

Arizona Humane Society

Financial Statements

Together with Independent Auditor's Report

October 31, 2016



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, 2016, 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, 2016 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 Arizona Humane Society's 2015 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated February 22, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended October 31, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Schmidt Westergard & Company, PLLC

Mesa, Arizona
March 1, 2017

ARIZONA HUMANE SOCIETY
STATEMENT OF FINANCIAL POSITION
October 31, 2016 (with comparative totals as of October 31, 2015)

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and cash equivalents	\$ 8,636,005	\$ 7,063,373
Estates receivable	2,127,615	2,522,879
Receivables:		
Field contracts receivable	170,000	-
Grants receivable	101,000	-
Other	11,200	46,485
Inventories	185,374	173,004
Prepaid expenses and other assets	370,374	284,844
Investments	10,367,968	10,241,560
Property and equipment, net	10,279,521	10,708,216
Deposits	38,808	40,677
Beneficial interest in remainder trusts	2,794,000	2,604,000
Beneficial interest in perpetual trusts	4,918,000	5,070,000
	<u>\$ 39,999,865</u>	<u>\$ 38,755,038</u>
LIABILITIES AND NET ASSETS		
Accounts payable	\$ 367,439	\$ 381,631
Accrued liabilities	1,330,953	1,219,427
Charitable gift annuities payable	228,234	225,710
	<u>1,926,626</u>	<u>1,826,768</u>
Net assets		
Unrestricted		
Invested in property and equipment	10,279,521	10,708,216
Board designated	8,000,000	8,000,000
Unrestricted and undesignated	9,380,703	7,097,809
	<u>27,660,224</u>	<u>25,806,025</u>
Temporarily restricted	5,495,015	6,052,245
Permanently restricted	4,918,000	5,070,000
	<u>38,073,239</u>	<u>36,928,270</u>
	<u>\$ 39,999,865</u>	<u>\$ 38,755,038</u>

ARIZONA HUMANE SOCIETY

STATEMENT OF ACTIVITIES

For the year ended October 31, 2016 (with comparative totals for the year ended October 31, 2015)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2016	2015
SUPPORT AND REVENUE					
Contributions and grants	\$ 9,629,196	\$ 2,617,796	\$ -	\$ 12,246,992	\$ 11,701,120
Donated materials and services	2,303,761	-	-	2,303,761	5,443,430
Clinic operations	1,380,711	-	-	1,380,711	1,584,356
Adoption fees	1,237,224	-	-	1,237,224	1,084,061
Field contract revenue	502,540	-	-	502,540	114,234
Animals intake	356,636	-	-	356,636	370,772
Other	152,901	-	-	152,901	62,703
Total support and revenue before special events, thrift store sales, pet supply stores sales, and net assets released from restrictions	<u>15,562,969</u>	<u>2,617,796</u>	<u>-</u>	<u>18,180,765</u>	<u>20,360,676</u>
Special events revenue	1,478,014	-	-	1,478,014	1,358,241
Less costs of direct donor benefits	<u>(209,349)</u>	<u>-</u>	<u>-</u>	<u>(209,349)</u>	<u>(204,949)</u>
Gross profit on special events	<u>1,268,665</u>	<u>-</u>	<u>-</u>	<u>1,268,665</u>	<u>1,153,292</u>
Thrift store sales	1,050,839	-	-	1,050,839	960,664
Less related costs	<u>(737,234)</u>	<u>-</u>	<u>-</u>	<u>(737,234)</u>	<u>(730,559)</u>
Gross profit on thrift store sales	<u>313,605</u>	<u>-</u>	<u>-</u>	<u>313,605</u>	<u>230,105</u>
Pet supply stores sales	373,828	-	-	373,828	370,926
Less related costs sales	<u>(436,218)</u>	<u>-</u>	<u>-</u>	<u>(436,218)</u>	<u>(371,831)</u>
Loss on pet supply stores sales	<u>(62,390)</u>	<u>-</u>	<u>-</u>	<u>(62,390)</u>	<u>(905)</u>
Total support and revenue	<u>17,082,849</u>	<u>2,617,796</u>	<u>-</u>	<u>19,700,645</u>	<u>21,743,168</u>
NET ASSETS RELEASED FROM RESTRICTIONS	<u>3,453,206</u>	<u>(3,453,206)</u>	<u>-</u>	<u>-</u>	<u>-</u>
TOTAL SUPPORT, REVENUE AND NET ASSETS RELEASED FROM RESTRICTIONS	<u>20,536,055</u>	<u>(835,410)</u>	<u>-</u>	<u>19,700,645</u>	<u>21,743,168</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, 2016 (with comparative totals for the year ended October 31, 2015)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2016	2015
EXPENSES					
Program services	15,265,779	-	-	15,265,779	17,808,083
Management and general	648,659	-	-	648,659	595,444
Fundraising and development	3,098,155	-	-	3,098,155	2,828,601
TOTAL EXPENSES	19,012,593	-	-	19,012,593	21,232,128
GAINS AND LOSSES					
Investment income, net	380,752	-	-	380,752	172,000
Gain on sale of property and equipment	9,382	-	-	9,382	21,610
Changes in value of split-interest agreements	(59,397)	188,180	(62,000)	66,783	(226,976)
TOTAL GAINS AND LOSSES	330,737	188,180	(62,000)	456,917	(33,366)
CHANGE IN NET ASSETS	1,854,199	(647,230)	(62,000)	1,144,969	477,674
NET ASSETS – Beginning of year	25,806,025	6,052,245	5,070,000	36,928,270	36,450,596
Change in restriction	-	90,000	(90,000)	-	-
NET ASSETS – End of year	<u>\$ 27,660,224</u>	<u>\$ 5,495,015</u>	<u>\$ 4,918,000</u>	<u>\$ 38,073,239</u>	<u>\$ 36,928,270</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, 2016 (with comparative totals for the year ended October 31, 2015)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ 1,144,969	\$ 477,674
Adjustments to reconcile change in net assets to net cash provided by operations:		
Non-cash contribution of investments	(30,907)	(324,822)
Realized and unrealized loss on investments, net	131,825	201,385
Depreciation	814,101	795,427
Gain on sale of property and equipment	(9,382)	(21,610)
Changes in value of split-interest agreements	(66,783)	226,976
Changes in operating assets and liabilities:		
(Increase) decrease in		
Estates receivable	395,264	1,265,188
Field contracts receivable	(170,000)	-
Grants receivable	(101,000)	-
Other receivable	35,285	(29,745)
Inventories	(12,370)	(38,235)
Prepaid expenses and other assets	(85,530)	(23,860)
Deposits	1,869	(2,082)
Beneficial interest in remainder trusts	88,180	78,000
Increase (decrease) in		
Accounts payable	(14,192)	(33,794)
Accrued liabilities	111,526	208,787
Charitable gift annuities payable	(56,873)	(37,784)
Net cash provided by operations	<u>2,175,982</u>	<u>2,741,505</u>
Cash flows from investing activities		
Purchases of investments	(6,145,905)	(8,135,293)
Proceeds from maturities and sale of investments	5,827,318	1,054,396
Change in cash held for investment	91,261	666,532
Proceeds from sale of property and equipment	10,200	186,561
Purchases of property and equipment	(386,224)	(337,139)
Net cash used in investing activities	<u>(603,350)</u>	<u>(6,564,943)</u>
Net increase (decrease) in cash and cash equivalents	1,572,632	(3,823,438)
Cash and cash equivalents at the beginning of year	<u>7,063,373</u>	<u>10,886,811</u>
Cash and cash equivalents at the end of year	<u>\$ 8,636,005</u>	<u>\$ 7,063,373</u>

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

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

1. Description of Organization

Every pet deserves a good life. This passionate belief has driven 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, 2015, 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, 2016 (with summarized comparative totals as of October 31, 2015)

Estates Receivable

Estates receivable are recognized in the period the Organization has received notification that the court has found the will of the donor's estate to be valid, the estate representative has provided information regarding the nature and value of estate assets and liabilities, and any conditions that have been substantially met. Estates receivable are stated at the net amount the Organization expects to receive, based upon the estimated fair value of the estate (net of potential fees and expenses) and the Organization's percentage interest as a beneficiary of the estate.

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, 2016 and 2015, 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.

Inventories

Inventories consist of various pet supply items held for sale at the four 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.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

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.

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.

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.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

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, 2016 and 2015.

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.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

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.

Field Contract Revenue

The Organization has contracts with various cities including Phoenix, Glendale, Gilbert, Chandler and Tempe to provide cruelty and investigation services. The term of the contracts range from one year to 18 months and revenue is recognized on a straight-line basis over the term of the contract or as services are performed.

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.

Donated materials and services consisted of the following for the year ended October 31, 2016:

	Functional Category Benefitted:			Total
	Program Services	Management and General	Fundraising and Development	
Media services	\$ 1,700,565	\$ -	\$ 568,968	\$ 2,269,533
Other	25,200	-	9,028	34,228
Total in-kind	<u>\$ 1,725,765</u>	<u>\$ -</u>	<u>\$ 577,996</u>	<u>\$ 2,303,761</u>

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

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>

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 \$4,214,000 and \$4,915,000, representing 280,904 hours and 327,644 hours, for the years ended October 31, 2016 and 2015, 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.

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.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

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, 2016, U.S. federal informational and income tax returns for years ended prior to October 31, 2013 and state returns for years ended prior to October 31, 2012 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.

4. Investments

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

	<u>2016</u>	<u>2015</u>
Interest income	\$ 512,577	\$ 373,385
Net realized and unrealized losses	<u>(131,825)</u>	<u>(201,385)</u>
Total investment income, net	<u>\$ 380,752</u>	<u>\$ 172,000</u>

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

5. Property and Equipment

Property and equipment consisted of the following at October 31:

	<u>2016</u>	<u>2015</u>
Buildings	\$ 13,774,720	\$ 13,667,509
Furniture and equipment	3,058,693	2,900,935
Land	2,141,769	2,141,769
Vehicles	1,126,853	1,234,127
Leasehold improvements	124,725	107,060
Assets not placed in service	<u>4,279</u>	<u>29,078</u>
Total property and equipment	20,231,039	20,080,478
Less - Accumulated depreciation	<u>(9,951,518)</u>	<u>(9,372,262)</u>
Property and equipment, net	<u>\$ 10,279,521</u>	<u>\$ 10,708,216</u>

Depreciation expense totaled approximately \$814,000 and \$795,000 for the years ended October 31, 2016 and 2015, 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, 2016 and 2015 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%.

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, 2016 and 2015 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 \$238,000 and \$229,000 for the years ended October 31, 2016 and 2015, respectively, and are included in investment income in the accompanying statement of activities.

ARIZONA HUMANE SOCIETY**NOTES TO FINANCIAL STATEMENTS**

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

During the year ended October 31, 2016, the Organization and other beneficiaries legally settled a dispute with the trustee of a perpetual trust. The settlement required that the total trust assets be distributed to the beneficiaries over five years beginning in 2016. As such, the Organization reclassified its estimated fair value of the beneficial interest in the perpetual trust of \$90,000, to beneficial interest in a remainder trust, as shown 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 \$16,000 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, 2016 and 2015 was an increase of approximately \$59,000 and \$32,000, respectively.

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:

	2016			Total
	Level 1	Level 2	Level 3	
Assets				
Investments				
Mutual funds - Equities	\$ 9,567,757	\$ -	\$ -	\$ 9,567,757
Cash held for investment	695,848	-	-	695,848
Savings bonds	65,408	-	-	65,408
Common stock and other	38,955	-	-	38,955
Total investments	10,367,968	-	-	10,367,968
Split-interest agreements	-	-	7,712,000	7,712,000
Total assets	<u>\$ 10,367,968</u>	<u>\$ -</u>	<u>\$ 7,712,000</u>	<u>\$ 18,079,968</u>

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

	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
Savings bonds	201,303	-	-	201,303
Common stock and other	62,864	-	-	62,864
Total investments	10,241,560	-	-	10,241,560
Split-interest agreements	-	-	7,674,000	7,674,000
Total assets	\$ 10,241,560	\$ -	\$ 7,674,000	\$ 17,915,560

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

	Split-Interest Agreements
Level 3 ending balance October 31, 2014	\$ 7,947,000
Distributions from trusts	(78,000)
Changes in value	(195,000)
Level 3 ending balance October 31, 2015	\$ 7,674,000
Distributions from trusts	(88,180)
Changes in value	126,180
Level 3 ending balance October 31, 2016	\$ 7,712,000

During the years ended October 31, 2016 and 2015, 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:

	2016			
	Level 1	Level 2	Level 3	Total
Liabilities				
Charitable gift annuities payable	\$ -	\$ -	\$ 8,589	\$ 8,589
Total Liabilities	\$ -	\$ -	\$ 8,589	\$ 8,589

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

	2015			
	Level 1	Level 2	Level 3	Total
Liabilities				
Charitable gift annuities payable	\$ -	\$ -	\$ 34,424	\$ 34,424
Total Liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 34,424</u>	<u>\$ 34,424</u>

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 annual compensation, as defined by the Plan. The Organization's matching contributions to the Plan for the years ended October 31, 2016 and 2015 were approximately \$41,000 and \$46,000, 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, grants or other revenue streams and for the potential purchase of a new site preceding a capital campaign. The funds will be kept in either the general operating account or in the investment account pursuant to the Organization's investment policy.

11. Restricted Net Assets

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

	2016	2015
Time restrictions:		
Estate receivables	\$ 2,127,615	\$ 2,522,879
Beneficial interest in remainder trusts	2,794,000	2,604,000
Purpose restrictions:		
Spay/neuter programs	83,802	134,201
Medical/behavioral health	97,862	404,719
Community cats program	160,869	184,630
Vet services	61,463	-
Other	68,404	42,765
Pet resource center	-	159,051

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

	<u>2016</u>	<u>2015</u>
Time and purpose restrictions:		
Pet resource center	\$ 85,500	\$ -
Spay/neuter programs	13,000	-
Medical/behavioral health	<u>2,500</u>	<u>-</u>
Total temporarily restricted net assets	<u>\$ 5,495,015</u>	<u>\$ 6,052,245</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 March 2022. 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 expired in June 2016. The monthly payments escalated from approximately \$3,500 to \$7,000 and are recorded as a reduction to rent expense. Total sublease rental income was approximately \$56,000 and \$74,000 for the years ended October 31, 2016 and 2015, respectively.

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

Year Ending <u>October 31</u>	
2017	\$ 209,465
2018	188,765
2019	185,496
2020	153,604
2021	123,589
Thereafter	<u>51,920</u>
Total future minimum lease payments	<u>\$ 912,839</u>

Rent expense (net of sublease income) totaled approximately \$329,000 and \$291,000 for the years ended October 31, 2016 and 2015, 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, 2016, the Organization had an uninsured cash balance of approximately \$8,382,000.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2016 (with summarized comparative totals as of October 31, 2015)

14. Subsequent Events

Management evaluated subsequent events through March 1, 2017, the date the financial statements were available.