



HOPE SERVICES

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2017 AND 2016

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
HOPE Services
San Jose, California

We have audited the accompanying financial statements of HOPE Services (a nonprofit organization), which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities, functional expenses, and cash flows for the years 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 U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of HOPE Services as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Abbott, Stringham & Lynch

December 6, 2017

HOPE SERVICES

STATEMENTS OF FINANCIAL POSITION

Assets

	June 30,	
	2017	2016
Current assets:		
Cash and cash equivalents	\$ 290,054	\$ 359,010
Accounts receivable, net of allowance for doubtful accounts of \$28,429 and \$-0- at June 30, 2017 and 2016, respectively	5,536,397	4,928,680
Pledges receivable	390	19,659
Investments	5,618,440	4,972,030
Prepaid expenses and other current assets	586,768	467,689
Total current assets	12,032,049	10,747,068
Assets limited as to use:		
Cash restricted for debt service	-	324,414
Cash restricted for endowment	368,838	196,859
Investments restricted for endowment	749,589	921,068
Total assets limited as to use	1,118,427	1,442,341
Noncurrent assets:		
Property and equipment, net	14,681,472	13,281,537
Debt issuance costs, net	59,900	-
Bond issuance costs, net	-	101,953
Other assets	105,814	88,486
Total noncurrent assets	14,847,186	13,471,976
	\$ 27,997,662	\$ 25,661,385

Liabilities and Net Assets

Current liabilities:		
Lines of credit	\$ 3,549,273	\$ 2,136,548
Notes payable, current maturities	59,718	101,785
Accounts payable	2,170,249	1,571,989
Accrued liabilities	3,430,397	2,683,102
Total current liabilities	9,209,637	6,493,424
Long-term liabilities:		
Notes payable, less current maturities	12,814	389,107
Serial bonds	-	1,170,000
Total noncurrent liabilities	12,814	1,559,107
Net assets:		
Unrestricted:		
Board designated	1,576,422	1,576,422
Undesignated	15,834,311	14,709,924
Temporarily restricted	246,051	204,581
Permanently restricted	1,118,427	1,117,927
Total net assets	18,775,211	17,608,854
Total liabilities and net assets	\$ 27,997,662	\$ 25,661,385

HOPE SERVICES

STATEMENTS OF ACTIVITIES

Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
State and county funding	\$31,501,700	\$ -	\$ -	\$31,501,700
Commercial contract services	6,694,589	-	-	6,694,589
In-kind donations of professional services	813,332	-	-	813,332
In-kind donations of property	34,000	-	-	34,000
Wholesale sales of salvage	7,004,924	-	-	7,004,924
Retail sales of salvage	1,244,479	-	-	1,244,479
In-kind donations of salvage	8,249,403	-	-	8,249,403
Contributions and pledges	942,616	287,474	500	1,230,590
Contributed use of facilities	32,766	-	-	32,766
Special events, less benefit to donor costs of \$27,123	77,665	-	-	77,665
Rental income	256,284	-	-	256,284
Gain on disposal of property and equipment	16,984	-	-	16,984
Other	50,360	-	-	50,360
Net assets released from restriction	246,004	(246,004)	-	-
Total revenues, gains and other support	57,165,106	41,470	500	57,207,076
Functional expenses:				
Program services	36,350,432	-	-	36,350,432
Supporting services:				
General and administrative	4,019,858	-	-	4,019,858
Fundraising:				
Salvage solicitation	7,330,715	-	-	7,330,715
Other	603,814	-	-	603,814
Cost of goods sold (salvage)	8,249,403	-	-	8,249,403
Total functional expenses	56,554,222	-	-	56,554,222
Change in net assets from operations	610,884	41,470	500	652,854
Investment income, net	513,503	-	-	513,503
Change in net assets	1,124,387	41,470	500	1,166,357
Net assets, beginning of year	16,286,346	204,581	1,117,927	17,608,854
Net assets, end of year	\$17,410,733	\$ 246,051	\$ 1,118,427	\$18,775,211

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

HOPE SERVICES

STATEMENTS OF ACTIVITIES (CONTINUED)

Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
State and county funding	\$ 25,669,417	\$ -	\$ -	\$ 25,669,417
Commercial contract services	6,684,784	-	-	6,684,784
In-kind donations of professional services	898,640	-	-	898,640
In-kind donations of property	214,875	-	-	214,875
Wholesale sales of salvage	5,518,195	-	-	5,518,195
Retail sales of salvage	885,558	-	-	885,558
In-kind donations of salvage	6,403,753	-	-	6,403,753
Contributions and pledges	423,773	175,714	5,000	604,487
Special events, less benefit to donor costs of \$80,305	210,702	-	-	210,702
Rental income	264,754	-	-	264,754
Gain on disposal of property and equipment	13,101	-	-	13,101
Other	75,857	-	-	75,857
Net assets released from restriction	188,319	(188,319)	-	-
Total revenues, gains and other support	<u>47,451,728</u>	<u>(12,605)</u>	<u>5,000</u>	<u>47,444,123</u>
Functional expenses:				
Program services	32,119,461	-	-	32,119,461
Supporting services:				
General and administrative	3,329,358	-	-	3,329,358
Fundraising:				
Salvage solicitation	4,972,070	-	-	4,972,070
Other	640,315	-	-	640,315
Cost of goods sold (salvage)	6,403,753	-	-	6,403,753
Total functional expenses	<u>47,464,957</u>	<u>-</u>	<u>-</u>	<u>47,464,957</u>
Change in net assets from operations	(13,229)	(12,605)	5,000	(20,834)
Investment loss, net	(26,469)	-	-	(26,469)
Change in net assets	(39,698)	(12,605)	5,000	(47,303)
Net assets, beginning of year	<u>16,326,044</u>	<u>217,186</u>	<u>1,112,927</u>	<u>17,656,157</u>
Net assets, end of year	<u>\$ 16,286,346</u>	<u>\$ 204,581</u>	<u>\$ 1,117,927</u>	<u>\$ 17,608,854</u>

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

HOPE SERVICES

STATEMENTS OF FUNCTIONAL EXPENSES

Year Ended June 30, 2017

	Supporting Services				Total Expenses	Non-Cash	
	Program Services	General and Administrative	Fundraising			Cost of Goods Sold (Salvage)	Total
			Salvage Solicitation	Other			
Personnel costs:							
Salaries and wages	\$20,003,101	\$ 1,999,445	\$ 2,667,371	\$ 255,548	\$24,925,465	\$ -	\$24,925,465
Benefits	5,681,331	591,974	1,019,739	46,574	7,339,618	-	7,339,618
Payroll taxes	1,444,126	143,301	199,546	19,591	1,806,564	-	1,806,564
Donated services	813,332	-	-	-	813,332	-	813,332
Total personnel costs	27,941,890	2,734,720	3,886,656	321,713	34,884,979	-	34,884,979
Cost of goods sold (salvage)	-	-	-	-	-	8,249,403	8,249,403
Occupancy	2,137,116	120,130	794,977	18,130	3,070,353	-	3,070,353
Operating supplies	1,276,691	42,504	99,072	4,864	1,423,131	-	1,423,131
Purchased services	2,297,673	369,220	1,585,749	33,274	4,285,916	-	4,285,916
Communications	294,667	67,598	43,327	8,268	413,860	-	413,860
Interest	24,286	127,790	65	-	152,141	-	152,141
Depreciation and amortization	530,110	186,960	66,995	2,549	786,614	-	786,614
Travel and transportation	1,335,038	28,048	663,695	6,015	2,032,796	-	2,032,796
Equipment rental and maintenance	173,783	87,653	35,513	12,991	309,940	-	309,940
Printing and publications	104,328	14,986	65,853	188,735	373,902	-	373,902
Amortization of bond issuance costs	-	101,953	-	-	101,953	-	101,953
Bad debt recovery	(1,067)	-	-	-	(1,067)	-	(1,067)
Insurance	199,174	54,725	46,344	1,609	301,852	-	301,852
Other	36,743	83,571	42,469	5,666	168,449	-	168,449
Total expenses	<u>\$36,350,432</u>	<u>\$ 4,019,858</u>	<u>\$ 7,330,715</u>	<u>\$ 603,814</u>	<u>\$48,304,819</u>	<u>\$ 8,249,403</u>	<u>\$56,554,222</u>
Percentage of total expenses	75%	8%	15%	2%	100%		

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

HOPE SERVICES

STATEMENTS OF FUNCTIONAL EXPENSES (CONTINUED)

Year Ended June 30, 2016

	Supporting Services				Total Expenses	Non-Cash Cost of Goods Sold (Salvage)	Total
	Program Services	General and Administrative	Fundraising				
			Salvage Solicitation	Other			
Personnel costs:							
Salaries and wages	\$ 17,419,768	\$ 1,824,443	\$ 1,811,205	\$ 308,431	\$ 21,363,847	\$ -	\$ 21,363,847
Benefits	5,320,708	449,891	782,745	74,255	6,627,599	-	6,627,599
Payroll taxes	1,253,290	130,889	132,592	24,938	1,541,709	-	1,541,709
Donated services	898,640	-	-	-	898,640	-	898,640
Total personnel costs	24,892,406	2,405,223	2,726,542	407,624	30,431,795	-	30,431,795
Cost of goods sold (salvage)	-	-	-	-	-	6,403,753	6,403,753
Occupancy	2,000,889	88,329	307,461	13,172	2,409,851	-	2,409,851
Operating supplies	1,130,149	33,433	48,219	3,850	1,215,651	-	1,215,651
Purchased services	2,241,722	307,399	1,103,072	35,028	3,687,221	-	3,687,221
Communications	242,160	60,001	32,816	7,275	342,252	-	342,252
Interest	46,825	46,103	150	1,012	94,090	-	94,090
Depreciation and amortization	451,271	172,846	55,988	2,316	682,421	-	682,421
Travel and transportation	748,263	26,047	558,701	7,422	1,340,433	-	1,340,433
Equipment rental and maintenance	130,484	57,981	37,333	6,935	232,733	-	232,733
Printing and publications	64,126	11,605	29,247	142,389	247,367	-	247,367
Amortization of bond issuance costs	17,220	6,354	-	954	24,528	-	24,528
Bad debt recovery	(79,757)	-	-	-	(79,757)	-	(79,757)
Insurance	203,207	54,152	57,953	1,752	317,064	-	317,064
Other	30,496	59,885	14,588	10,586	115,555	-	115,555
Total expenses	<u>\$ 32,119,461</u>	<u>\$ 3,329,358</u>	<u>\$ 4,972,070</u>	<u>\$ 640,315</u>	<u>\$ 41,061,204</u>	<u>\$ 6,403,753</u>	<u>\$ 47,464,957</u>
Percentage of total expenses	78%	8%	12%	2%	100%		

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

HOPE SERVICES

STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

	June 30,	
	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ 1,166,357	\$ (47,303)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	786,614	682,421
Amortization of debt issuance costs	100	-
Amortization of bond issuance costs	101,953	24,528
Net realized and unrealized (gain) loss on investments	(427,751)	140,861
In-kind donation of property	(34,000)	(214,875)
Gain on disposition of property and equipment	(16,984)	(13,101)
Changes in operating assets and liabilities:		
Accounts receivable, net	(607,717)	(1,057,447)
Pledges receivable	19,269	53,616
Prepaid expenses and other assets	(102,407)	(380,210)
Accounts payable	598,260	178,715
Accrued liabilities	747,295	309,593
Net cash provided by (used in) operating activities	2,230,989	(323,202)
Cash flows from investing activities:		
Cash unrestricted for debt service	324,414	675
Proceeds from maturities and sales of investments	1,892,079	3,002,268
Purchases of investments	(1,939,259)	(2,870,645)
Proceeds from sale of property and equipment	24,232	14,407
Purchases of property and equipment	(2,193,797)	(957,932)
Net cash used in investing activities	(1,892,331)	(811,227)
Cash flows from financing activities:		
Repayments on notes payable	(418,360)	(99,826)
Payment of bond issuance costs	(60,000)	(1,000)
Repayment of bonds	(1,170,000)	-
Borrowings on lines of credit, net of repayments	1,412,725	1,408,614
Net cash (used in) provided by financing activities	(235,635)	1,307,788
Net increase in cash and cash equivalents	103,023	173,359
Cash and cash equivalents at beginning of year	555,869	382,510
Cash and cash equivalents at end of year	\$ 658,892	\$ 555,869
Reconciliation of cash and cash equivalents at end of year:		
Cash and cash equivalents	\$ 290,054	\$ 359,010
Cash restricted for endowment	368,838	196,859
Cash and cash equivalents at end of year	\$ 658,892	\$ 555,869
Supplemental disclosure of cash flows information:		
Interest paid	\$ 156,381	\$ 91,525
Non-cash investing and financing activities:		
In-kind donation of property	\$ 34,000	\$ 214,875

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

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 1 - Nature of activities

HOPE Services (HOPE) is a California public benefit corporation which provides comprehensive services to more than 4,000 individuals with developmental and other related disabilities, and their families. The individuals served by HOPE may have autism spectrum disorders, Down syndrome, and other related conditions. Services include a range of employment and job training programs, developmental activities, professional counseling, infant services, senior services, supported and independent living services, and mobility training for children, adults and seniors all rendered in five Northern California counties.

Note 2 - Summary of significant accounting policies

Basis of presentation

The financial statements of HOPE have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Financial statement presentation

HOPE accounts for its assets, liabilities, and operations into three categories: unrestricted, temporarily restricted, and permanently restricted. HOPE's net assets and changes therein are classified and reported as follows:

Unrestricted net assets - consist of net assets for which there are no donor-imposed restrictions or such donor-imposed restrictions were temporary and expired during the current or previous years. Certain cash and cash equivalents, and certain investments, are reflected as designated unrestricted net assets by HOPE's Board of Directors.

Temporarily restricted net assets - consist of contributions receivable or received that are restricted by the donor for specific purposes or for subsequent periods. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restriction.

Permanently restricted net assets - consist of all contributions receivable or received from donors that are subject to restrictions requiring the funds to be maintained permanently for the purpose of producing support for HOPE. Income from these assets is recorded as temporarily restricted net assets unless otherwise restricted by donor stipulations or until appropriated for expenditure by HOPE.

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and reported amounts of revenues and expenses during the reporting period. Significant estimates used in preparing these financial statements include the allowance for doubtful accounts, the useful lives of property and equipment, the value of donated materials, property and equipment, and professional services, and the fair market value of assets and liabilities. Actual results could differ from those estimates.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 2 - Summary of significant accounting polices (continued)

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments and investments with an original maturity of three months or less at the time of purchase. Cash and cash equivalents restricted by donors for use for certain purposes or restricted for debt service under the terms of the bond agreement are not considered to be available for current use, and are not included in cash and cash equivalents for presentation purposes in the statements of financial position.

Accounts and pledges receivable

Accounts receivable consist primarily of public funding and contract service revenues. Contract service revenues are primarily from companies located in Northern California. Approximately 66% of accounts receivable at June 30, 2017 and 2016 are from government agencies. Pledges receivable represent amounts committed by donors that have not been received by HOPE. HOPE makes estimates as to the ability to collect all of its outstanding receivables and provides allowances for amounts when collection becomes doubtful. Provisions are made based upon a specific review of past due and other outstanding balances for which collection is considered uncertain.

State, county, and contract services revenues

Revenue from state and county funding is recognized based on the terms of the respective fee for service contract. Most contracts provide that HOPE will be paid at pre-established rates based on attendance of clients, coaching hours provided, or other measures. Approximately 82% and 80% of state and county funding revenue recognized during the years ended June 30, 2017 and 2016, respectively, are from one state funding agency. Revenue from contract services provided by HOPE clients to commercial companies is recognized upon completion of the services or based on quantities of piecemeal completed.

In-kind donations

HOPE records various types of in-kind donations including professional services, tangible assets, and the use of tangible assets. 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 donation. Contributions of tangible assets, or the use thereof, are recognized when promised or received, whichever is earlier. The amounts reflected in the accompanying financial statements as in-kind donations are offset by like amounts of expenses, or in the case of long-term assets, over the period benefited. Additionally, HOPE receives a significant amount of contributed time from volunteers, which does not meet the recognition criteria described above. Accordingly, the value of this contributed time has not been determined and is not reflected in the accompanying financial statements.

Retail sales of salvage

HOPE operates retail stores in Fremont and San Jose, California to facilitate the sale of donated clothing and other household items. In May 2016, HOPE opened a bicycle shop in the same location as the Fremont retail store to facilitate the sale of donated bicycles. Sales of bicycles totaled approximately \$97,000 and \$35,000 during the years ended June 30, 2017 and 2016, respectively, and are included in retail sales of salvage on the statements of activities. Revenue is recognized at the time of sale, as all sales to customers are unconditional and returns are not allowed.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 2 - Summary of significant accounting policies (continued)

Cost of goods sold (salvage)

HOPE collects donated items from the general public for sale to a third-party retailer of used goods and for HOPE's two retail stores. As the value of donated items is not determinable at the time of donation, HOPE has historically recorded in-kind revenue from its salvage operations equal to the annual revenue generated from wholesale and retail salvage sales, with a corresponding in-kind charge to cost of goods sold (salvage).

Inventory consists of donated clothing and other household items and is sold through HOPE's retail stores or directly to other third parties. Inventory is valued at management's best estimate of fair market value at year-end because the value of the donated inventory is not determinable until the items are sold at the retail stores. For slow-moving or non-salable items, necessary provisions are recorded to reduce inventory to its net realizable value. As of June 30, 2017 and 2016, inventory of approximately \$60,000 and \$29,000, respectively, is included in prepaid expenses and other current assets in the statements of financial position.

Investments

Investments in marketable securities are reported at fair market value based on quoted market prices. Unrealized gains and losses are included in net investment income in the statements of activities. Income and gains on restricted investments are reported as increases in temporarily restricted net assets unless otherwise restricted by donor stipulations or until appropriated for expenditure by HOPE. Investments classified as current assets are readily marketable and are available for conversion to cash within one year of the date of the financial statements.

Fair value measurements

HOPE measures and discloses fair value measurements as required by the *Fair Value Measurements and Disclosures Topic* of the Financial Accounting Standards Board (FASB) Accounting Standards Codification.

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the FASB establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 - Valuations based on observable inputs that reflect unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 - Valuations based on quoted prices for similar assets or liabilities or identical assets or liabilities in less active markets, such as dealer or broker markets.
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer, or broker-traded transactions.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 2 - Summary of significant accounting policies (continued)

Fair value measurements (continued)

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Property and equipment

Purchased property and equipment are recorded at cost. It is HOPE's policy to capitalize property and equipment acquisitions over \$1,000. Donated property and equipment are recorded at their estimated fair value at the time of the donation. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of the term of the respective leases (including anticipated renewal options, where appropriate) or the estimated useful lives of the assets.

Building and improvements	7 - 40 years
Office furniture and equipment	5 - 7 years
Equipment and tools	5 - 10 years
Computer equipment	3 years
Transportation equipment	3 - 5 years
Leasehold improvements	Lesser of 15 years or remaining lease term

Donations of property and equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Donations of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained; expirations of donor restrictions are reported as released from restriction when the donated or acquired long-lived assets are placed in service.

Impairment of long-lived assets

HOPE reviews its long-lived assets for impairment whenever events or changes in circumstances indicate the carrying value may not be fully recoverable. HOPE evaluates the recoverability of long-lived assets by measuring the carrying amount of such assets against the estimated undiscounted future cash flows associated with them. At the time such evaluation indicates that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair value. To date, HOPE has not recorded any impairment of its long-lived assets as a result of this analysis.

Tax exempt status

HOPE has been approved to be exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Code. HOPE is also exempt from California franchise taxes under Section 23701(d) of the California Revenue and Taxation Code.

Although HOPE is recognized as a tax-exempt nonprofit organization, it is still liable for tax on any unrelated business taxable income (UBTI). HOPE does not believe it has UBTI that should have been reported for tax purposes.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 2 - Summary of significant accounting policies (continued)

Tax exempt status (continued)

HOPE has adopted the accounting standard related to uncertainties in income taxes. The Organization evaluates uncertain tax positions through its review of the source of revenue to identify unrelated business income and certain other matters, including those which may affect its tax exempt status. Management believes their estimates related to income tax uncertainties are appropriate based on the current facts and circumstances. HOPE is subject to examination by major tax jurisdictions back to the fiscal year ended June 30, 2013.

Functional expenses

The costs of providing HOPE's various programs and services have been summarized on a functional basis in the statements of functional expenses. Directly identifiable expenses are charged to the related program or service benefited. Indirect expenses are allocated to programs and services based principally on the percentage of personnel time spent in each area.

Advertising

Costs associated with advertising are expensed when incurred. Advertising expenses were \$315,388 and \$177,903 for the years ended June 30, 2017 and 2016, respectively.

New accounting pronouncements not yet adopted

In May 2014, the FASB issued new accounting guidance for reporting revenue with customers. The five-step process in the new guidance may necessitate more judgment and estimation within the revenue recognition process than required under existing pronouncements, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. This new guidance is effective for annual reporting periods beginning after January 1, 2019, though early adoption is permitted for annual reporting periods beginning after January 1, 2017, and may be applied using either a full retrospective or a modified retrospective approach upon adoption. The Organization is currently evaluating the impact of adopting the new standard on its results of operations and financial position.

In February 2016, the FASB issued new accounting guidance for reporting leases, which requires an entity that is a lessee to classify leases as either finance or operating and to recognize a lease liability and a right-of-use asset for all leases that have a term of greater than 12 months. Leases of 12 months or less will be accounted for similar to existing guidance for operating leases. The new standard will be effective for annual reporting periods beginning after January 1, 2020, with early adoption permitted, and must be applied using a modified retrospective approach. The Organization is currently evaluating the impact of adopting this standard on its financial statements.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 2 - Summary of significant accounting policies (continued)

New accounting pronouncements not yet adopted (continued)

In August 2016, the FASB issued new accounting guidance for presentation of financial statements of not-for-profit entities. The update, which is the first phase of a two-phase project, makes significant changes in seven areas:

- *Net assets classes* - the three classes of net assets, (unrestricted, temporarily restricted and permanently restricted), will be replaced with two classes of net assets (net assets with donor restrictions and net assets without donor restrictions).
- *Liquidity and availability of resources* - organizations will be required to disclose both qualitative and quantitative information about how it manages its liquid resources.
- *Classification and disclosure of underwater endowment funds* - reporting of accumulated losses of a donor-restricted endowment fund that is considered to be underwater, will be included together with that fund in net asset with donor restrictions. The fund balance of a donor-restricted endowment fund will be reported entirely within net assets with donor restrictions, and the fund balance for a board-designated endowment fund will be reported entirely within net assets without donor restrictions.
- *Expense reporting* - all not-for-profit organizations will be required to present an analysis of expenses by functional and natural classifications as well as to provide a description of the methods used to allocate costs among program and support functions.
- *Statement of cash flows* - continue to permit an organization to choose whether to provide a statement of cash flows using the direct or indirect method. However, if direct method is used, the indirect reconciliation will no longer be required.
- *Investment returns* - requires that investment expenses related to total return investing be netted against investment returns on the statement of activities and eliminates the requirement to disclose investment expenses that have never been netted.
- *Release of restrictions on capital assets* - requires not-for-profit organizations to report expirations of restrictions on gifts of long-lived assets and cash or other assets to be used to acquire or construct long-lived assets.

The update is effective for annual financial statements issued for fiscal years beginning after January 1, 2018, with early adoption permitted. The update is to be applied on a retrospective basis. The Organization is currently evaluating the impact of adopting this standard on its financial statements.

Subsequent events

In preparing its financial statements, HOPE has evaluated subsequent events through December 6, 2017, which is the date the financial statements were available to be issued.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 3 - Investments and fair value measurements

Fair values for Level 1 investments are determined by reference to quoted market prices and other relevant information generated by market transactions. Fair values for Level 2 investments are determined by reference to quoted market transactions in a less active market for assets similar to those held to support the underlying assets. There have been no changes in valuation techniques and related inputs between the years ended June 30, 2017 and 2016.

Fair values of assets measured on a recurring basis as of June 30, 2017 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Equity securities:				
Consumer goods	\$ 464,125	\$ 464,125	\$ -	\$ -
Energy and precious metals	40,111	40,111	-	-
Financial services	481,824	481,824	-	-
Healthcare	388,861	388,861	-	-
Industrial	118,179	118,179	-	-
Real estate	81,229	81,229	-	-
Technology	895,968	895,968	-	-
Telecommunication services	70,086	70,086	-	-
Other	465,356	465,356	-	-
Total equity securities	3,005,739	3,005,739	-	-
Mutual funds:				
Bond funds	570,945	570,945	-	-
Blend funds	724,309	724,309	-	-
Total mutual funds	1,295,254	1,295,254	-	-
Exchange traded funds	1,116,607	1,116,607	-	-
Fixed income securities:				
Government	425,147	-	425,147	-
Corporate	525,282	-	525,282	-
Total fixed income securities	950,429	-	950,429	-
Total investments at fair value	<u>\$ 6,368,029</u>	<u>\$ 5,417,600</u>	<u>\$ 950,429</u>	<u>\$ -</u>

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 3 - Investments and fair value measurements (continued)

Fair values of assets measured on a recurring basis as of June 30, 2016 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Equity securities:				
Consumer goods	\$ 291,577	\$ 291,577	\$ -	\$ -
Energy and precious metals	25,050	25,050	-	-
Financial services	567,306	567,306	-	-
Healthcare	323,348	323,348	-	-
Industrial	130,479	130,479	-	-
Technology	811,916	811,916	-	-
Telecommunication services	142,083	142,083	-	-
Other	533,151	533,151	-	-
Total equity securities	2,824,910	2,824,910	-	-
Mutual funds:				
Bond funds	860,129	860,129	-	-
Blend funds	376,223	376,223	-	-
Total mutual funds	1,236,352	1,236,352	-	-
Exchange traded funds	1,134,484	1,134,484	-	-
Fixed income securities:				
Government	356,257	-	356,257	-
Corporate	341,095	-	341,095	-
Total fixed income securities	697,352	-	697,352	-
Total investments at fair value	<u>\$ 5,893,098</u>	<u>\$ 5,195,746</u>	<u>\$ 697,352</u>	<u>\$ -</u>

Total investments at fair value are reflected on the accompanying statements of financial position as follows:

	June 30,	
	2017	2016
Investments	\$ 5,618,440	\$ 4,972,030
Investments restricted for endowment	749,589	921,068
	<u>\$ 6,368,029</u>	<u>\$ 5,893,098</u>

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 3 - Investments and fair value measurements (continued)

Unrestricted investment income (loss) is comprised of the following:

	June 30,	
	2017	2016
Dividends and interest	\$ 153,476	\$ 184,552
Net realized and unrealized gains (losses)	427,751	(140,861)
	581,227	43,691
Less investment expenses	(67,724)	(70,160)
	<u>\$ 513,503</u>	<u>\$ (26,469)</u>

Risks and uncertainties

HOPE holds investments in various securities which are exposed to risks such as interest rate and market risks. Due to the level of risk associated with these securities and the level of uncertainty related to changes in value, it is at least reasonably possible that changes in the risk factors will occur in the near term that could materially affect the value of the investments reported in the accompanying financial statements.

Note 4 - Property and equipment

Property and equipment consisted of the following:

	June 30,	
	2017	2016
Building and improvements	\$ 12,207,104	\$ 11,604,480
Land	5,239,795	5,239,795
Transportation equipment	1,770,529	2,087,412
Computer equipment	1,676,460	1,510,146
Leasehold improvements	1,484,451	583,086
Office furniture and equipment	1,051,516	850,295
Equipment and tools	618,126	545,944
Construction in progress	206,738	-
	24,254,719	22,421,158
Less accumulated depreciation and amortization	(9,573,247)	(9,139,621)
	<u>\$ 14,681,472</u>	<u>\$ 13,281,537</u>

Depreciation and amortization expense for the years ended June 30, 2017 and 2016 totaled \$786,614 and \$682,421, respectively.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 5 - Accrued liabilities

Accrued liabilities consisted of the following:

	June 30,	
	2017	2016
Accrued vacation	\$ 1,469,409	\$ 1,360,017
Accrued payroll and related taxes	1,138,987	991,138
Accrued rent	481,988	160,790
Employee benefits	74,313	62,873
Accrued interest	-	4,340
Other accrued expenses	265,700	103,944
	<u>\$ 3,430,397</u>	<u>\$ 2,683,102</u>

Note 6 - Borrowing arrangements

Notes payable

Notes payable consisted of the following:

	June 30,	
	2017	2016
Vehicle notes, payable in varying monthly installments, including interest at rates ranging from 0.9% - 8.24%, due at various dates through April 2019; secured by vehicles.	\$ 72,532	\$ 154,866
Mortgage notes (3) with bank, payable in monthly installments ranging from \$952 to \$1,960, including interest at rates ranging from 7.0% to 7.25% through December 2026; secured by deeds of trust on real property; all were repaid during the year ended June 30, 2017.	-	336,026
	72,532	490,892
Less current maturities	<u>(59,718)</u>	<u>(101,785)</u>
	<u>\$ 12,814</u>	<u>\$ 389,107</u>

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 6 - Borrowing arrangements (continued)

Future aggregate principal payments required are as follows:

<u>Years Ending June 30,</u>	<u>Amount</u>
2018	\$ 59,718
2019	12,814
	<u>\$ 72,532</u>

Bonds payable

Bonds payable of \$1,170,000 as of June 30, 2016 consisted of California Health Facilities Financing Authority Insured Health Facility Refunding Revenue Bonds. The outstanding obligation on these bonds, including all accrued interest, was repaid in full during the year ended June 30, 2017.

The full amount of principal and interest of the serial bonds was insured by the Office of Statewide Health Planning and Development (OSHPD) of the State of California. The bond agreement provided for various restrictive covenants including, among other things, maintaining a minimum debt coverage ratio, timely financial reporting, and repaying all outstanding short-term indebtedness for a 30-day period during the year. As of and for the year ended June 30, 2017, HOPE was not in compliance with the 30-day short-term debt clean out requirement, and was in technical default. In a letter dated subsequent to June 30, 2016, OSHPD provided a waiver which stated OSHPD agreed not to take any action against HOPE related to covenant violations for the year ended June 30, 2016.

In addition, HOPE was required to maintain a bond reserve account in an amount equal to the maximum annual bond service requirement under the bond agreement. As a result, cash of \$324,414 as of June 30, 2016 was restricted for debt service to satisfy this requirement. During the year ended June 30, 2017, the funds in these accounts were released and applied against the outstanding principal and interest due on the bonds.

Lines of credit

As of June 30, 2016, HOPE had a \$4,200,000 line of credit with a bank bearing interest at the bank's Prime Reference Rate minus the Applicable Margin (3.25% at June 30, 2016). Outstanding borrowings on the line of credit were \$2,136,548 as of June 30, 2016. This line of credit was repaid in full during the year ended June 30, 2017.

In February 2017, Hope entered into a revolving line of credit agreement with a bank that allows for borrowings up to \$5,000,000. The line of credit bears interest at the bank's Prime Reference Rate minus 0.25% with a minimum rate of 3.50% per annum (4.0% at June 30, 2017). The line of credit matures in February 2018. Outstanding borrowings on this line of credit were \$2,194,812 as of June 30, 2017. The line of credit is secured by first deeds of trust on several of the Organization's real estate properties and all of the Organization's personal property.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 6 - Borrowing arrangements (continued)

Lines of credit (continued)

In April 2017, Hope entered into a promissory note which provides for a non-revolving line of credit agreement with the same bank that allows for borrowings up to a \$6,000,000. The line of credit bears a fixed rate of interest at 4.60% per annum and requires interest only payments during the 24-month draw period expiring in April 2019 (conversion date). Upon expiration of the draw period, the line of credit will convert to a term note and no further advances will be permitted. Beginning May 2019, monthly principal and interest payments will be based on a 300-month amortization period which will be calculated based on the outstanding principal balance as of the conversion date. The note matures in April 2027. Outstanding borrowings on the line of credit were \$1,354,461 as of June 30, 2017. This line of credit is also secured by first deeds of trust on several of the Organization's real estate properties and all of the Organization's personal property.

Note 7 - Net assets

Temporarily restricted net assets consisted of the following:

	June 30,	
	2017	2016
Program services (time and purpose restrictions)	\$ 216,772	\$ 204,581
Unappropriated endowment earnings	29,279	-
	<u>\$ 246,051</u>	<u>\$ 204,581</u>

Note 8 - Net assets released from restrictions

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

	June 30,	
	2017	2016
Program services (time and purpose restrictions)	<u>\$ 246,004</u>	<u>\$ 188,319</u>

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 9 - Endowment

HOPE's endowment consists of both contributions receivable or received with donor-restrictions and funds designated by the Board of Directors to function as endowments. As required by U.S. generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

HOPE's Board of Directors has interpreted the State Prudent Management of Institutional Funds Act ("SPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, HOPE classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified in temporarily restricted net assets until those amounts are appropriated for expenditure by HOPE in a manner consistent with the standard of prudence prescribed by SPMIFA. In circumstances when net investment losses exceed cumulative investment earnings, those losses will be classified in unrestricted net assets until such time that endowment investment earnings exceed these losses.

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

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

Endowment net assets consisted of the following as of June 30, 2017:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 1,118,427	\$ 1,118,427
Board-designated funds	<u>1,576,422</u>	<u>-</u>	<u>1,576,422</u>
	<u>\$ 1,576,422</u>	<u>\$ 1,118,427</u>	<u>\$ 2,694,849</u>

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 9 - Endowment (continued)

Endowment net assets consisted of the following as of June 30, 2016:

	<u>Unrestricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 1,117,927	\$ 1,117,927
Board-designated funds	<u>1,576,422</u>	<u>-</u>	<u>1,576,422</u>
	<u>\$ 1,576,422</u>	<u>\$ 1,117,927</u>	<u>\$ 2,694,349</u>

The unrestricted board-designated endowment funds of \$1,576,422 relate to a portion of proceeds received from an estate that the Board of Directors designated in 2009.

HOPE has adopted an investment policy for endowment assets with the primary objective to preserve principal, while generating a competitive rate of return and maintaining liquidity. Under this policy, funds are invested in cash and cash equivalents, and readily marketable equity and fixed income securities, unless otherwise approved by HOPE's Board of Directors. Limiting risks and protecting principal is an integral part of the investment policy objectives.

HOPE has adopted a spending policy whereby the Organization shall distribute funds from the return on each endowment fund at its "normal spending rate" according to its investment policy and guidelines established by the Board of Directors. Currently, the normal spending rate is up to 5% on a 12-quarter rolling average of the market value. Return on the endowment funds that exceed the normal spending allocation will normally be added to the principal (and accounted for in the temporarily restricted fund). At the discretion of the Board of Directors, some portion or all of such excess may be expended for a particular need or project related to the purpose of the endowment.

HOPE did not appropriate any endowment funds for expenditure for the years ended June 30, 2017 and 2016.

Note 10 - Operating lease arrangements

HOPE leases seventeen separate facilities under non-cancellable operating lease agreements, many with renewal options, which expire at various dates through 2053. Management expects that in the normal course of business the leases will be renewed or replaced, either by other leases or by acquisition or construction of similar facilities. HOPE also leases equipment and vehicles under non-cancellable operating lease agreements of five (5) years or less.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 10 - Operating lease arrangements (continued)

Future minimum lease payments for equipment, vehicles and facilities are as follows:

<u>Years Ending June 30,</u>	<u>Facilities</u>	<u>Vehicles and Equipment</u>	<u>Total</u>
2018	\$ 1,519,992	\$ 1,262,587	\$ 2,782,579
2019	2,006,508	1,160,685	3,167,193
2020	2,105,620	945,255	3,050,875
2021	2,107,248	478,352	2,585,600
2022	1,972,921	30,894	2,003,815
Thereafter	<u>15,679,347</u>	<u>-</u>	<u>15,679,347</u>
	<u>\$ 25,391,636</u>	<u>\$ 3,877,773</u>	<u>\$ 29,269,409</u>

Facilities rent expense under operating leases totaled \$1,671,803 and \$1,250,608 for the years ended June 30, 2017 and 2016, respectively, exclusive of in-kind rent. Vehicles and equipment rent expense under operating lease agreements totaled \$93,426 and \$83,456 for the years ended June 30, 2017 and 2016, respectively.

HOPE leases a building in San Jose, California under an agreement that expired in November 2016, which provided for annual rent of \$1. Upon expiration of the agreement, the lease converted to a month-to-month arrangement under the same terms as the expired agreement. The lessor has the right to terminate this agreement upon 30-days written notice. The fair value of this rent in 2017 and 2016 has been estimated by HOPE at approximately \$52,000.

The land which houses the Whittier facility is leased under a 48-year operating lease agreement which expires in 2038. Prior to an amendment effective June 1, 2013, the basic monthly rental payments under this lease were subject to two possible adjustments: (1) a consumer price index (CPI) based adjustment which occurs every three years, and (2) a market value adjustment which can occur, at the option of either the landlord or HOPE, every ten years. The amendment effectively eliminated the CPI adjustment and replaced it with a 5% periodic rate adjustment occurring every five years, with the first adjustment occurring on June 5, 2016. The amendment also changed the date of the next market rate adjustment to occur on June 5, 2026, with a following market adjustment occurring ten years later.

The market value adjustment is determined by an appraisal that can occur every ten years at the option of the landlord or HOPE. The market value adjustment establishes the new base rent, although the appraised value of the property can never result in a base rent that is less than the rent determined in the appraisal from ten years earlier. The last appraisal and market value adjustment took place in June 2001. The landlord waived his right to revalue the base rent in June 2013. However, the landlord retained his right to the future lease adjustments under the lease. Future minimum lease payments of this lease have been computed and are included in the above schedule based on the June 2001 market value base rent amount.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 11 - Related parties

In 1997, South County/Hope Villa Esperanza, Inc. (SCHVE), a nonprofit organization, was incorporated with a mission to build and maintain a housing facility for persons with disabilities financed by the U.S. Department of Housing and Urban Development. Representatives from HOPE and South County Housing Corporation serve as directors of SCHVE. While HOPE has control through majority representation on the Board of Directors, it does not have an economic interest in, or any financial commitments to, SCHVE. Therefore, SCHVE operations are not consolidated into HOPE's financial statements.

In 1995, Arroyo Commons, Inc. (Arroyo Commons), a nonprofit organization, was incorporated with a mission to own and operate a housing facility for persons with disabilities financed by the U.S. Department of Housing and Urban Development. The original sponsor of this project was AID Employment, a now dissolved California public benefit corporation. In March 2012, the subject project was approved for transfer to HOPE as its new sponsor by the Department of Housing and Urban Development. While HOPE is the sponsoring organization, it does not have an economic interest in, or any financial commitments to Arroyo Commons. Therefore, Arroyo Commons operations are not consolidated into HOPE's financial statements.

For purposes of making this determination, control is defined as the direct or indirect ability to determine the direction of management and policies through ownership, contract or otherwise. Economic interest is defined as an interest in the related entity that exists if the related entity holds or utilizes significant resources that must be used for the unrestricted or restricted purposes of HOPE, either directly or indirectly by producing income or providing services, or if HOPE is responsible for the liabilities of the related entity.

Note 12 - Concentrations

Financial instruments that potentially subject HOPE to concentrations of credit risk consist primarily of cash and cash equivalents, investments, accounts receivable and pledges receivable.

Risks associated with cash and cash equivalents and investments are mitigated by maintaining deposits in multiple credit-worthy financial institutions. HOPE maintains its cash in bank deposit accounts which, at times, may exceed amounts insured by the Federal Deposit Insurance Corporation. HOPE's investment balances exceeded the level insured by the Securities Investor Protection Corporation ("SIPC"). As of June 30, 2017, HOPE has not experienced any losses in its cash deposit accounts nor had any claims on amounts insured by the SIPC. Management believes it is not exposed to any significant risk on cash and cash equivalents or investment accounts. HOPE's investment portfolio and invested cash are managed by HOPE's Board of Directors and Investment Committee.

One pledge represents 100% of total pledges receivable as of June 30, 2017 and 2016.

HOPE SERVICES

Notes to Financial Statements

June 30, 2017 and 2016

Note 13 - Employee retirement plans

Defined contribution retirement plan

HOPE instituted a defined contribution retirement plan (the "Plan") in 1978 for employees meeting certain employment service requirements. The Plan operates under Internal Revenue Code Section 403(b). Eligible employees can defer a percentage of their gross salary into the Plan, not to exceed the annual IRS limits. Retirement benefits expense related to the Plan totaled \$580,196 and \$556,077 for the years ended June 30, 2017 and 2016, respectively. The employer discretionary contributions are equal to the predetermined percentage of eligible compensation based on each participant's completed years of service. The benefits fully vest upon contribution.

Deferred compensation plan

HOPE has a deferred compensation plan covering one key employee and one former employee. Annual contributions to the plan are determined by HOPE's Executive Committee. HOPE contributed \$100,000 and \$17,107 to this plan during the years ended June 30, 2017 and 2016, respectively.

Note 14 - Reclassifications

Certain reclassifications have been made to the June 30, 2016 financial statements to conform to the June 30, 2017 financial statements presentation. These reclassifications have no effect on net assets or changes in net assets.