

Arizona Humane Society

Financial Statements

Together with Independent Auditor's Report

October 31, 2015



ARIZONA HUMANE SOCIETY

ARIZONA HUMANE SOCIETY

TABLE OF CONTENTS

| | |
|---------------------------------|---|
| INDEPENDENT AUDITOR'S REPORT | 1 |
| FINANCIAL STATEMENTS | |
| Statement of financial position | 3 |
| Statement of activities | 4 |
| Statement of cash flows | 6 |
| Notes to financial statements | 7 |

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Arizona Humane Society
Phoenix, Arizona

We have audited the accompanying financial statements of Arizona Humane Society, an Arizona nonprofit organization (the "Organization"), which comprise the statement of financial position as of October 31, 2015, and the related statements of activities 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. 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 Arizona Humane Society as of October 31, 2015, 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.

Report on Summarized Comparative Information

We have previously audited the Arizona Humane Society's 2014 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated March 2, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended October 31, 2014, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Schmidt Westergard & Company, PLLC

Mesa, Arizona
February 22, 2016

ARIZONA HUMANE SOCIETY
STATEMENT OF FINANCIAL POSITION
October 31, 2015 (with comparative totals as of October 31, 2014)

| | <u>2015</u> | <u>2014</u> |
|---|----------------------|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 7,063,373 | \$ 10,886,811 |
| Estate receivables | 2,522,879 | 3,788,067 |
| Receivables | 46,485 | 16,740 |
| Inventories | 173,004 | 134,769 |
| Prepaid expenses and other assets | 284,844 | 260,984 |
| Investments | 10,241,560 | 3,703,758 |
| Property and equipment, net | 10,708,216 | 11,169,555 |
| Property held for sale | - | 161,900 |
| Deposits | 40,677 | 38,595 |
| Beneficial interest in remainder trusts | 2,604,000 | 2,565,000 |
| Beneficial interest in perpetual trusts | 5,070,000 | 5,382,000 |
| | <u>\$ 38,755,038</u> | <u>\$ 38,108,179</u> |
| LIABILITIES AND NET ASSETS | | |
| Accounts payable | \$ 381,631 | \$ 415,425 |
| Accrued liabilities | 1,219,427 | 1,010,640 |
| Charitable gift annuities payable | 225,710 | 231,518 |
| Total liabilities | <u>1,826,768</u> | <u>1,657,583</u> |
| Net assets | | |
| Unrestricted | | |
| Invested in property and equipment | 10,708,216 | 11,169,555 |
| Board designated | 8,000,000 | 1,513,240 |
| Unrestricted and undesignated | 7,097,809 | 11,621,148 |
| Total unrestricted | 25,806,025 | 24,303,943 |
| Temporarily restricted | 6,052,245 | 6,764,653 |
| Permanently restricted | 5,070,000 | 5,382,000 |
| Total net assets | <u>36,928,270</u> | <u>36,450,596</u> |
| | <u>\$ 38,755,038</u> | <u>\$ 38,108,179</u> |

ARIZONA HUMANE SOCIETY

STATEMENT OF ACTIVITIES

For the year ended October 31, 2015 (with comparative totals for the year ended October 31, 2014)

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total | |
|--|-------------------|---------------------------|---------------------------|-------------------|-------------------|
| | | | | 2015 | 2014 |
| SUPPORT AND REVENUE | | | | | |
| Contributions and grants | \$ 8,659,324 | \$ 2,839,103 | \$ - | \$ 11,498,427 | \$ 11,024,238 |
| Tributes and memorials | 202,693 | - | - | 202,693 | 163,274 |
| Donated materials and services | 5,443,430 | - | - | 5,443,430 | 2,364,515 |
| Clinic operations | 1,584,356 | - | - | 1,584,356 | 1,270,343 |
| Adoption fees | 1,084,061 | - | - | 1,084,061 | 1,352,669 |
| Animals intake | 370,772 | - | - | 370,772 | 661,756 |
| Investment income, net | 172,000 | - | - | 172,000 | 290,527 |
| Education | 26,681 | - | - | 26,681 | 21,528 |
| Gain (loss) on sale of property and equipment | 21,610 | - | - | 21,610 | (3,460) |
| Changes in value of split-interest agreements | (31,976) | 117,000 | (312,000) | (226,976) | 297,888 |
| Other | 150,256 | - | - | 150,256 | 74,430 |
| Total support and revenue before special events, thrift store sales, retail sales, and net assets released from restrictions | <u>17,683,207</u> | <u>2,956,103</u> | <u>(312,000)</u> | <u>20,327,310</u> | <u>17,517,708</u> |
| Special events revenue | 1,358,241 | - | - | 1,358,241 | 1,174,609 |
| Less costs of direct donor benefits | <u>(204,949)</u> | <u>-</u> | <u>-</u> | <u>(204,949)</u> | <u>(173,137)</u> |
| Gross profit on special events | <u>1,153,292</u> | <u>-</u> | <u>-</u> | <u>1,153,292</u> | <u>1,001,472</u> |
| Thrift store sales | 960,664 | - | - | 960,664 | 956,099 |
| Less related costs | <u>(730,559)</u> | <u>-</u> | <u>-</u> | <u>(730,559)</u> | <u>(946,213)</u> |
| Gross profit on thrift store sales | <u>230,105</u> | <u>-</u> | <u>-</u> | <u>230,105</u> | <u>9,886</u> |
| Pet supply stores | 370,926 | - | - | 370,926 | 321,888 |
| Less related costs | <u>(371,831)</u> | <u>-</u> | <u>-</u> | <u>(371,831)</u> | <u>(377,727)</u> |
| Loss on pet supply stores | <u>(905)</u> | <u>-</u> | <u>-</u> | <u>(905)</u> | <u>(55,839)</u> |
| Total support and revenue | <u>19,065,699</u> | <u>2,956,103</u> | <u>(312,000)</u> | <u>21,709,802</u> | <u>18,473,227</u> |

The accompanying notes are an integral part of this financial statement.

ARIZONA HUMANE SOCIETY

STATEMENT OF ACTIVITIES (CONTINUED)

For the year ended October 31, 2015 (with comparative totals for the year ended October 31, 2014)

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total | |
|---|----------------------|---------------------------|---------------------------|----------------------|----------------------|
| | | | | 2015 | 2014 |
| NET ASSETS RELEASED FROM RESTRICTIONS | <u>3,668,511</u> | <u>(3,668,511)</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| TOTAL SUPPORT, REVENUE AND NET ASSETS RELEASED FROM RESTRICTIONS | <u>22,734,210</u> | <u>(712,408)</u> | <u>(312,000)</u> | <u>21,709,802</u> | <u>18,473,227</u> |
| EXPENSES | | | | | |
| Program services | 17,808,083 | - | - | 17,808,083 | 14,235,933 |
| Management and general | 595,444 | - | - | 595,444 | 516,894 |
| Fundraising and development | <u>2,828,601</u> | <u>-</u> | <u>-</u> | <u>2,828,601</u> | <u>2,364,384</u> |
| TOTAL EXPENSES | <u>21,232,128</u> | <u>-</u> | <u>-</u> | <u>21,232,128</u> | <u>17,117,211</u> |
| CHANGE IN NET ASSETS | 1,502,082 | (712,408) | (312,000) | 477,674 | 1,356,016 |
| NET ASSETS – Beginning of year | <u>24,303,943</u> | <u>6,764,653</u> | <u>5,382,000</u> | <u>36,450,596</u> | <u>35,094,580</u> |
| NET ASSETS – End of year | <u>\$ 25,806,025</u> | <u>\$ 6,052,245</u> | <u>\$ 5,070,000</u> | <u>\$ 36,928,270</u> | <u>\$ 36,450,596</u> |

The accompanying notes are an integral part of this financial statement.

ARIZONA HUMANE SOCIETY**STATEMENT OF CASH FLOWS**

For the year ended October 31, 2015 (with comparative totals for the year ended October 31, 2014)

| | <u>2015</u> | <u>2014</u> |
|---|---------------------|----------------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ 477,674 | \$ 1,356,016 |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operations: | | |
| Non-cash contribution of investments | (324,822) | (8,859) |
| Realized and unrealized (gain) loss on investments, net | 201,385 | (36,485) |
| Depreciation | 795,427 | 737,834 |
| (Gain) loss on sale of property and equipment | (21,610) | 3,460 |
| Non-cash contribution of property held for sale | - | (161,900) |
| Non-cash contribution of beneficial interest in perpetual trust | - | (96,000) |
| Changes in value of split-interest agreements | 226,976 | (297,888) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in | | |
| Estate receivables | 1,265,188 | (2,430,681) |
| Receivables | (29,745) | 1,448 |
| Inventories | (38,235) | 58,122 |
| Prepaid expenses and other assets | (23,860) | (67,661) |
| Deposits | (2,082) | (7,262) |
| Beneficial interest in remainder trusts | 78,000 | 80,780 |
| Increase (decrease) in | | |
| Accounts payable | (33,794) | 101,671 |
| Accrued liabilities | 208,787 | 361,725 |
| Charitable gift annuities payable | (37,784) | (73,676) |
| Net cash provided by (used in) operations | <u>2,741,505</u> | <u>(479,356)</u> |
| Cash flows from investing activities | | |
| Purchases of investments | (8,135,293) | (1,198,444) |
| Proceeds from maturities and sale of investments | 1,054,396 | 502,180 |
| Change in cash held for investment | 666,532 | (1,448,910) |
| Proceeds from sale of property and equipment | 186,561 | 1,000 |
| Purchases of property and equipment | (337,139) | (736,823) |
| Net cash used in investing activities | <u>(6,564,943)</u> | <u>(2,880,997)</u> |
| Net decrease in cash and cash equivalents | (3,823,438) | (3,360,353) |
| Cash and cash equivalents at the beginning of year | <u>10,886,811</u> | <u>14,247,164</u> |
| Cash and cash equivalents at the end of year | <u>\$ 7,063,373</u> | <u>\$ 10,886,811</u> |

The accompanying notes are an integral part of this financial statement.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

1. Description of Organization

Every pet deserves a good life. This passionate belief has driven the Arizona Humane Society (the "Organization") to serve a critical role in the community for nearly 60 years. The Organization rescues, heals, adopts and advocates for homeless, sick, injured and abused animals. Through collaborative partnerships, affordable community services, emergency rescue and a medical trauma center, the Organization is committed to providing second chances and saving the lives of animals.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Organization have been prepared on the accrual basis of accounting according to accounting principles generally accepted in the United States of America ("US GAAP"). The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Net assets and changes therein are classified and reported as follows:

- Unrestricted net assets - Includes unrestricted amounts associated with the operating activities of the Organization.
- Temporarily restricted net assets - Includes amounts for which donor-imposed purposes or time restrictions have not been met.
- Permanently restricted net assets - Includes amounts for which the donor-imposed restrictions state that the corpus is to be invested in perpetuity with the income to be made available for specified programs or uses.

Prior Year Summarized Information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with US GAAP. Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended October 31, 2014, from which the summarized information was derived.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits, savings and money market accounts. The Organization considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents temporarily held in investment portfolios are included with investments.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Estate Receivables

Estate receivables are recognized in the period the Organization receives notification that the court has found the will of the donor's estate to be valid and conditions have been substantially met. Estate receivables are stated at the fair value of the assets the Organization expects to receive under the provisions of the will and are expected to be received in less than one year. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible estate receivables based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance and a credit to estate receivables. At October 31, 2015 and 2014, estate receivables are considered by management to be fully collectible and, accordingly, an allowance for uncollectible estate receivables has not been provided.

Receivables

Receivables are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible receivables based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance and a credit to receivables. Management considers all receivables to be fully collectible at October 31, 2015 and 2014, and, accordingly, an allowance for doubtful accounts has not been provided.

Promises to Give

Unconditional promises to give are recognized as contributions in the period the promise is received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met. Unconditional promises to give that are to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are received, adjusted for market risk. Amortization of the discounts is included in contribution support.

Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible contribution receivables based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible contribution receivable and a credit to contribution receivable.

During the year ended October 31, 2014, an unrelated company informed the Organization that it would donate up to approximately \$562,000 if the Organization meets specific criteria, including the spay/neuter of cats in certain geographical areas in the Phoenix metropolitan area. During the years ended October 31, 2015 and 2014, the Organization received installments of approximately \$184,000 and \$188,000, respectively, which are included in contributions and grants in the accompanying statement of activities. Because the remaining installment is subject to significant conditions imposed by the company, it is not reflected in the Organization's financial statements until the conditions are substantially met.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Inventories

Inventories consist of various pet supply items held for sale at the three Petique locations and are stated at the lower of cost or market using the first-in, first-out (FIFO) method. Inventory in the thrift stores is recorded at estimated fair value, which is determined based on its anticipated future economic benefits.

Investments and Investment Income

Investments are recorded at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. US GAAP establishes a framework for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and enhances disclosure requirements for fair value measurements. This guidance maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows.

- Level 1* Quoted prices are available in active markets for identical assets or liabilities as of the date of the financial statements. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.
- Level 2* Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the date of the financial statements. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.
- Level 3* Securities that have little to no pricing observability as of the date of the financial statements. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation. Also included in Level 3 are investments measured using a Net Asset Valuation (NAV) per share, or its equivalent, that can never be redeemed at the NAV or for which redemption at NAV is uncertain due to lock-up periods or other investment restrictions.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

However, the determination of what constitutes "observable" requires significant judgment by the Organization. The Organization considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Organization's perceived risk of that instrument.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

The fair values of publicly traded securities are based on quoted market prices. Investment income is recorded on an accrual basis and purchases and sales of investment securities are reflected on a trade-date basis. Realized gains and losses are calculated using the average cost for securities sold.

Investments, in general, are exposed to various risks, such as interest rate, credit and market risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the near term could materially affect account balances and the amounts reported in the accompanying financial statements.

The Organization has ownership of certain cash and cash equivalents held, along with other marketable securities, by outside investment managers for the benefit of the Organization. Although these cash and cash equivalents are readily available, it is the intent of the Organization to hold these cash and cash equivalents for investment purposes, and accordingly, these cash and cash equivalents are classified as investment assets in the accompanying financial statements.

Income earned from investments, including realized and unrealized gains and losses, is reported as increases or decreases in unrestricted net assets, unless a donor or law temporarily or permanently restricts their use.

Property and Equipment

Depreciation of property and equipment is provided using the straight-line method over the following estimated useful lives:

| | |
|-------------------------|--------------|
| Buildings | 5 - 40 years |
| Furniture and equipment | 3 - 20 years |
| Vehicles | 3 - 5 years |
| Leasehold improvements | 1 - 5 years |

Donations of property and equipment are reported as increases in unrestricted net assets unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted contributions. Absent donor stipulations regarding how long those donated assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor, at which time the Organization reclassifies temporarily restricted net assets to unrestricted net assets.

Impairment of Long-Lived Assets

The Organization reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No impairment loss was recorded during the years ended October 31, 2015 and 2014.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Property Held for Sale

Property held for sale consisted of a house and land located in Casa Grande, Arizona which was donated to the Organization during the year ended October 31, 2014 and was stated at the fair value less costs to sell at October 31, 2014. The property was sold during the year ended October 31, 2015 and net proceeds from the sale totaled approximately \$161,000.

Split-Interest Agreements

The Organization has received various types of split-interest agreements including remainder and perpetual trusts. Under remainder trust agreements, the Organization records a temporarily restricted contribution at the present value of the estimated future benefits to be received. Subsequent changes in fair value for the remainder trust are recorded as changes in value of split-interest agreements in the temporarily restricted net asset class.

Under perpetual trust agreements, the Organization records the permanently restricted contribution at the fair value of the Organization's beneficial interest in the trust assets. Income earned on the trust assets is recorded as unrestricted investment income in the accompanying statement of activities, unless otherwise restricted by the donor or law. Subsequent changes in fair value of the beneficial interest in the trust assets are recorded as changes in value of split-interest agreements in the permanently restricted net asset class.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily or permanently restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, if a restriction is fulfilled in the same period in which it is received, the Organization reports the support as unrestricted.

Special Events Revenue

The Organization conducts special events in which a portion of the gross proceeds paid by the participant represents payment for the direct cost of the benefits received by the participant at the event. Unless a verifiable, objective method exists to demonstrate otherwise, the fair value of meals and entertainment provided at special events is measured at the actual cost to the Organization. The direct costs of the special events, which ultimately benefit the donor rather than the Organization, are included in special events revenues and simultaneously recorded as costs of direct donor benefits. All proceeds received in excess of the direct costs are recorded as gross profit on special events in the accompanying statement of activities.

Donated Materials and Services

The Organization recognizes donations of materials and services received at their estimated fair value if such services create or enhance nonfinancial assets or require specialized skills which are provided by individuals possessing those skills and would otherwise need to be purchased if not donated. Donated materials and services are recognized as contributions in the accompanying financial statements at their estimated fair value at the date of receipt.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Donated materials and services consisted of the following for the year ended October 31, 2015:

| | Functional Category Benefitted: | | | Total |
|----------------|---------------------------------|------------------------|-----------------------------|---------------------|
| | Program Services | Management and General | Fundraising and Development | |
| Media services | \$ 4,836,379 | \$ - | \$ 572,904 | \$ 5,409,283 |
| Other | 25,000 | - | 9,147 | 34,147 |
| Total in-kind | <u>\$ 4,861,379</u> | <u>\$ -</u> | <u>\$ 582,051</u> | <u>\$ 5,443,430</u> |

Donated materials and services consisted of the following for the year ended October 31, 2014:

| | Functional Category Benefitted: | | | Total |
|--|---------------------------------|------------------------|-----------------------------|---------------------|
| | Program Services | Management and General | Fundraising and Development | |
| Media services | \$ 1,925,770 | \$ - | \$ 371,255 | \$ 2,297,025 |
| Legal services | - | - | 10,000 | 10,000 |
| Other | 28,600 | - | 3,890 | 32,490 |
| Total in-kind | <u>\$ 1,954,370</u> | <u>\$ -</u> | <u>\$ 385,145</u> | 2,339,515 |
| Net increase in donated thrift store inventory | | | | <u>25,000</u> |
| Total in-kind contributions | | | | <u>\$ 2,364,515</u> |

No amounts have been reflected in the financial statements for certain donated volunteer services because they did not qualify for recording under current accounting requirements; however, a substantial number of volunteers have donated significant amounts of their time to the Organization's program services and its fundraising campaigns. The Organization received volunteer time and other donated services valued at approximately \$4,915,000 and \$4,593,000, representing 327,644 hours and 306,223 hours, for the years ended October 31, 2015 and 2014, respectively, that did not meet the recognition requirements. Accordingly, these amounts are not reflected in the accompanying financial statements.

Thrift Store Revenues

The Organization receives donations of supplies and food and sells these items to the general public through three thrift stores. The donated items are recorded in the statement of activities at their fair value which is based on the selling price of the specific items. Net thrift store revenues were approximately \$961,000 and \$956,000 for the years ended October 31, 2015 and 2014, respectively.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Clinic Operations and Other Fees

The Organization charges a fee for the adoption of animals. Adoption fee revenue is recognized at the time an animal is adopted. The Organization also charges a fee for hospital operations and spay/neutering services. Hospital and public clinic operations revenue is recognized at the time services are performed. Intake fee revenue is recognized at the time an animal is surrendered to the Organization's care.

Functional Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the accompanying statement of activities. Accordingly, certain costs have been allocated among the programs and supporting activities benefited, determined by specific identification and estimates of time spent and benefits derived.

Income Tax Status

The Organization is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code (the "IRC") and similar state provisions. However, income from certain activities not directly related to the Organization's tax-exempt purpose may be subject to taxation as unrelated business income. In addition, the Organization qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the IRC and has been classified as an organization other than a private foundation under Section 509(a)(1) of the IRC. The Organization has provided for income taxes on its unrelated business income, which have not been significant, as required by Section 512 of the Code.

The Organization follows the guidance issued by US GAAP related to accounting for income tax uncertainties. Under this guidance, the Organization accounts for the effect of any uncertain tax positions based on whether it is "more-likely-than-not" that the position will be sustained by the taxing authority upon examination. The Organization routinely evaluates potential uncertain tax positions. The Organization has identified its status as an exempt organization as a tax position; however, the Organization has determined that such tax position does not result in an uncertainty that requires recognition.

The Organization files informational and income tax returns in the U.S. federal jurisdiction and in certain state and local jurisdictions. As of October 31, 2015, U.S. federal informational and income tax returns for years ended prior to October 31, 2012 and state returns for years ended prior to October 31, 2011 are closed to assessment. Interest and penalties, if any, are accrued as a component of management and general expenses when assessed.

Reclassifications

Certain reclassifications have been made to the prior year summarized comparative information in order to conform to the current year presentation. The reclassification had no effect on the change in net assets.

3. Estimates

The presentation of financial statements in conformity with US GAAP requires 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 reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

4. Investments

Investment income is presented net of fees and consisted of the following for the years ended October 31:

| | <u>2015</u> | <u>2014</u> |
|--|-------------------|-------------------|
| Interest income | \$ 373,385 | \$ 254,042 |
| Net realized and unrealized gains (losses) | <u>(201,385)</u> | <u>36,485</u> |
| Total investment income, net | <u>\$ 172,000</u> | <u>\$ 290,527</u> |

5. Property and Equipment

Property and equipment consisted of the following at October 31:

| | <u>2015</u> | <u>2014</u> |
|---------------------------------|----------------------|----------------------|
| Buildings | \$ 13,667,509 | \$ 13,667,509 |
| Furniture and equipment | 2,900,935 | 2,547,921 |
| Land | 2,141,769 | 2,141,769 |
| Vehicles | 1,234,127 | 1,400,035 |
| Assets not placed in service | 29,078 | 132,418 |
| Leasehold improvements | <u>107,060</u> | <u>104,690</u> |
| Total property and equipment | 20,080,478 | 19,994,342 |
| Less - Accumulated depreciation | <u>(9,372,262)</u> | <u>(8,824,787)</u> |
| Property and equipment, net | <u>\$ 10,708,216</u> | <u>\$ 11,169,555</u> |

Depreciation expense totaled approximately \$795,000 and \$738,000 for the years ended October 31, 2015 and 2014, respectively.

6. Split-Interest Agreements*Remainder Trusts*

The Organization is the beneficiary of certain remainder trusts that are controlled by third party trustees. The Organization is entitled to certain specified percentages of the annual income distributions of the trusts which range from 25% to 100%. At the various expiration dates, the trusts will distribute any remaining assets held in the trust, at which time the Organization will be entitled to certain specified percentages of those final distribution amounts which range from 25% to 100%, with no restrictions. The Organization estimated the fair value of its beneficial interests in the remainder trusts at October 31, 2015 and 2014 based upon the fair value of the assets held by the trusts and the expected terms of the trusts, using a discount rate of 5%.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Perpetual Trusts

The Organization is also the income beneficiary of certain perpetual trusts. The trusts are held and controlled by third party trustees. The Organization is entitled to a specified percentage defined in each trust agreement which range from 1.5% to 100%, of the annual income distributions from each of the trusts. The Organization will also be entitled to a specified percentage of the total amount of the corpus assets that will be distributed if the trusts are ever dissolved. The Organization estimated the fair value of its beneficial interest in perpetual trusts at October 31, 2015 and 2014 based upon the Organization's respective percentage interest in the fair value of the underlying assets held by the trust. Income distributions from perpetual trusts totaled approximately \$229,000 and \$214,000 for the years ended October 31, 2015 and 2014, respectively, and are included in investment income in the accompanying statement of activities.

7. Charitable Gift Annuities Payable

Charitable gift annuities are arrangements between a donor and the Organization in which the donor contributes assets to the Organization in exchange for a promise from the Organization to pay the donor (or the donor's designated beneficiary) a fixed amount for a specified period of time. These agreements provide for quarterly payments totaling approximately \$20,000 to the donors (or their designated beneficiary) over the term of the agreements (the donors' expected lifetimes).

Assets received have been recognized at fair value, and an annuity payment liability was recorded at the present value of the estimated annuity awards payable to the beneficiaries over the expected term of the agreement using a discount rate of 8%. Unrestricted contribution revenue is recognized as the difference between these two amounts as the donor has placed no restriction on the Organization's use of its portion of the assets. Assets of the Organization that are derived from charitable gift annuities are included in investments in the accompanying statement of financial position. Charitable gift annuity amounts payable are estimated through March 2046.

The charitable gift annuities balance is reduced by payments to the beneficiaries. Adjustments to the value of the charitable gift annuities related to changes in present value or actuarial assumptions during the term of the charitable gift annuities agreement are recognized as changes in the value of split-interest agreements in the accompanying statement of activities. The change in the value of the charitable gift annuities for the years ended October 31, 2015 and 2014 was an increase of approximately \$32,000 and \$25,000, respectively.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

8. Fair Value Measurements

The following tables set forth, by level within the fair value hierarchy, the Organization's assets that are measured at fair value on a recurring basis as of October 31:

| | 2015 | | | |
|---------------------------|----------------------|-------------|---------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Investments | | | | |
| Mutual funds - Equities | \$ 9,190,284 | \$ - | \$ - | \$ 9,190,284 |
| Cash held for investment | 787,109 | - | - | 787,109 |
| Common stock and other | 201,303 | - | - | 201,303 |
| Savings bonds | 62,864 | - | - | 62,864 |
| Total investments | 10,241,560 | - | - | 10,241,560 |
| Split-interest agreements | - | - | 7,674,000 | 7,674,000 |
| Total assets | <u>\$ 10,241,560</u> | <u>\$ -</u> | <u>\$ 7,674,000</u> | <u>\$ 17,915,560</u> |

| | 2014 | | | |
|---------------------------|---------------------|-------------|---------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Investments | | | | |
| Mutual funds - Equities | \$ 2,065,056 | \$ - | \$ - | \$ 2,065,056 |
| Cash held for investment | 1,448,910 | - | - | 1,448,910 |
| Savings bonds | 186,816 | - | - | 186,816 |
| Common stock and other | 2,976 | - | - | 2,976 |
| Total investments | 3,703,758 | - | - | 3,703,758 |
| Split-interest agreements | - | - | 7,947,000 | 7,947,000 |
| Total assets | <u>\$ 3,703,758</u> | <u>\$ -</u> | <u>\$ 7,947,000</u> | <u>\$ 11,650,758</u> |

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

The following is a reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using Level 3:

| | <u>Split-Interest Agreements</u> |
|---|--------------------------------------|
| Level 3 ending balance October 31, 2013 | \$ 7,609,000 |
| Additions (contributions) | 96,000 |
| Distributions from trusts | (80,780) |
| Changes in value | <u>322,780</u> |
| Level 3 ending balance October 31, 2014 | \$ 7,947,000 |
| Distributions from trusts | (78,000) |
| Changes in value | <u>(195,000)</u> |
| Level 3 ending balance October 31, 2015 | <u>\$ 7,674,000</u> |

During the year ended October 31, 2014, the Organization received property held for sale. The Organization estimated the value of the property as described in Note 1. During the years ended October 31, 2015 and 2014, the Organization received charitable gift annuities. The Organization estimates the fair value of the liabilities associated with these charitable gift annuities on a non-recurring basis at the date of gift using the methods described in Note 7. The following sets forth, by level within the fair value hierarchy, the fair value of the assets and liabilities measured on a non-recurring basis on the date of the gift during the years ended October 31:

| | <u>2015</u> | | | |
|-----------------------------------|----------------|-------------------|------------------|-------------------|
| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
| Liabilities | | | | |
| Charitable gift annuities payable | \$ - | \$ - | \$ 34,424 | \$ 34,424 |
| Total Liabilities | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 34,424</u> | <u>\$ 34,424</u> |
| | <u>2014</u> | | | |
| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
| Assets | | | | |
| Property held for sale | \$ - | \$ 161,900 | \$ - | \$ 161,900 |
| Total Assets | <u>\$ -</u> | <u>\$ 161,900</u> | <u>\$ -</u> | <u>\$ 161,900</u> |
| Liabilities | | | | |
| Charitable gift annuities payable | \$ - | \$ - | \$ 4,479 | \$ 4,479 |
| Total Liabilities | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 4,479</u> | <u>\$ 4,479</u> |

ARIZONA HUMANE SOCIETY**NOTES TO FINANCIAL STATEMENTS**

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

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

9. 401(K) Plan

The Organization has a 401(k) Plan that covers all employees who meet specified age and time of service requirements. The Plan provides for participating employees to defer up to 80% of their compensation, not to exceed \$17,000 (as adjusted for inflation). The Organization's matching contributions to the Plan for the years ended October 31, 2015 and 2014 were approximately \$46,000 and \$26,000, respectively.

10. Board Designated Net Assets

Board designated funds are unrestricted, but have been earmarked for purposes identified and approved by the Board including fluctuations in contributions and grants or other revenue streams. The funds will be kept in either the general operating account or in the investment account pursuant to the Organization's investment policy. During the year ended October 31, 2015, the Board increased the designation by approximately \$7,000,000 for the potential purchase of a new site preceding a capital campaign.

11. Restricted Net Assets

Temporarily restricted net assets consisted of the following at October 31:

| | <u>2015</u> | <u>2014</u> |
|---|---------------------|---------------------|
| Time restrictions: | | |
| Estate receivables | \$ 2,522,879 | \$ 3,788,067 |
| Beneficial interest in remainder trusts | 2,604,000 | 2,565,000 |
| Purpose restrictions: | | |
| Spay/neuter programs | 134,201 | 363,304 |
| Medical/behavioral health | 404,719 | - |
| Pet resource center | 159,051 | - |
| Community cats program | 184,630 | - |
| Other | 42,765 | 48,282 |
| Total temporarily restricted net assets | <u>\$ 6,052,245</u> | <u>\$ 6,764,653</u> |

All permanently restricted net assets are held in perpetual trusts as defined in Note 6.

12. Commitments

The Organization leases equipment, vehicles, and store space under operating lease agreements with terms expiring through January 2019. In September 2014, the Organization began leasing a portion of its thrift store space to an unrelated third party. This sublease is non-cancelable and expires in June 2016. The monthly payments escalate from approximately \$3,500 to \$7,000 and are recorded as a reduction to rent expense. Total sublease rental income was approximately \$74,000 and \$12,000 for the years ended October 31, 2015 and 2014, respectively. Future minimum sublease rental income to be received under this agreement is approximately \$56,000 at October 31, 2015.

ARIZONA HUMANE SOCIETY**NOTES TO FINANCIAL STATEMENTS**

October 31, 2015 (with summarized comparative totals as of October 31, 2014)

Future minimum rental payments under the non-cancellable operating leases are as follows:

| Year Ending October 31 | |
|-------------------------------------|--------------------------|
| 2016 | \$ 296,137 |
| 2017 | 116,857 |
| 2018 | 55,170 |
| 2019 | 51,283 |
| 2020 | <u>25,106</u> |
| Total future minimum lease payments | <u><u>\$ 544,553</u></u> |

Rent expense (net of sublease income) totaled approximately \$291,000 and \$310,000 for the years ended October 31, 2015 and 2014, respectively.

13. Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash deposits in financial institutions and investments.

Cash deposits in excess of amounts insured by the Federal Deposit Insurance Corporation ("FDIC") of \$250,000 and the Securities Investors Protection Corporation ("SPIC") of \$100,000 are exposed to loss in the event of nonperformance by the financial institution. At times during the year, the Organization had cash deposits in excess of the FDIC insurance coverage. The Organization does not anticipate nonperformance by financial institutions. At October 31, 2015, the Organization had an uninsured cash balance of approximately \$6,462,000.

14. Subsequent Events

Management evaluated subsequent events through February 22, 2016, the date the financial statements were available.