
Contributions receivable	<u>\$ 3,352,456</u>	<u>\$ 1,761,393</u>
Amounts due in:		
Less than one year	\$ 1,213,329	\$ 531,433
One to five years	\$ 2,139,127	\$ 1,229,960

During the fiscal year ending September 30, 2016, the Organization received conditional pledges in the total of \$3,000,000 dependent on the receipt of private and governmental funds for future capital expenditures.

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 20165. Property and equipment:

	<u>2017</u>	<u>2016</u>
Building	\$ 12,028,904	\$ 1,235,416
Building improvements	5,183,735	4,535,956
Office equipment	2,473,700	2,368,841
Warehouse equipment	2,147,443	2,242,555
Autos and trucks	4,596,296	4,921,167
Land	<u>2,690,000</u>	<u>220,000</u>
	29,120,078	15,523,935
Less accumulated depreciation and amortization	<u>11,196,977</u>	<u>10,709,468</u>
	<u>\$ 17,923,101</u>	<u>\$ 4,814,467</u>

6. Line of credit:

The Organization has a bank line of credit, secured by certain assets, in the amount of \$1,200,000. The line carries an interest of 2.50% over 1-month LIBOR rate (LIBOR rate is 1.24% at September 30, 2017), and an interest of prime less 0.25% (3.50% at September 30 2016). The balance of the line was \$0 and \$500,000 at September 30, 2017 and 2016, respectively. The line is scheduled to expire on May 30, 2018.

7. Long-term debt:

	<u>2017</u>	<u>2016</u>
Mortgage payable with interest at 0.25% over the prime rate with a ceiling of 5.25%. The prime rate was 4.00% and 3.50% at September 30, 2017 and 2016. Payable in monthly installments of \$28,148 and this mortgage was paid off as of September 30, 2017. Mortgage was collateralized by building and accessories.		\$ 545,939
Mortgage payable with interest at 0.25% over 1-month LIBOR rate with a floor of 2.50%. The 1-month LIBOR rate was 1.24% at September 30, 2017. Interest accrues and is due monthly and principal payments begin July 2019. Mortgage is collateralized by building and accessories, and matures on June 21, 2020.	\$ 10,266,000	
Mortgage payable with interest at 0.25% over 1-month LIBOR rate with a floor of 2.50%. The 1-month LIBOR rate was 1.24% at September 30, 2017. Interest accrues and is due monthly and principal payments begin July 2019. Mortgage is collateralized by building and accessories, and matures on June 21, 2020	<u>3,134,000</u>	
	13,400,000	545,939
Less current portion		<u>324,006</u>
	<u>\$ 13,400,000</u>	<u>\$ 221,933</u>

SECOND HARVEST HEARTLAND

7. Long-term debt (continued):

Principal balances on the mortgage payables (\$10,266,000 and 3,134,000) are due on June 21, 2020 unless the Organization is not awarded state bonds and financing approval to renovate the Brooklyn Park property in amounts and on terms acceptable to the Lender in its sole and absolute discretion on or before June 1, 2019. Then commencing July 1, 2019 and monthly thereafter, the Organization will pay to the Lender equal monthly installments of principal in the amount necessary to fully amortize the outstanding principal balances over a twenty-year period commencing on June 1, 2019.

Future maturities of long-term debt are as follows:

<u>Year ending September 30</u>	<u>Amount</u>
2019	\$ 167,500
2020	<u>13,232,500</u>
	<u>\$ 13,400,000</u>

8. Operating leases:

The Organization leases office equipment expiring through a lease expiring in 2020. Total rent expense for the years ended September 30, 2017 and 2016 was \$322,156 and \$146,100, respectively.

The Organization also leases space to carry out organization objectives. This lease expires in May 2018. In addition to minimum base rental payments, the Organization is required to pay its proportional share of real estate taxes and operating expenses. Rent expense was \$341,112 and \$337,339 for the years ended September 30, 2017 and 2016, respectively.

Future minimum lease payments are as follows:

<u>Year ending September 30</u>	<u>Amount</u>
2018	\$ 143,818
2019	4,552
2020	<u>379</u>
	<u>\$ 148,749</u>

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 20169. Capital leases:

The Organization has capital leases for vehicles and warehouse equipment which expire at various dates during fiscal years 2022 – 2023. The vehicles and warehouse equipment were recorded at fair value on the lease commitment date.

The cost and accumulated amortization related to an asset that was held under capital leases are as follows:

	<u>2017</u>	<u>2016</u>
Equipment cost	\$ 1,904,209	\$ 1,782,448
Less accumulated amortization	<u>516,262</u>	<u>256,191</u>
	<u>\$ 1,387,947</u>	<u>\$ 1,526,257</u>

Future principal and interest payments under the capital lease as of September 30, 2017, are as follows:

<u>Year ending September 30</u>	<u>Amount</u>
2018	\$ 301,788
2019	301,788
2020	301,788
2021	301,788
2022	293,602
Thereafter	<u>77,856</u>
	1,578,610
Less amounts representing interest	<u>140,374</u>
Present value of net minimum lease obligation payments	<u>\$ 1,449,231</u>

10. Temporarily restricted net assets:

Temporarily restricted net assets are available for the following purposes:

	<u>2017</u>	<u>2016</u>
SNAP	\$ 35,300	\$ 14,000
Child Nutrition	70,745	295,492
Capital investment	53,333	5,931
Equipment	18,227	6,877
Hunger and Health	448,473	809,953
Capital Campaign	4,745,604	2,131,756
Other programming and fundraising	<u>344,659</u>	<u>478,141</u>
	<u>\$ 5,716,341</u>	<u>\$ 3,742,150</u>

SECOND HARVEST HEARTLANDNOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2017 AND 2016**11. Net assets released from restriction:**

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by donors as follows:

	<u>2017</u>	<u>2016</u>
SNAP	\$ 40,700	\$ 114,000
Produce		74,040
Child Nutrition	255,647	153,893
Capital investment	26,667	137,069
Equipment	32,581	17,910
Hunger and Health	364,359	189,047
Capital Campaign	859,251	149,745
Other programming and fundraising	451,372	138,600
	<u>\$ 2,030,577</u>	<u>\$ 974,304</u>

12. Fiscal agent:

During the years ending September 30, 2017 and 2016, the Organization received cash from donors for which it is acting as a fiscal agent, which were not fully disbursed at September 30, 2017 and 2016. As such, these funds have been treated as current liabilities in the accompanying financial statements.

The Organization has received food donations that are, by contract, allocated to other food banks. Amounts of inventory on-site that were so allocated were \$342,097 and \$446,082 for September 30, 2017 and 2016, respectively. These amounts were not included in the final inventory as presented on the statement of financial position.

13. Retirement plan:

The Organization has a defined contribution 403(b) thrift plan, in which employees are eligible to participate on the first of the month following 30 days of employment. The Organization contributes 4% of the employees' annual salaries to the Plan regardless of whether the employees contribute any of their pretax wages to the Plan. The Organization also matches 50% of employees' contributions up to 4%. The employees vest at a rate of 25% per year and are fully vested after four years in the plan. The expense for the plan was \$446,802 and \$384,337 for the years ended September 30, 2017 and 2016, respectively.