

Arizona Humane Society

Financial Statements

Together with Independent Auditor's Report

October 31, 2014



ARIZONA HUMANE SOCIETY

ARIZONA HUMANE SOCIETY

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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, 2014, 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, 2014, 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 2013 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated February 13, 2014. In our opinion, the summarized comparative information presented herein as of and for the year ended October 31, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Schmidt Westergard & Company, PLLC

Mesa, Arizona
March 2, 2015

ARIZONA HUMANE SOCIETY
STATEMENT OF FINANCIAL POSITION
October 31, 2014 (with comparative totals as of October 31, 2013)

	<u>2014</u>	<u>2013</u>
ASSETS		
Cash and cash equivalents	\$ 10,886,811	\$ 14,247,164
Estate receivables	3,788,067	1,357,386
Receivables	16,740	18,188
Inventories	134,769	192,891
Prepaid expenses and other assets	260,984	193,323
Investments	3,703,758	1,513,240
Property and equipment, net	11,169,555	11,175,026
Property held for sale	161,900	-
Deposits	38,595	31,333
Beneficial interest in remainder trusts	2,565,000	2,509,000
Beneficial interest in perpetual trusts	5,382,000	5,100,000
	<u>\$ 38,108,179</u>	<u>\$ 36,337,551</u>
LIABILITIES AND NET ASSETS		
Accounts payable	\$ 415,425	\$ 313,754
Accrued liabilities	1,010,640	648,915
Charitable gift annuities payable	231,518	280,302
Total liabilities	<u>1,657,583</u>	<u>1,242,971</u>
Net assets		
Unrestricted		
Invested in property and equipment	11,169,555	11,175,026
Board designated	1,513,240	1,513,240
Unrestricted and undesignated	<u>11,621,148</u>	<u>13,221,001</u>
Total unrestricted	24,303,943	25,909,267
Temporarily restricted	6,764,653	4,085,313
Permanently restricted	<u>5,382,000</u>	<u>5,100,000</u>
Total net assets	<u>36,450,596</u>	<u>35,094,580</u>
	<u>\$ 38,108,179</u>	<u>\$ 36,337,551</u>

ARIZONA HUMANE SOCIETY

STATEMENT OF ACTIVITIES

For the year ended October 31, 2014 (with comparative totals for the year ended October 31, 2013)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2014	2013
SUPPORT AND REVENUE					
Contributions	\$ 6,599,533	\$ 3,966,365	\$ 96,000	\$ 10,661,898	\$ 8,068,216
Tributes and memorials	163,274	-	-	163,274	184,972
Donated materials and services	2,364,515	-	-	2,364,515	2,186,675
Grants	362,340	-	-	362,340	194,330
Clinic operations	1,270,343	-	-	1,270,343	1,252,263
Adoption fees	1,352,669	-	-	1,352,669	854,202
Animals intake	661,756	-	-	661,756	627,049
Investment income, net	290,527	-	-	290,527	254,253
Education	21,528	-	-	21,528	19,049
Loss on sale of property and equipment	(3,460)	-	-	(3,460)	(41,054)
Changes in value of split-interest agreements	(24,892)	136,780	186,000	297,888	966,774
Other	74,430	-	-	74,430	35,540
	<u>13,132,563</u>	<u>4,103,145</u>	<u>282,000</u>	<u>17,517,708</u>	<u>14,602,269</u>
Total support and revenue before special events, thrift store sales, retail sales, and net assets released from restrictions					
Special events revenue	1,174,609	-	-	1,174,609	1,130,097
Less costs of direct donor benefits	(173,137)	-	-	(173,137)	(199,352)
	<u>1,001,472</u>	<u>-</u>	<u>-</u>	<u>1,001,472</u>	<u>930,745</u>
Gross profit on special events					
Thrift store sales	956,099	-	-	956,099	713,895
Less related costs	(946,213)	-	-	(946,213)	(536,287)
	<u>9,886</u>	<u>-</u>	<u>-</u>	<u>9,886</u>	<u>177,608</u>
Gross profit (loss) on thrift store sales					
Pet supply stores	321,888	-	-	321,888	301,392
Less related costs	(377,727)	-	-	(377,727)	(308,642)
	<u>(55,839)</u>	<u>-</u>	<u>-</u>	<u>(55,839)</u>	<u>(7,250)</u>
Gross profit (loss) on pet supply stores					
Total support and revenue	<u>14,088,082</u>	<u>4,103,145</u>	<u>282,000</u>	<u>18,473,227</u>	<u>15,703,372</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, 2014 (with comparative totals for the year ended October 31, 2013)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2014	2013
NET ASSETS RELEASED FROM RESTRICTIONS	<u>1,423,805</u>	<u>(1,423,805)</u>	<u>-</u>	<u>-</u>	<u>-</u>
TOTAL SUPPORT, REVENUE AND NET ASSETS RELEASED FROM RESTRICTIONS	<u>15,511,887</u>	<u>2,679,340</u>	<u>282,000</u>	<u>18,473,227</u>	<u>15,703,372</u>
EXPENSES					
Program services	14,235,933	-	-	14,235,933	12,820,517
Management and general	516,894	-	-	516,894	515,202
Fundraising and development	<u>2,364,384</u>	<u>-</u>	<u>-</u>	<u>2,364,384</u>	<u>1,737,947</u>
TOTAL EXPENSES	<u>17,117,211</u>	<u>-</u>	<u>-</u>	<u>17,117,211</u>	<u>15,073,666</u>
CHANGE IN NET ASSETS	(1,605,324)	2,679,340	282,000	1,356,016	629,706
NET ASSETS – Beginning of year	<u>25,909,267</u>	<u>4,085,313</u>	<u>5,100,000</u>	<u>35,094,580</u>	<u>34,464,874</u>
NET ASSETS – End 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>

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

ARIZONA HUMANE SOCIETY**STATEMENT OF CASH FLOWS**

For the year ended October 31, 2014 (with comparative totals for the year ended October 31, 2013)

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Change in net assets	\$ 1,356,016	\$ 629,706
Adjustments to reconcile change in net assets to net cash provided by (used in) operations:		
Depreciation	737,834	736,119
Loss on sale of property and equipment	3,460	41,054
Non-cash contribution of property held for sale	(161,900)	-
Non-cash contribution of investments	(8,859)	(7,504)
Realized and unrealized (gain) loss on investments, net	(36,485)	9,887
Non-cash contribution of beneficial interest in perpetual trust	(96,000)	-
Non-cash contribution of beneficial interest in remainder trust	-	(93,000)
Changes in value of split-interest agreements	(297,888)	(966,774)
Changes in operating assets and liabilities:		
(Increase) decrease in		
Estate receivables	(2,430,681)	467,994
Receivables	1,448	(5,154)
Inventories	58,122	(81,728)
Prepaid expenses and other assets	(67,661)	46,306
Deposits	(7,262)	(11,975)
Beneficial interest in remainder trusts	80,780	85,864
Increase (decrease) in		
Accounts payable	101,671	25,382
Accrued liabilities	361,725	(146,583)
Charitable gift annuities payable	(73,676)	(59,269)
Net cash provided by (used in) operations	<u>(479,356)</u>	<u>670,325</u>
Cash flows from investing activities		
Purchases of investments	(2,647,354)	(921,615)
Proceeds from maturities and sale of investments	502,180	858,295
Proceeds from sale of property and equipment	1,000	9,000
Purchases of property and equipment	<u>(736,823)</u>	<u>(987,988)</u>
Net cash used in investing activities	<u>(2,880,997)</u>	<u>(1,042,308)</u>
Net increase (decrease) in cash and cash equivalents	(3,360,353)	(371,983)
Cash and cash equivalents at the beginning of year	<u>14,247,164</u>	<u>14,619,147</u>
Cash and cash equivalents at the end of year	<u>\$ 10,886,811</u>	<u>\$ 14,247,164</u>

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

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2014 (with summarized comparative totals as of October 31, 2013)

1. Description of Organization

Arizona Humane Society (the "Organization") was incorporated in the state of Arizona in June 1957 as a nonprofit corporation. The Organization provides programs and services including animal intake and sheltering; adoptions; animal rescues and cruelty investigations; temporary sheltering for the pets of domestic violence victims, and for the pets of individuals in crisis; veterinary care for injured and ill animals; low-cost spay/neuter, wellness clinics, and other veterinary services; and mobile spay/neuter and disaster response services throughout the state of Arizona.

2. Summary of Significant Accounting Policies

Basis of Presentation

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. Unrestricted net assets include unrestricted amounts associated with the operating activities of the Organization. Certain unrestricted net assets have been designated as quasi-endowments by the Board of Directors. Temporarily restricted net assets include amounts for which donor-imposed purpose or time restrictions have not yet been met. Permanently restricted net assets include 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 or in some cases, general operations.

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 accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended October 31, 2013, 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.

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 any 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, 2014 and 2013, estate receivables are considered by management to be fully collectible and, accordingly, an allowance for uncollectible estate receivables has not been provided.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2014 (with summarized comparative totals as of October 31, 2013)

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 a valuation allowance 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 valuation allowance and a credit to receivables. Management considers all receivables to be fully collectible at October 31, 2014 and 2013, 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 promises to give 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 by providing services, including the spay/neuter of cats in certain geographical areas in the Phoenix metropolitan area. The Organization received the first installment of approximately \$188,000 which is included in grants in the accompanying statement of activities. Because the remaining two installments are subject to significant conditions imposed by the company, they are not reflected in the Organization's financial statements until the conditions are substantially met.

Inventories

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

Investments and Investment Income

The Organization reports its investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. The fair values of investments are based on quoted market prices.

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.

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2014 (with summarized comparative totals as of October 31, 2013)

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
Leasehold improvements	1 - 5 years
Furniture and equipment	3 - 20 years
Vehicles	3 - 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. Management does not believe impairment indicators are present.

Property Held for Sale

Property held for sale consists of a house and land located in Casa Grande, Arizona which was donated to the Organization during the year ended October 31, 2014 and is stated at the fair value less costs to sell.

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, 2014 (with summarized comparative totals as of October 31, 2013)

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.

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 expense	<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>

ARIZONA HUMANE SOCIETY

NOTES TO FINANCIAL STATEMENTS

October 31, 2014 (with summarized comparative totals as of October 31, 2013)

Donated materials and services consisted of the following for the year ended October 31, 2013:

	Functional Category Benefitted:			Total
	Program Services	Management and General	Fundraising and Development	
Media services	\$ 1,752,173	\$ -	\$ 301,753	\$ 2,053,926
Legal services	-	-	5,000	5,000
Other	28,600	-	9,149	37,749
Total in-kind	<u>\$ 1,780,773</u>	<u>\$ -</u>	<u>\$ 315,902</u>	2,096,675
Net increase in donated thrift store inventory				<u>90,000</u>
Total in-kind contributions				<u>\$ 2,186,675</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 \$4,593,000 and \$4,672,000, representing 306,223 hours and 311,484 hours, for the years ended October 31, 2014 and 2013, 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 \$956,000 and \$714,000 for the years ended October 31, 2014 and 2013, respectively.

Revenue Recognition

The Organization charges a fee for the adoption of animals. Adoption fee revenue is recognized at the time an animal is adopted. The Organization 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, 2014 (with summarized comparative totals as of October 31, 2013)

Advertising

The Organization uses advertising to promote its programs to the various groups it serves. Advertising costs are charged to operations as incurred. Advertising expense totaled approximately \$147,000 and \$210,000, not including donated services described above, for the years ended October 31, 2014 and 2013, respectively.

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 the Financial Accounting Standards Board ("FASB") 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, 2014, U.S. federal informational and income tax returns for years ended prior to October 31, 2011 and state returns for years ended prior to October 31, 2010 are closed to assessment. Interest and penalties, if any, are accrued as a component of management and general expenses when assessed.

Reclassifications

The Organization determined that cash and cash equivalents temporarily held in investment portfolios should be included in investments and reclassified approximately \$922,000 from cash and cash equivalents to investments at October 31, 2013. The reclassifications have been made to the prior year summarized comparative information in order to conform to the current year presentation. The reclassifications had no effect on the change in net assets.

3. Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America 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, 2014 (with summarized comparative totals as of October 31, 2013)

4. Investments

The Organization did not incur any investment expense for the years ended October 31, 2014 and 2013. Investment income consisted of the following for the years ended October 31:

	<u>2014</u>	<u>2013</u>
Interest income	\$ 254,042	\$ 264,140
Net realized and unrealized gains/(losses)	<u>36,485</u>	<u>(9,887)</u>
Total investment income, net	<u>\$ 290,527</u>	<u>\$ 254,253</u>

5. Property and Equipment

Property and equipment consisted of the following at October 31:

	<u>2014</u>	<u>2013</u>
Buildings	\$ 13,667,509	\$ 13,429,293
Furniture and equipment	2,547,921	2,291,634
Land	2,141,769	2,139,948
Vehicles	1,400,035	1,191,083
Assets not placed in service	132,418	272,521
Leasehold improvements	<u>104,690</u>	<u>88,859</u>
Total property and equipment	19,994,342	19,413,338
Less - Accumulated depreciation	<u>(8,824,787)</u>	<u>(8,238,312)</u>
Property and equipment, net	<u>\$ 11,169,555</u>	<u>\$ 11,175,026</u>

Depreciation expense totaled approximately \$738,000 and \$736,000 for the years ended October 31, 2014 and 2013, 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 11% through 100% of the annual income distributions of the trusts. 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 11% through 100% of those final distribution amounts, with no restrictions. The Organization estimated the fair value of its beneficial interests in the remainder trusts at October 31, 2014 and 2013 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, 2014 (with summarized comparative totals as of October 31, 2013)

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, as defined in each trust agreement, 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, 2014 and 2013 based upon the Organization's respective interest in the fair value of the underlying assets held by the trust. Income distributions from perpetual trusts totaled approximately \$214,000 and \$208,000 for the years ended October 31, 2014 and 2013, 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 a fixed amount for a specified period of time. These agreements provide for quarterly payments of approximately \$20,000 to the donors 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 December 2045.

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, 2014 and 2013 was a decrease of approximately \$25,000 and \$56,000, respectively.

8. Fair Value Measurements

The Organization follows the authoritative guidance for accounting for certain assets and liabilities that are required to be measured at fair value. This guidance outlines a valuation framework that provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

Fair value measurements are determined based on the assumptions (referred to as "inputs") that market participants would use in pricing the asset. 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 the Organization's own assumptions about the assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The fair value hierarchy includes three levels that are based on the extent to which inputs used in measuring fair value are observable in the market:

- Level 1* Inputs for the fair value measurement are quoted prices in an active market for identical assets or liabilities. Quoted prices in an active market for identical assets or liabilities provide the most reliable evidence of fair value.

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Level 2 Inputs for the fair value measurement are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date.

Level 3 Inputs for the fair value measurement are unobservable and are used to measure fair value only when observable inputs are not available.

The fair value hierarchy requires the use of observable market data when available. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement is determined based upon the lowest level input that is significant to the fair value measurement in its entirety.

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:

	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	\$ 3,703,758	\$ -	\$ 7,947,000	\$ 11,650,758
	2013			
	Level 1	Level 2	Level 3	Total
Assets				
Investments				
Certificates of deposit	\$ -	\$ 97,978	\$ -	\$ 97,978
Cash held for investment	921,615	-	-	921,615
Savings bonds	180,012	-	-	180,012
Common stock	113,359	-	-	113,359
Government bonds	50,591	-	-	50,591
Mutual funds - Equities	149,685	-	-	149,685
Total investments	1,415,262	97,978	-	1,513,240
Split-interest agreements	-	-	7,609,000	7,609,000
Total assets	\$ 1,415,262	\$ 97,978	\$ 7,609,000	\$ 9,122,240

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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, 2012	\$ 6,579,000
Additions (contributions)	93,000
Distributions from trusts	(85,864)
Changes in value	<u>1,022,864</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	<u>\$ 7,947,000</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, 2014 and 2013, 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 property held for sale and charitable gift annuity liabilities recognized on the date of gift during the years ended October 31:

	<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>
	<u>2013</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Liabilities				
Charitable gift annuities payable	\$ -	\$ -	\$ 24,346	\$ 24,346
Total Liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,346</u>	<u>\$ 24,346</u>

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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 100% of their compensation, not to exceed \$17,000 (as adjusted for inflation). The Organization's contributions to the Plan for the years ended October 31, 2014 and 2013 were approximately \$26,000 and \$23,000, respectively.

10. Board Designated Net Assets

The Organization has set aside approximately \$1,513,000 as Board designated net assets to be used in the future as determined by the Board. The earnings from the Board designated net assets are currently being reinvested, but may be used for operating expenses of the Organization in the future.

11. Restricted Net Assets

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

	2014	2013
Time restrictions:		
Estate receivables	\$ 3,788,067	\$ 1,357,386
Beneficial interest in remainder trusts	2,565,000	2,509,000
Purpose restrictions:		
Spay/neuter programs	363,304	147,092
Other	48,282	71,835
Total temporarily restricted net assets	<u>\$ 6,764,653</u>	<u>\$ 4,085,313</u>

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

12. Commitments

The Organization leases equipment and store space under operating lease agreements with terms expiring through March 2017. 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 \$12,000 for the year ended October 31, 2014. Future minimum sublease rental income to be received under this agreement is approximately \$130,000.

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

Year Ending October 31	
2015	\$ 266,428
2016	222,018
2017	<u>59,388</u>
Total future minimum lease payments	<u>\$ 547,834</u>

Rent expense (net of sublease income) totaled approximately \$310,000 and \$196,000 for the years ended October 31, 2014 and 2013, respectively.

13. Cash Flow Information

During the years ended October 31, 2014 and 2013, the Organization purchased approximately \$0 and \$110,000, respectively, of property and equipment through accounts payable.

14. 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, 2014, the Organization had an uninsured cash balance of approximately \$9,539,000.

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

15. Subsequent Events

Management evaluated subsequent events through March 2, 2015, the date the financial statements were available.