

Mid-South Food Bank, Inc.

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

JUNE 30, 2017

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June 30, 2017

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MID-SOUTH FOOD BANK, INC.
GOVERNANCE OFFICIALS
YEAR ENDED JUNE 30, 2017

BOARD OF DIRECTORS

James R. Huffman, III, Chairman
Rod Halsell, Secretary
Bryan T. Foley, Treasurer

Brooke Balducci
Diane Fahey
Florence Hervery
Perre Coleman Magness
LaTina Epps-Thomas

Matthew L. Barron
Joel Goldblatt
Susan Hunsberger
Thomas Rieger
Rebecca Z. Yeung

Clifford DeBerry
Scot Hendricks
Rick James
Harley Steffens

ADMINISTRATIVE OFFICIALS

Estella H. Mayhue-Greer, President & Chief Executive Officer
Afshan Latif Kirk, Chief Financial Officer



INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Mid-South Food Bank
Memphis, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of Mid-South Food Bank, Inc. (a nonprofit organization), 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; 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 United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Mid-South Food Bank, Inc.'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 Mid-South Food Bank, Inc.'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 qualified audit opinion.



Basis for Qualified Opinion

We were unable to obtain sufficient appropriate audit evidence about the recorded receipts and disbursements of contributed food and USDA commodities as of June 30, 2017 and for the year then ended. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion, except for the possible effects on the 2017 financial statements of the matter described in the “Basis for Qualified Opinion” paragraph, the financial statements referred to on the previous page present fairly, in all material respects, the financial position of Mid-South Food Bank, Inc., 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 United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards and state financial assistance, 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 United States of America. In our opinion, except for the qualification of the opinion on the basic financial statements as described under “Basis for Qualified 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 March 28, 2018, on our consideration of Mid-South Food Bank Inc.'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 Mid-South Food Bank's internal control over financial reporting and compliance.

Reynolds, Bone & Griesbeck PLC

March 28, 2018

STATEMENT OF FINANCIAL POSITION

Mid-South Food Bank, Inc.
June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
ASSETS			
Current assets			
Cash and cash equivalents	\$ 1,103,990	\$ 2,128,930	\$ 3,232,920
Certificates of deposit	757,103	-	757,103
Investments, at fair value	2,231,294	300,000	2,531,294
Receivables, net	72,891	157,670	230,561
Current portion of pledges receivable	40,000	977,637	1,017,637
Inventories			
Jumpstart food	332,484	-	332,484
Contributed food	1,093,575	-	1,093,575
Purchased product	203,127	-	203,127
Undistributed USDA commodities	-	1,479,318	1,479,318
Prepaid expenses	59,259	-	59,259
Total current assets	<u>5,893,723</u>	<u>5,043,555</u>	<u>10,937,278</u>
Long-term portion of pledges receivables, net	120,000	1,544,837	1,664,837
Property and equipment, net	5,405,219	-	5,405,219
Interest rate swap contract	22,396	-	22,396
Total assets	<u>\$ 11,441,338</u>	<u>\$ 6,588,392</u>	<u>\$ 18,029,730</u>
LIABILITIES AND NET ASSETS			
Current liabilities			
Accounts payable	\$ 60,484	\$ -	\$ 60,484
Accrued expenses	176,324	-	176,324
Current installments of long-term debt	37,964	-	37,964
Total current liabilities	<u>274,772</u>	<u>-</u>	<u>274,772</u>
Long-term debt, less current installments	<u>1,435,919</u>	<u>-</u>	<u>1,435,919</u>
Total liabilities	<u>1,710,691</u>	<u>-</u>	<u>1,710,691</u>
Net assets	<u>9,730,647</u>	<u>6,588,392</u>	<u>16,319,039</u>
Total liabilities and net assets	<u>\$ 11,441,338</u>	<u>\$ 6,588,392</u>	<u>\$ 18,029,730</u>

See notes to financial statements.

STATEMENT OF ACTIVITIES

Mid-South Food Bank, Inc.
Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Total
Revenues, gains, and other support:			
Direct contributions:			
Contributions	\$ 3,121,227	\$ 4,416,779	\$ 7,538,006
In-kind contributions:			
USDA commodities	-	5,891,833	5,891,833
Contributed food	12,912,103	-	12,912,103
Other	80,563	-	80,563
	<u>12,992,666</u>	<u>5,891,833</u>	<u>18,884,499</u>
Grants:			
Government	-	596,282	596,282
Other	213,991	874,784	1,088,775
	<u>213,991</u>	<u>1,471,066</u>	<u>1,685,057</u>
Other income:			
Shared maintenance	632,304	-	632,304
Investment income	264,220	-	264,220
Gain from interest rate swap	22,396	-	22,396
Miscellaneous	24,744	-	24,744
	<u>943,664</u>	<u>-</u>	<u>943,664</u>
Net assets released from restrictions:			
Contributions	344,975	(344,975)	-
USDA commodities	4,889,922	(4,889,922)	-
Grants - Federal and other	1,483,213	(1,483,213)	-
	<u>6,718,110</u>	<u>(6,718,110)</u>	<u>-</u>
Total revenue	23,989,658	5,061,568	29,051,226
Expenses			
Food Bank Warehouse			
Contributed food	13,117,879	-	13,117,879
Contributed food - USDA	4,889,922	-	4,889,922
Operations	3,812,552	-	3,812,552
General and Administration	525,875	-	525,875
Fundraising	916,630	-	916,630
Total expenses	<u>23,262,858</u>	<u>-</u>	<u>23,262,858</u>
Change in net assets	726,800	5,061,568	5,788,368
Net assets at beginning of year	<u>9,003,847</u>	<u>1,526,824</u>	<u>10,530,671</u>
Net assets at end of year	<u>\$ 9,730,647</u>	<u>\$ 6,588,392</u>	<u>\$ 16,319,039</u>

See notes to financial statements.

STATEMENT OF FUNCTIONAL EXPENSES

Mid-South Food Bank, Inc.
Year Ended June 30, 2017

	Food Bank Warehouse	General and Administration	Fundraising	Total
Salaries and wages	\$ 1,251,031	\$ 235,044	\$ 322,736	\$ 1,808,811
Taxes and fringe benefits	289,598	47,968	60,889	398,455
Contract personnel	26,891	10,400	-	37,291
Professional services	64,917	79,412	518,181	662,510
Travel and meetings	21,584	5,178	3,038	29,800
Personnel expenses	1,287	11,871	-	13,158
Building/equipment maintenance	151,206	1,274	-	152,480
Vehicle maintenance	115,897	-	-	115,897
Fuel and oil	77,043	-	-	77,043
Freight	2,662	-	-	2,662
Utilities	251,671	-	-	251,671
Taxes and licenses	9,180	314	-	9,494
Insurance	50,188	61,191	-	111,379
Security	11,896	-	-	11,896
Telephone and internet	14,987	17,793	458	33,238
Postage	7,331	1,487	7,164	15,982
Equipment rental	34,145	1,854	-	35,999
Supplies	98,667	13,748	3,346	115,761
Memberships and subscriptions	290	27,637	340	28,267
Food purchases	1,061,316	-	328	1,061,644
Miscellaneous	2,846	2,650	-	5,496
In-kind	68,360	8,054	150	76,564
Expenses before depreciation	<u>3,612,993</u>	<u>525,875</u>	<u>916,630</u>	<u>5,055,498</u>
Depreciation	199,559	-	-	199,559
Total expenses	<u>3,812,552</u>	<u>525,875</u>	<u>916,630</u>	<u>5,255,057</u>
In-kind food disbursed	13,117,879	-	-	13,117,879
USDA food disbursed	<u>4,889,922</u>	<u>-</u>	<u>-</u>	<u>4,889,922</u>
Total expenses including in-kind	<u><u>\$ 21,820,353</u></u>	<u><u>\$ 525,875</u></u>	<u><u>\$ 916,630</u></u>	<u><u>\$ 23,262,858</u></u>

See notes to financial statements.

STATEMENT OF CASH FLOWS

Mid-South Food Bank, Inc.
Year Ended June 30, 2017

Operating activities	
Change in net assets	\$ 5,788,368
Adjustments to reconcile the change in net assets to net cash provided by operating activities	
Depreciation	199,559
Donated equipment	(4,000)
Loss on disposal of property and equipment	3,311
Net realized and unrealized gain on investments	(207,527)
Gain from interest rate swap contract	(22,396)
Inventory - contributed food	179,218
Inventory - contributed USDA commodities	(1,001,911)
Changes in operating assets and liabilities:	
Receivables, net	(46,934)
Pledges receivables, net	(2,418,072)
Inventories	(305,636)
Prepaid expenses	8,018
Accounts payable	(33,912)
Accrued expenses	(6,534)
Contributions restricted for long-term purposes	
Net change in discount on unconditional promises to give	(77,945)
Net cash provided by operating activities	<u>2,053,607</u>
Investing activities	
Purchases of property and equipment	(97,142)
Purchase of certificates of deposits and investments	(36,298)
Net cash used for investing activities	<u>(133,440)</u>
Financing activity - principal payments on long-term debt	<u>(34,015)</u>
Net change in cash and cash equivalents	1,886,152
Cash and cash equivalents at beginning of year	<u>1,346,768</u>
Cash and cash equivalents at end of year	<u><u>\$ 3,232,920</u></u>
Supplemental cash flow information:	
Interest paid	<u><u>\$ 47,484</u></u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The Mid-South Food Bank, Inc. (the "Food Bank") is a nonprofit Tennessee corporation serving West Tennessee, East Arkansas and North Mississippi. The Food Bank is a member of Feeding America, a national food bank network. The Food Bank operates as a clearinghouse to receive, store and distribute food and non-grocery items. Donors include food manufacturers, wholesalers, brokers, retailers, other food service establishments, local companies, and individuals. The Food Bank distributes food to nonprofit agencies that serve the ill, needy, and infants. For the year ending June 30, 2017, the Food Bank distributed food to approximately 294 charitable programs.

Financial Statements

The Food Bank prepares its financial statements on the accrual basis of accounting. Balances and transactions are recorded according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of such balances and transactions into three classes of net assets – permanently restricted, temporarily restricted, and unrestricted.

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that must be maintained permanently by the Food Bank.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met by actions of the Food Bank or the passage of time.

Unrestricted net assets - Net assets not subject to donor-imposed stipulations.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expiration of temporary restrictions on net assets (i.e., the donor-imposed stipulated purpose has been fulfilled or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets. During the year ended June 30, 2017, the Food Bank released temporarily restricted net assets for expenses related to the distribution of food.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

Use of Estimates

Accounting principles generally accepted in the United States of America (U.S. GAAP) require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant financial statement estimates are the estimated fair value of the investments and the valuation of inventories (below under "Inventories" and Note 3). Management believes that its estimates provided in the financial statements are reasonable. However, actual results could differ from those estimates.

Concentrations of Credit Risk

Due to the nature of its business and the volume of revenue activity, the Food Bank can accumulate, from time to time, bank balances in excess of the insurance provided by federal deposit insurance authorities. The risk of maintaining deposits in excess of amounts insured by federal deposit insurance authorities is managed by maintaining such deposits in high quality financial institutions.

Cash and Cash Equivalents and Certificates of Deposit

Cash and cash equivalents include all cash balances and highly liquid investments with an original maturity of three months or less. The carrying value of certificates of deposit is equivalent to their fair value.

Receivables

In exchange for the food and grocery items agencies receive, the agencies contribute a per-pound handling fee to the Food Bank, referred to as a shared maintenance fee. This fee ranges from zero to nineteen cents per pound. It is the policy of the Food Bank to reserve the right to suspend the shopping privileges of an agency with past due balances of 60 days or more when an agency remains unresponsive to collection efforts. Collateral is not required to support customer receivables. An allowance for bad debt is established for accounts receivable that are determined to be uncollectible based on a periodic review of the accounts by management. As of June 30, 2017, the allowance for doubtful accounts totaled \$1,000.

Also included in receivables are amounts owed to the Food Bank from various granting agencies.

Pledges Receivables

Pledges receivable represent unconditional promises to give that are available for unrestricted use unless specifically restricted by the donor and amounts received that are designated for future periods or restricted by the donor for specific purposes. These receivables are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

Unconditional promises to give are recorded at the net present value of estimated cash flows, less an allowance for doubtful accounts, on the statement of financial condition. Conditional promises to give are not included as support until the conditions are substantially met.

A significant portion of pledges receivable are considered to be restricted at June 30, 2017 for the Food Bank's capital campaign.

Inventories – Food and Commodities

Inventories consist of purchased product, jumpstart food, contributed food, and undistributed United States Department of Agriculture (USDA) commodities.

- Purchased Product and Jumpstart Food – This inventory consists of undistributed food purchased by the Food Bank, which is valued at cost using the first-in, first-out method.
- Contributed Food - This inventory consists of contributed food which is valued at an average wholesale market price per pound, as determined by Feeding America. For the year ended June 30, 2017, the average wholesale market price per pound was \$1.73.
- Undistributed USDA Commodities - By virtue of a federal non-cash award (grant) program, the Tennessee Department of Agriculture, in accordance with regulations set forth by the USDA, provides commodities to the Food Bank for distribution to charitable agencies that serve meals to the homeless, low-income families, and other needy individuals. The value of the commodities received is valued at an average wholesale market price as determined by Feeding America (\$1.73 per pound).

Long-Lived Assets

Property and equipment purchased by the Food Bank are recorded at cost. The Food Bank follows the practice of capitalizing all expenditures for property and equipment in excess of \$2,500. Donated equipment is recorded at its estimated fair value at the date of donation. Depreciation of property and equipment is provided on a straight-line basis over the estimated useful lives of the assets. Upon the disposal of property and equipment, the cost and accumulated depreciation are removed from the related accounts and any gain or loss is reflected in operations. Maintenance, repairs, and renewals that neither materially add to the value of the property and equipment, nor appreciably prolong its life are charged to expense as incurred.

The Food Bank reviews its long-lived assets, including property and equipment, for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. In the event an impairment exists, a loss is recognized as the amount by which the carrying amount of the asset exceeds its fair value. No impairment has been recognized in the accompanying statement of activities.

Derivative Financial Instrument

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

The Food Bank uses an interest rate swap contract as a fair value hedge to eliminate the exposure of interest rate movements on variable rate debt. The interest rate swap contract is recorded at the fair value of the swap on the statement of financial position and correspondingly the change in the fair value is recorded as a gain or loss on the statement of activities.

Investments

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

Income Recognition and Investment Valuation

Dividend income is recorded on the payable date. Income from other investments is recorded as earned on an accrual basis.

Purchases and sales of securities are recorded on a settlement date basis. Gain or loss on sales of securities is based upon specific identification.

In-Kind Contributions

The Food Bank records various types of in-kind contributions received in the course of daily operations including professional services, supplies, and food. Contributed professional services are recognized if the services received (a) create or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donations (Note 10).

Advertising

The Food Bank charges the costs of advertising to expense as incurred. Advertising expenses totaled \$2,500 for the year ended June 30, 2017.

Income Taxes

The Internal Revenue Service has classified the Food Bank as other than a private foundation which is exempt from federal income taxes on related business income and federal unemployment taxes under Section 501(c)(3) of the United States Internal Revenue Code. The Food Bank is similarly exempted from Tennessee taxes in its related exempt income under provisions of the Tennessee Tax Code. Consequently, no federal or state income taxes have been provided in these statements. The Food Bank does not have any unrelated business income for the year ended June 30, 2017.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

In accordance with U.S. GAAP, if applicable, the Food Bank recognizes interest expense and penalties related to uncertain tax positions as interest expense and penalties in operating expenses. No amounts have been recognized in operating expenses for the year ended June 30, 2017. The Food Bank is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. It is intended to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP. The new guidance is effective for reporting periods beginning after December 15, 2018. Early application is not permitted; however, both public and nonpublic entities will be permitted to apply the new revenue recognition standard as of the effective date, which are annual periods beginning after December 15, 2016. The effects of adopting ASU No. 2014-09 have not been determined.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses on investments available for sale and purchased financial assets with credit deterioration. The new guidance is effective for reporting periods beginning after December 15, 2020. Early adoption of ASU 2016-13 is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The effects of adopting ASU 2016-13 have not been determined.

In August 2016, the FASB issued ASU No. 2016-14: *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. It is intended to simplify and improve how a not-for-profit entity classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. The ASU is effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Application to interim financial statements is permitted but not required in the initial year of application. Early application is permitted. The Food Bank has elected not to early implement ASU 2016-14 at this time. The effects of adopting ASU 2016-14 have not been determined.

Functional Allocation of Expenses

The cost of providing the program, fund-raising and general and administrative activities has been summarized on a functional basis in the statement of functional expenses. Accordingly, certain costs have been allocated among the program, fund-raising, and general and administrative activities benefited.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

Subsequent Events

Management has reviewed events occurring through March 28, 2018 the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.

2. BENEFICIAL INTEREST IN ASSETS HELD BY COMMUNITY FOUNDATION

The Food Bank has a beneficial interest in certain funds, which are held by the Community Foundation of Greater Memphis (“CFGM”). These investments are governed by an agreement between the Food Bank and CFGM. The Food Bank may, at any time, without premium or penalty, request that all or part of the unrestricted assets constituting the fund be granted to the Food Bank.

Fees related to the management of these funds were \$16,459 for the year ended June 30, 2017.

3. FAIR VALUE OF INVESTMENTS

U.S. GAAP defines fair value and establishes a framework for measuring fair value. Fair value measurements apply to financial assets and liabilities, as well as non-financial assets and liabilities which are re-measured at least annually.

U.S. GAAP establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable market data, when available, and minimizes the use of unobservable inputs when determining fair value. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources. Unobservable inputs reflect the Food Bank’s assumptions about the assumptions market participants would use in pricing an asset or liability based on the best information available in the circumstances.

The Food Bank groups its assets and liabilities measured at fair value in three levels based on the reliability of valuation inputs used to determine fair value. The proper level of fair value measurement is determined based on the lowest level of significant input. The levels are as follows:

- ◆ Level 1 valuations are based on quoted prices in active markets for identical assets or liabilities.
- ◆ Level 2 valuations are based on inputs other than quoted prices included in Level 1 that are observable for assets or liabilities, either directly or indirectly. These inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active (i.e. markets in which there are few transactions for the assets or liabilities, the prices are not current, or price quotes vary substantially either over time or among market makers), and modeling techniques based on inputs that are observable for the assets or liabilities.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

- ◆ Level 3 valuations are based on modeling techniques using significant assumptions that are not observable in the market. The assumptions reflect the Food Bank's own assumptions that market participants would use in pricing the assets or liabilities.

The availability of observable inputs varies from product to product and is affected by a variety of factors, including the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Food Bank in determining fair value is greatest for instruments categorized in Level 3.

The fair value of the pooled funds below as of June 30, 2017, was estimated by CFGM based primarily on the fair market value of the underlying investments. Because the fair value is based on unobservable inputs, the account is classified within Level 3 valuation hierarchy. Disclosure of unobservable inputs to fair value measurement has not been included for the pooled investments because quantitative unobservable inputs are not developed by the Food Bank when measuring fair value and have not been made available to the Food Bank by CFGM.

Financial assets measured at fair value on a recurring basis include the following:

CFGM balanced pool: Invested in equities, fixed income securities, cash equivalents, alternative investments and real assets.

CFGM equity pool: Invested in large-cap U.S. equities, small-and mid-cap U.S. equities, international equities and hedged equities.

CFGM money market pool: Invested in money market funds.

Interest rate swap: Interest rate swaps are reported at fair value using Level 2 inputs. The Food Bank utilizes a third party to determine fair value based on inputs that generally are observable including contractual terms, LIBOR-based curve rates, and other factors.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

The following table sets forth by level within fair value hierarchy the Food Bank's financial assets accounted for at fair value on a recurring basis as of June 30, 2017:

	Total Carrying Value	Value Using Level 1	Value Using Level 2	Value Using Level 3
CFGM Balanced Pool	\$ 1,131,321	\$ -	\$ -	\$ 1,131,321
CFGM Equity Pool	1,152,588	-	-	1,152,588
CFGM Money Market Pool	247,385	-	-	247,385
Interest rate swap	22,396	-	22,396	-
Total	<u>\$ 2,553,690</u>	<u>\$ -</u>	<u>\$ 22,396</u>	<u>\$ 2,531,294</u>

Changes in Fair Value Levels

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

The following details the activity for the year ended June 30, 2017 for financial instruments valued by the Food Bank using the Level 3 of the valuation hierarchy for assets measured at fair value on a recurring basis. When a determination is made to classify a financial instrument as Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources), the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

	Pooled Funds
Fair value at July 1, 2016	\$ 2,290,172
Interest and dividend income	33,595
Realized gain	26,882
Unrealized gain	197,104
Fees and charges	<u>(16,459)</u>
Fair value at June 30, 2017	<u>\$ 2,531,294</u>

Continued

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

4. RECEIVABLES, NET

Accounts receivable at June 30, 2017, consist of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Shared maintenance, net	\$ 50,100	\$ -	\$ 50,100
Grant	-	157,670	157,670
Other	22,791	-	22,791
Total receivables	<u>\$ 72,891</u>	<u>\$ 157,670</u>	<u>\$ 230,561</u>

The grant receivable at June 30, 2017, consists of \$157,670 from the Tennessee Department of Agriculture.

5. PLEDGES RECEIVABLE, NET

Pledges receivable, net at June 30, 2017 consists of the following:

Temporarily restricted pledges	\$ 2,761,962
Less unamortized present value discount	<u>(79,488)</u>
Net pledges receivable	<u>\$ 2,682,474</u>
Amount due in:	
Less than one year	\$ 1,017,637
One to five years	<u>1,744,325</u>
	<u>\$ 2,761,962</u>

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

6. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30, 2017 follows:

Land and improvements	\$ 238,490
Building and improvements	6,676,086
Furniture and equipment	799,247
Automotive equipment	999,554
	<u>8,713,377</u>
Accumulated depreciation and amortization	(3,308,158)
Total property and equipment, net	<u>\$ 5,405,219</u>

7. ACCRUED EXPENSES

Accrued expenses consist of the following:

Salaries and payroll tax payable	\$ 67,001
Vacation payable	29,258
401(k) payable	21,050
Shared maintenance - credit balance	22,132
Other	36,883
	<u>\$ 176,324</u>

8. DERIVATIVE FINANCIAL INSTRUMENT

In September 2016, in order to minimize the effects of changes in the variable interest related to long-term debt, the Company entered into an interest rate swap contract under which the amount of interest that the Company pays is fixed (See Note 15). The interest rate swap contract requires payment at a fixed rate (2.96%) on a notional amount of 1,473,883 at June 30, 2017. The interest rate swap matures on September 9, 2021.

9. IN-KIND CONTRIBUTED FOOD AND SERVICES

Contributions of food donated by the general public to the Food Bank and food purchased with contributed funds and distributed to charitable agencies is classified in the statement of activities under support and revenue and a corresponding expense is recognized under program services as contributed food is disbursed. Feeding America values the donated food at an average of \$1.73 per pound for the year ended June 30, 2017. Purchased food is valued at cost.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

The value of the USDA commodities received and distributed is included in the statement of activities as USDA commodities and an offsetting expense is recognized under Food Bank warehouse program services as USDA commodities distributed. The value of commodities received but not distributed has been recorded on the statement of financial position as undistributed USDA commodities and as temporarily restricted net assets. It is also valued at \$1.73 per pound for the year ended June 30, 2017.

Development and special events coordinators manage the Food Bank's fundraising activities, with significant participation by members of the Board of Directors. The fundraising expenses in the accompanying financial statements reflect the expenses of staff members, but do not reflect the value of the volunteer fundraising effort by the Board of Directors.

Additionally, the Food Bank received a significant amount of contributed time from general volunteers and various donated supplies, which do not meet the recognition criteria. Accordingly, the value of this contributed time and donated supplies has not been determined and is not reflected in the accompanying financial statements.

The Food Bank recognized in-kind contributions, changes in inventory, and expenses for the year ended June 30, 2017 as follows:

	<u>Contribution</u>	<u>Expense</u>
Contributed Food	\$ 12,912,103	\$ 13,117,879
Contributed Food - USDA	5,891,833	4,889,922
Donated equipment	4,000	4,000
Goods	49,715	49,715
Services	8,506	8,506
Transportation	18,342	18,342
	<u>\$ 18,884,499</u>	<u>\$ 18,088,364</u>

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

10. GRANT INCOME

Grants, excluding USDA commodities, consist of the following for the year ended June 30, 2017:

	Unrestricted Support	Temporarily Restricted Support	Total Support	Net Assets Released from Restrictions
Government Grants:				
TN Dept of Agriculture - Cash Assistance	\$ -	\$ 316,548	\$ 316,548	\$ 158,878
City of Memphis, TN:				
Perishable Food Program	-	40,000	40,000	40,000
Backpack Program	-	25,000	25,000	25,000
Federal Emergency Management Agency		89,734	89,734	89,734
State Grants:				
TN Dept of HS	-	125,000	125,000	125,000
 Total government grants	 -	 596,282	 596,282	 438,612
Other Grants:				
Unrestricted	\$ 213,991	\$ -	\$ 213,991	\$ -
Other Restricted	-	69,000	69,000	29,268
Mobile Pantry	-	70,000	70,000	22,002
Food Purchase	-	183,816	183,816	183,816
Feeding Children	-	119,293	119,293	113,160
Feeding Seniors	-	407,480	407,480	405,518
Other Feeding Programs	-	25,196	25,196	3,079
 Total other grants	 213,991	 874,785	 1,088,776	 756,843
 Total grants	 <u>\$ 213,991</u>	 <u>\$ 1,471,067</u>	 <u>\$ 1,685,058</u>	 1,195,455
 Release of grant revenue received in prior years				 <u>287,758</u>
				<u>\$ 1,483,213</u>

11. DEFINED CONTRIBUTION RETIREMENT PLAN

The Food Bank has a 401(k) defined contribution retirement plan that covers all eligible employees. All employees at least twenty and one-half years of age with a minimum of twelve months of service are eligible to participate. Participants may contribute up to the annual limit as established by the tax laws. For the year ended June 30, 2017, the employer made a 3% Safe Harbor non-elective contribution and a 2% discretionary contribution. All employer contributions are allocated to the plan participants proportionate to their salary. Benefits vest in accordance with the terms contained within the plan.

Employer contributions for the year ended June 30, 2017 totaled \$49,047 which is included in taxes and fringe benefits. The employer's liability under the plan is limited to the amounts contributed, as defined in the plan documents.

NOTES TO FINANCIAL STATEMENTS

Mid-South Food Bank, Inc.
June 30, 2017

12. RELATED PARTY TRANSACTIONS

In the normal course of business, the Food Bank purchases food from local grocers who have representatives on the Food Bank's Board of Directors. The amount purchased from these grocers during the year ended June 30, 2017 totaled \$1,729. The Food Bank also purchased graphic services from a local artist, who is also the spouse of one of the Food Bank's employees, totaling \$300 for the year ended June 30, 2017.

13. TEMPORARILY RESTRICTED NET ASSETS

Net assets temporarily restricted for time and purpose are detailed as follows:

USDA commodities to distribute	\$ 1,479,318
Capital Campaign for renovation of new building	4,277,841
Assisi Foundation Food Assurance Fund	300,000
USDA Grant	157,670
Food Purchase	236,347
Backpack	37,176
Mobile Pantry	47,998
Other Restricted	29,927
Other Feeding Programs	22,115
	<u>\$ 6,588,392</u>

14. LONG-TERM DEBT

In November 2013, the Food Bank obtained a note payable due to bank to purchase a building to be used as its new facility. In September 2016, the Food Bank entered into a new agreement with the bank to refinance the note payable. As part of the new agreement, the Food Bank entered into an interest rate swap agreement to effectively fix the interest rate until September 9, 2021. The note payable is due in escalating monthly principal and interest payments ranging from \$6,700 through \$6,900 including interest at a fixed rate of 2.96% with a balloon payment due at the maturity date of August 9, 2021 of approximately \$1,356,000. The outstanding balance as of June 30, 2017 was \$1,473,883.

The approximate aggregate amount of long-term debt installments for each of the five years following June 30, 2017 is: 2018 - \$37,964; 2019 - \$39,088; 2020 - \$40,256; 2021 - \$1,356,575.

The amount of interest capitalized during the year ended June 30, 2017 was \$47,484 as the building is under renovations and has not been placed in service as of June 30, 2017.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE

Mid-South Food Bank, Inc.
Year Ended June 30, 2017

<u>Grantor</u>	<u>CFDA Number</u>	<u>Contract Number</u>	<u>Total Federal Expenditures</u>	<u>Expenditures to Subrecipients</u>
<u>MAJOR FEDERAL PROGRAMS:</u>				
U.S. Department of Agriculture				
Pass-through from the TN Department of Agriculture				
Food Distribution Cluster:				
Emergency Food Assistance Program - cash assistance	10.568	54373	\$ 138,000	\$ -
Emergency Food Assistance Program - cash assistance	10.568	62636	146,988	-
Emergency Food Assistance Program - cash assistance	10.568	62411	31,560	-
Program 10.568 Subtotal			316,548	-
Emergency Food Assistant Program - commodities	10.569	54373		
		62636		
		62411	4,889,922	4,889,922
Total Food Distribution Cluster			5,206,470	4,889,922
<u>OTHER FEDERAL PROGRAMS:</u>				
U.S. Department of Housing and Urban Development				
Community Development Block				
Grants/Entitlement Grants Cluster				
Pass-through from the City of Memphis, TN - Housing and Community Development				
Perishable Food Recovery Program	14.218	33607	40,000	-
Backpack Program	14.218	32701	25,000	-
Total Block Grants/Entitlement Grants Cluster			65,000	-
Federal Emergency Management Agency (FEMA)/				
United Way of the Mid-South				
Emergency Food and Shelter Board Program	97.024	Phase 33- 778200-004	89,734	-
Total Other Federal Programs			154,734	-
TOTAL FEDERAL AWARDS			5,361,204	4,889,922
<u>STATE FINANCIAL ASSISTANCE:</u>				
State of Tennessee Department of Human Services				
Pass-through from Second Harvest Food Bank of Middle Tennessee, Inc.				
	99-UNKNOWN		125,000	-
TOTAL STATE AWARDS:			125,000	-
TOTAL FEDERAL AND STATE AWARDS:			\$ 5,486,204	\$ 4,889,922

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE

Mid-South Food Bank, Inc.
June 30, 2017

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards and state financial assistance (the "Schedule") includes the federal grant activity of the Mid-South Food Bank, Inc. under programs of the federal government 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* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the schedule presents only a selected portion of the operations of the Mid-South Food Bank, Inc., it is not intended to and does not present the financial position, changes in net assets or cash flows of the Mid-South Food Bank, Inc.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

NOTE 3 - FOOD DISTRIBUTION

Non-monetary assistance is reported in the schedule of expenditures of government awards as determined by the Tennessee Department of Agriculture.

NOTE 4 – SUB-RECIPIENTS

All of the commodities distributed were done so to eligible recipient agencies considered to be sub-recipients of the Food Bank.

NOTE 5 – DE MINIMIS INDIRECT COST RATE

The organization did not elect to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

NOTE 6 – ADMINISTRATIVE REIMBURSEMENT

Mid-South Food Bank, Inc. receives reimbursement of claims from USDA as a sub-grantee. The program's objective is to provide administrative funds for the distribution of available commodities to agencies serving needy individuals. For the year ended June 30, 2017, Mid-South Food Bank, Inc. was entitled to \$316,548 of which \$157,670 is included in receivables.



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

Board of Directors
Mid-South Food Bank, Inc.
Memphis, Tennessee

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Mid-South Food Bank, Inc. (a nonprofit organization), 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 March 28, 2018. Our opinion on the financial statements was qualified because as we discussed in the “Basis for Qualified Opinion” paragraph in the report on the financial statements, we were unable to obtain sufficient appropriate audit evidence of the recorded amounts of contributed food and USDA commodities as of June 30, 2017 and for the year then ended.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Mid-South Food Bank, Inc.'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 Mid-South Food Bank, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of the Mid-South Food Bank, Inc.'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 Mid-South Food Bank, Inc.'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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be material weaknesses as item 2017-001.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mid-South Food Bank, Inc.'s financial statements are free of 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as item 2017-001.

Mid-South Food Bank, Inc.'s Response to Findings

Mid-South Food Bank, Inc.'s response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Mid-South Food Bank, Inc.'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

Reynolds, Bone & Grisebeck PLC

March 28, 2018



Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance

Board of Directors
Mid-South Food Bank, Inc.
Memphis, Tennessee

Report on Compliance for Each Major Federal Program

We have audited Mid-South Food Bank, Inc.'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Mid-South Food Bank, Inc.'s major federal programs for the year ended June 30, 2017. Mid-South Food Bank, Inc.'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 Mid-South Food Bank, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and 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 Mid-South Food Bank, Inc.'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 qualified opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Mid-South Food Bank, Inc.'s compliance.



Basis for Qualified Opinion on the U.S. Department of Agriculture Emergency Food Assistance Program (10.569)

As described in item 2017-001 in the accompanying schedule of findings and questioned costs, Mid-South Food Bank, Inc. did not comply with requirements regarding inventory records that are applicable to its USDA Commodities program. Compliance with such requirements is necessary, in our opinion, for Mid-South Food Bank, Inc. to comply with the requirements applicable to that program.

Qualified Opinion on the U.S. Department of Agriculture Emergency Food Assistance Program (10.569)

In our opinion, except for the noncompliance described in the “Basis for Qualified Opinion” paragraph, Mid-South Food Bank, Inc. compiled, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on the U.S. Department of Agriculture Emergency Food Assistance Program for the year ended June 30, 2017.

Other Matters

The results of our auditing procedures disclosed another instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2017-002. Our opinion on each major federal program is not modified with respect to this matter.

Mid-South Food Bank, Inc.’s response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Mid-South Food Bank, Inc.’s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of Mid-South Food Bank, Inc. 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 Mid-South Food Bank, Inc.'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 Mid-South Food Bank, Inc.'s internal control over compliance.



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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We identified a certain deficiency in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item 2017-002, that we consider to be a material weakness.

Mid-South Food Bank, Inc.'s response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Mid-South Food Bank, Inc.'s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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.

Reynolds, Bone & Griesbeck PLC

March 28, 2018

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

Part I - Summary of Audit Results

1. The independent auditor's report expresses a qualified opinion on the financial statements of Mid-South Food Bank, Inc.
2. One material weakness relating to the audit of the financial statements is reported in the 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*. No significant deficiencies were reported.
3. One instances of noncompliance considered material to the financial statements of the Food Bank were disclosed during the audit during the financial statements reported in the Independent Auditor's Report on Internal Control Over Financial Reporting on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.
4. Two material weaknesses relating to the audit of the major federal award programs is reported in the Independent Auditor's Report on Compliance for Each Major Program and on Internal Control Over Compliance Required by the Uniform Guidance.
5. No significant deficiencies relating the audit of the major federal award programs are reported in the Independent Auditor's Report on Compliance for Each Major Program and on Internal Control Over Compliance Required by the Uniform Guidance.
6. The Independent Auditor's Report on Compliance for the Major Program and on Internal Control Over Compliance Required by the Uniform Guidance expressed a qualified opinion.
7. Audit findings relative to the major federal awards program that are required to be reported under CFR Section 200.516(a) in accordance with Uniform Guidance are reported in this schedule.
8. The Food Bank's major programs are:

<u>CFDA Number</u>	<u>Name of Major Federal Program or Cluster</u>
10.568	Emergency Food Assistance Program - Cash Assistance
10.569	Emergency Food Assistance Program - Commodities
9. The dollar threshold for distinguishing between Types A and B programs was \$750,000.
10. The Food Bank qualifies as a low-risk auditee as that term is defined in the Uniform Guidance.

Continued

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

Part II – Financial Statement Findings

2017-001: Material Weakness – Donated Food Inventory

Criteria: The Food Bank must maintain accurate records over inventory movement and cost.

Condition: Inventory records for primarily all contributed food were not properly maintained for the receipt and distribution of inventory during the year ended June 30, 2017, to support the recorded revenues and expenses, in accordance with U.S. GAAP. Furthermore, the inventory details provided during the inventory observation of the audit was only provided by pounds or cases. After extensive testing of inventory and working with management, it was determined that the system could not go “back in time” and produce accurate reports. When the inventory reports tested during the inventory observation were mathematically calculated to determine the extended values, there were significant differences between the calculation extended value and the final inventory reports provided by the Food Bank. Since the findings result in inaccurate reporting to the Food Bank’s pass-through grantor, this finding is also reported under Part III. See Part III below for further information.

Part III – Federal Award Findings and Questioned Costs

2017 – 001: Material Weakness – Reporting - Relating to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must maintain accurate records over inventory movement and cost.

Condition: Inventory records for primarily all contributed food were not properly maintained for the receipt and distribution of inventory during the year ended June 30, 2017, to support the recorded revenues and expenses, in accordance with U.S. GAAP.

Context: As stated above, inventory records for primarily all contributed food were not properly maintained for the receipt and distribution of inventory during the year ended June 30, 2017, to support the recorded revenues and expenses, in accordance with U.S. GAAP. Furthermore, the inventory details provided during the inventory observation of the audit was only provided by pounds or cases. After extensive testing of inventory and working with management, it was determined that the system could not go “back in time” and produce accurate reports. When the inventory reports tested during the inventory observation were mathematically calculated to determine the extended values, there were significant difference between the calculation extended value and the final inventory reports provided by the Food Bank.

Cause: The condition appears to be due to the lack of controls over oversight and understanding of the new inventory management system.

Effect: The Food Bank’s donated inventory records are not accurate.

Questioned Costs: Unknown

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

Recommendation: We recommend that additional training be provided to all employees who process information through the new inventory management system. We also recommend the Food Bank perform monthly or, at least a minimum, quarterly inventory counts until management can fully gain an understanding of the new the system. Performing these counts would ensure the accuracy of the financial reports, as well as assist in the tracking of inventory movement. The Food Bank should also work with the software manufacturer to create accurate reports and to be able to go “back in time.”

View of Responsible Official: See Corrective Action Plan.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

Part III – Federal Award Findings and Questioned Costs

2017 – 002: Material Weakness – Reporting - Relating to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must send accurate and complete reports to the appropriate regulatory authorities regarding the receipt and distribution of USDA food.

Condition: Testing of selected reports sent to the USDA did not agree to the monthly details.

Context: During our testing of the 12 monthly USDA reports, which were submitted during the year ended June 30, 2017, we selected 25 individual line items for food distribution testing. Out of 25 items selected, 4 items of distributed USDA food did not agree to the inventory reports generated by the new inventory management system. These errors occurred in July, August, and September of 2017.

Cause: This condition appears to be due to the lack of controls over oversight and understanding of the new inventory management system, as well as not maintaining proper support for items reported to regulatory authorities.

Effect: The Food Bank is not in compliance with this requirement.

Questioned Costs: Unknown

Recommendation: We recommend that additional training be provided to all employees who process information through the new inventory management system. We also recommend the Food Bank maintain supporting documentation for each line item on the monthly USDA report and review these reports in conjunction with the monthly transmittal to the appropriate regulatory authorities.

View of Responsible Official: See Corrective Action Plan.



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CORRECTIVE ACTION PLAN For the Fiscal Year Ended June 30, 2017

Part II- Financial Statement Findings

2017- 001: Material Weakness- Donated Food Inventory

Criteria: The Food Bank must maintain accurate records over inventory movement and cost.

Condition: Inventory records for all contributed food were not properly maintained for the receipt and distribution of inventory during the year ended June 30, 2017, to support the recorded revenues and expenses, in accordance with U. S. GAAP. Furthermore, the inventory details provided during the inventory observation of the audit was only provided by pounds or cases. After extensive testing of inventory and working with management, it was determined that the system cannot go “back in time” and produce accurate reports. When the inventory reports tested during the inventory observation were mathematically calculated to determine the extended values, there were significant difference between those and the final inventory reports provided by the Food Bank. Since the findings results in inaccurate reporting to the Food Bank’s pass-through grantor, this finding is also reported under Part III. See Part III below for further information.

Part III- Federal Award Findings and Questioned Costs

2017- 001: Material Weakness – Reporting- Relating to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must maintain accurate records over inventory movement and cost.

Condition: Condition: Inventory records for all contributed food were not properly maintained for the receipt and distribution of inventory during the year ended June 30, 2017, to support the recorded revenues and expenses, in accordance with U. S. GAAP. Furthermore, the inventory details provided during the inventory observation of the audit was only provided by pounds or cases. After extensive testing of inventory and working with management, it was determined that the system cannot go “back in time” and produce accurate reports. When the inventory reports tested during the inventory observation were mathematically calculated to determine the extended values, there were significant difference between those and the final inventory reports provided by the Food Bank.

Cause: The condition appears to be due to lack of controls over oversight and understanding of the new inventory system.

Effect: The Food Bank's perpetual inventory records are not accurate.

Part III- Federal Award Findings and Questioned Costs

2017- 002: Material Weakness- Reporting Related to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must send accurate and complete reports to the appropriate regulatory authorities regarding the receipt and distribution of USDA food.

Condition: During our testing of the 12 monthly USDA reports, which were submitted during the year ended June 30, 2017, we selected 25 individual line items for food distribution testing. Out of the 25 items selected, 4 items of distributed USDA food did not agree to the inventory reports generated by the new inventory system. These errors occurred in July, August and September 2017.

Cause: This condition appears to be due to lack of controls over oversight and understanding of the new inventory management system, as well as not maintaining proper support for items reported to regulatory authorities.

Effect: The Food Bank is not in compliance with this requirement.

Corrective Action Plan for 2017 – 001 and 2017 - 002:

Current Status: Mid South Food Bank transitioned to a new integrated inventory management system in August 2016. During that time, the operations of the food bank were shut down as the staff prepared itself and underwent the system transition. However, even with the intensive training at that time, there were issues in the inventory between physical count and reporting which was never addressed nor corrected at any time during the fiscal year. The physical movement of product in the warehouse was never correctly reflected in the inventory management system. The Food Bank also experienced a high turnover which resulted in a knowledge gap of the actual system itself. The staff was erroneously miss-picking orders and was not simultaneously updating the system to reflect the activity that was occurring in the warehouse to be able to maintain data integrity.

Corrective Action: The following describes the continuing remediation that management is taking to address the accountability in picking and processing orders by the staff at the Mid-South Food Bank:

- Create accounting policies and standard operating procedures for warehouse personnel for establishing and monitoring inventory.
- Conduct additional and on-going training on warehouse inventory system.
- Conduct additional training on all accounting policies with special emphasis on physical inventory counts and reconciliations.

- Create new monitoring controls to identify and correct physical inventory to what is being reported.
- Train users on the inventory management system and related controls.
- Implement specific review procedures designed to ensure inventory values are being accurately extended
- Performing periodic inventory cycle counts to maintain accuracy; and
- Performing monthly internal inventory audit carried out by the Finance department and auditor to match counted inventory to system generated reports

Expected Completion Date of Corrective Action: Since August 2017 the operations and finance management at the Food Bank is conducting physical inventory audits on a monthly basis to correct the physical inventory to what is being reported in the system. The leadership at the Food Bank is committed to June 30, 2018 as the day when the physical inventory will match the systematic inventory report.

Contact person responsible, President & CEO, Estella Mayhue- Greer at 901.527.0841 or egreer@midsouthfoodbank.org

SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

Financial Statement Findings

None noted.

Federal Award Findings and Questioned Costs

2016 – 001: Significant Deficiency – Special Tests and Provisions relating to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must maintain accurate and complete records with respect to the receipt, distribution/use, and inventory of USDA foods.

Condition: Each agency that gets USDA food submits a Monthly Distribution Report (“Report”). This Report shows the number of meals and snacks served or households fed, and number of adults and children that were included. The agency cannot get more food from the Food Bank until the Report has been submitted. Out of a sample of 40, The Food Bank could not provide the Reports for two sites that had received USDA food.

Cause: This condition appears to be due to a lack of oversight by the Food Bank agency monitors, due to employee turnover in this area.

Effect: The Food Bank is not in compliance with this requirement if it lacks accurate and complete records.

Questioned Costs: None

Recommendation: We recommend that the Food Bank establish procedures to ensure all required reports are on file.

Client Response: All partner agencies have been contacted regarding the status of all monthly distribution and USDA reports. Agencies that are not in compliance have been suspended from receiving USDA products. The process for tracking the monthly distribution and USDA reports has been recorded as a standard operating procedure, which includes screenshots of how to update Ceres 4 with the status of the monthly reports for each agency. The physical filing system for the monthly distribution and USDA reports has also been updated. Each agency now has a labeled file that contains the monthly reports for the agency.

***Current Status:* This finding was corrected. Management has updated its policies and procedures to ensure the records are complete.**

SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS

Mid-South Food Bank, Inc.
June 30, 2017

2016 – 002: Significant Deficiency – Special Tests and Provisions Subrecipient Monitoring relating to the Emergency Food Assistance Program – Commodities (10.569)

Criteria: The Food Bank must maintain accurate and complete records with respect to the receipt, distribution/use, and inventory of USDA foods.

Condition: Out of a sample of 40 sites, site visit monitoring results could not be located for eight sites. Furthermore, out of these 40 sites, 21 had not had a site visit within a 12-month period.

Cause: During the year ended June 30, 2016, the Food Bank had significant turnover in its agency relations department and could not keep up with the annual visits. Furthermore, as to the eight sites which the monitoring report could not be located, during the year ended June 30, 2016, the Food Bank changed its methodology from storing this information from manual files to storing it on an electronic tablet. During our audit, we discovered that the information on the tablet could not be recovered due to a software malfunction and the Food Bank failed to back-up the information due to employee turnover. Although there is not a State of Tennessee Department of Agriculture requirement that the Food Bank monitor sites annually the Food Bank developed this internal control to assist with monitoring and reporting.

Effect: The Food Bank is not in compliance with this requirement if it does not monitor its sites timely or provide evidence of monitoring sites.

Questioned Costs: None

Recommendation: We recommend the Food Bank enhance controls related to sub-recipient agency monitoring and storing of information by having someone in management review compliance with monitoring and storing of the related information on a regular basis.

Client Response: All partner agencies have been reviewed to acknowledge the last documented inspection date. All agencies that do not have documented inspections within the last 12 months have been scheduled for an inspection within the next 120 days. Inspections that were completed but cannot be verified due to the loss of electronic data were rescheduled to be properly documented. Inspections will be completed in paper form to be filed both electronically on the shared drive in the assigned agency folders and in the physical files.

***Current Status:* This finding was corrected. Management has updated its policies and procedures to ensure site monitoring results are properly documented and sites are visited annually.**