

HUMANE SOCIETY OF SOUTHERN ARIZONA

Audited Financial Statements

For the years ended June 30, 2018 and 2017

HUMANE SOCIETY OF SOUTHERN ARIZONA

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LUDWIG KLEWER & CO. PLLC

Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Humane Society of Southern Arizona

We have audited the accompanying financial statements of the Humane Society of Southern Arizona (a nonprofit organization), which comprise the statements of financial position as of June 30, 2018 and 2017, and the related statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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 audits. We conducted our audits 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 of 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 the Humane Society of Southern Arizona as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Ludwig Klewer & Co. PLLC

September 25, 2018

Chris Wu, Ludwig, CPA Julie S. Klewer, CPA, MBA Luc S. Rudner, CPA

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HUMANE SOCIETY OF SOUTHERN ARIZONA
STATEMENTS OF FINANCIAL POSITION
June 30, 2018 and 2017

ASSETS

	2018	2017
Current assets:		
Cash and cash equivalents	\$ 2,179,275	\$ 2,310,695
Accounts and other receivables	35,030	40,859
Unconditional promises to give, capital campaign, current portion	168,740	258,540
Bequests and memorials receivable, net	1,442,825	820,486
Investments	4,030,583	7,672,654
Inventory	149,305	170,287
Prepaid expenses and other assets	81,444	132,016
Total current assets	8,087,202	11,405,537
Unconditional promises to give, capital campaign, non-current portion, net	116,305	217,815
Beneficial interest in perpetual trusts	3,350,799	3,330,207
Beneficial interest in charitable remainder trust	428,206	421,640
Property held for sale	296,493	-
Property and equipment, net	10,547,748	4,957,655
Total assets	\$ 22,826,753	\$ 20,332,854

LIABILITIES AND NET ASSETS

Current liabilities:		
Accounts payable	\$ 229,419	\$ 183,481
Construction accounts payable	50,000	635,984
Construction line of credit	-	2,175
Accrued payroll and taxes	326,517	355,221
Capital lease payable, current portion	13,541	-
Note payable, current portion	96,125	-
Beneficiary annuity obligations	34,771	42,518
Total current liabilities	750,373	1,219,379
Capital lease payable, non-current portion	27,282	-
Note payable, non-current portion	896,063	-
Total liabilities	1,673,718	1,219,379
Net assets:		
Unrestricted:		
Expended for property and equipment	9,505,560	4,957,655
Board-designated endowment	250,000	250,000
Board-designated capital campaign	-	1,000,000
Available for operations	7,112,870	6,948,418
Total unrestricted net assets	16,868,430	13,156,073
Temporarily restricted	841,708	2,535,097
Permanently restricted	3,442,897	3,422,305
Total net assets	21,153,035	19,113,475
Total liabilities and net assets	\$ 22,826,753	\$ 20,332,854

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA

STATEMENT OF ACTIVITIES For the year ended June 30, 2018

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and support:				
Support:				
Trusts and bequests	\$ 3,251,529	\$ -	\$ -	\$ 3,251,529
Contributions	987,337	1,128,058	-	2,115,395
Grants	92,933	452,427	-	545,360
Special events	349,752	-	-	349,752
Donated supplies and services	216,988	-	-	216,988
Merchandise sales, net	124,076	-	-	124,076
Thrift store, net	2,419	-	-	2,419
Loss on disposal of property and equipment	(8,097)	-	-	(8,097)
Total support	5,016,937	1,580,485	-	6,597,422
Revenue and other income:				
Animal services	800,703	-	-	800,703
Investment gain, net	261,293	11,311	-	272,604
Gain on beneficial interest in perpetual trusts	-	-	20,592	20,592
Gain on beneficial interest in charitable remainder trust	-	6,566	-	6,566
Other income	49,382	-	-	49,382
Total revenue and other income	1,111,378	17,877	20,592	1,149,847
Net assets released from restrictions:				
Satisfaction of donor restrictions	3,291,751	(3,291,751)	-	-
Total revenue and support	9,420,066	(1,693,389)	20,592	7,747,269
Expenses:				
Program services	4,656,055	-	-	4,656,055
Administrative	182,802	-	-	182,802
Fund-raising	790,125	-	-	790,125
Special events - costs of direct donor benefits	78,727	-	-	78,727
Total expenses	5,707,709	-	-	5,707,709
Change in net assets	3,712,357	(1,693,389)	20,592	2,039,560
Net assets, beginning of year	13,156,073	2,535,097	3,422,305	19,113,475
Net assets, end of year	<u>\$ 16,868,430</u>	<u>\$ 841,708</u>	<u>\$ 3,442,897</u>	<u>\$ 21,153,035</u>

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA

STATEMENT OF ACTIVITIES For the year ended June 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and support:				
Support:				
Contributions	\$ 1,417,918	\$ 1,799,042	\$ 502	\$ 3,217,462
Trusts and bequests	2,438,646	-	-	2,438,646
Special events	412,804	-	-	412,804
Grants	139,181	119,782	-	258,963
Merchandise sales, net	185,643	-	-	185,643
Donated supplies and services	150,114	-	-	150,114
Thrift store, net	47,256	-	-	47,256
Gain on disposal of property and equipment	2,269	-	-	2,269
Total support	4,793,831	1,918,824	502	6,713,157
Revenue and other income:				
Animal services	819,398	-	-	819,398
Investment income, net	326,973	7,827	-	334,800
Gain on beneficial interest in perpetual trusts	-	-	193,930	193,930
Gain on beneficial interest in charitable remainder trust	-	32,005	-	32,005
Other income	70,602	-	-	70,602
Total revenue and other income	1,216,973	39,832	193,930	1,450,735
Net assets released from restrictions:				
Satisfaction of donor restrictions	2,939,645	(2,939,645)	-	-
Total revenue and support	8,950,449	(980,989)	194,432	8,163,892
Expenses:				
Program services	4,528,088	-	-	4,528,088
Administrative	193,379	-	-	193,379
Fund-raising	997,739	-	-	997,739
Special events - costs of direct donor benefits	78,488	-	-	78,488
Total expenses	5,797,694	-	-	5,797,694
Change in net assets	3,152,755	(980,989)	194,432	2,366,198
Net assets, beginning of year	10,003,318	3,516,086	3,227,873	16,747,277
Net assets, end of year	\$ 13,156,073	\$ 2,535,097	\$ 3,422,305	\$ 19,113,475

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2018

	Program Services							
	Animal Shelter	Offsite	Spay and Neuter Clinic	Humane Education and Cruelty Prevention	Total Program Services	Administrative	Fund-raising	Total
Personnel:								
Salaries and wages	\$ 1,138,048	\$ 241,504	\$ 734,727	\$ 198,430	\$ 2,312,709	\$ 47,934	\$ 291,026	\$ 2,651,669
Employee benefits	136,679	22,205	57,322	11,590	227,796	6,544	23,682	258,022
Payroll taxes	106,981	22,132	66,260	15,658	211,031	7,866	22,492	241,389
Total personnel	1,381,708	285,841	858,309	225,678	2,751,536	62,344	337,200	3,151,080
Other operating expenses	376,064	31,314	107,805	51,908	567,091	50,645	90,038	707,774
Veterinary services and supplies	261,810	-	262,119	861	524,790	-	-	524,790
Advertising and promotion	77,184	31,978	59,692	18,102	186,956	57	150,244	337,257
Occupancy	156,945	67,915	49,638	10,461	284,959	15,986	2,926	303,871
Office expenses	36,745	7,879	28,550	6,777	79,951	10,311	160,369	250,631
Depreciation	91,544	10,984	42,356	6,503	151,387	9,885	2,311	163,583
Professional services	42,115	7,469	25,076	1,267	75,927	33,094	44,605	153,626
Auto and travel	15,366	8,659	2,936	6,497	33,458	480	2,432	36,370
Total functional expenses	<u>\$ 2,439,481</u>	<u>\$ 452,039</u>	<u>\$ 1,436,481</u>	<u>\$ 328,054</u>	<u>\$ 4,656,055</u>	<u>\$ 182,802</u>	<u>\$ 790,125</u>	<u>\$ 5,628,982</u>

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2017

	Program Services							
	Animal Shelter	Offsite	Spay and Neuter Clinic	Humane Education and Cruelty Prevention	Total Program Services	Administrative	Fund-raising	Total
Personnel:								
Salaries and wages	\$ 1,146,299	\$ 248,965	\$ 743,083	\$ 196,814	\$ 2,335,161	\$ 87,002	\$ 270,851	\$ 2,693,014
Employee benefits	128,655	18,747	49,240	13,019	209,661	5,038	21,951	236,650
Payroll taxes	99,145	19,678	63,062	15,145	197,030	7,488	24,013	228,531
Total personnel	1,374,099	287,390	855,385	224,978	2,741,852	99,528	316,815	3,158,195
Other operating expenses	323,212	42,982	108,811	44,901	519,906	37,069	129,096	686,071
Veterinary services and supplies	319,196	-	208,286	-	527,482	-	-	527,482
Advertising and promotion	66,282	27,327	51,217	15,483	160,309	405	211,510	372,224
Occupancy	127,208	73,660	82,083	5,971	288,922	10,940	11,326	311,188
Professional services	21,424	1,794	6,054	339	29,611	34,380	174,813	238,804
Office expenses	32,938	10,182	33,705	7,188	84,013	6,775	146,558	237,346
Depreciation	78,867	7,193	52,392	1,274	139,726	3,885	5,771	149,382
Auto and travel	18,482	9,693	3,533	4,559	36,267	397	1,850	38,514
Total functional expenses	<u>\$ 2,361,708</u>	<u>\$ 460,221</u>	<u>\$ 1,401,466</u>	<u>\$ 304,693</u>	<u>\$ 4,528,088</u>	<u>\$ 193,379</u>	<u>\$ 997,739</u>	<u>\$ 5,719,206</u>

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA

STATEMENTS OF CASH FLOWS
For the years ended June 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ 2,039,560	\$ 2,366,198
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation	164,639	150,476
Donated property and equipment	(74,350)	(101,400)
Loss (gain) on disposal of property and equipment	8,097	(2,269)
Reinvested dividends	(1,640)	(4,274)
Realized and unrealized gain on investments	(27,854)	(72,816)
Gain on beneficial interest in perpetual trusts	(20,592)	(193,930)
Gain on beneficial interest in charitable remainder trust	(6,566)	(32,005)
Contribution of interest in charitable remainder trust	-	(91,580)
Change in the allowance for uncollectible bequests and memorials receivable	(25,000)	(8,126)
Change in the allowance for net present value, uncollectible promises to give	(5,756)	12,768
Change in the provision for uncollectible promises to give	(1,555)	29,366
Contributions restricted for capital purposes	(1,124,704)	(1,606,269)
Changes in operating assets and liabilities:		
Accounts and other receivables	5,829	22,153
Inventory	20,982	(19,380)
Prepaid expenses and other assets	50,572	(36,660)
Bequests and memorials receivable	(597,339)	162,537
Accounts payable	45,938	28,541
Construction accounts payable	(585,984)	635,984
Accrued payroll and taxes	(28,704)	53,518
Total adjustments	(2,203,987)	(1,073,366)
Net cash (used in) provided by operating activities	(164,427)	1,292,832
Cash flows from investing activities:		
Purchases of marketable securities	(1,808,741)	(7,110,835)
Proceeds from sales of marketable securities	5,480,306	7,518,676
Distributions received from charitable remainder trust	-	8,537
Purchases related to property held for sale	(20,630)	-
Purchases of property and equipment	(6,491,534)	(2,579,281)
Proceeds from disposal of property and equipment	571,452	4,500
Net cash used in investing activities	(2,269,147)	(2,158,403)
Cash flows from financing activities:		
Collection on contributions restricted for capital purposes	1,323,325	1,555,812
Advances on construction line of credit	-	2,175
Borrowings under note payable	997,900	-
Repayments on note payable	(7,887)	-
Payments on capital lease payable	(3,437)	-
Payments on gift annuity obligations	(7,747)	(5,138)
Net cash provided by financing activities	2,302,154	1,552,849
Change in cash and cash equivalents	(131,420)	687,278
Cash and cash equivalents, beginning of year	2,310,695	1,623,417
Cash and cash equivalents, end of year	\$ 2,179,275	\$ 2,310,695

See independent auditor's report
and notes to financial statements.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

1. Organization

Humane Society of Southern Arizona (Society) was organized in March 1944 to promote the prevention of cruelty to animals, to promote the welfare of animals through legislation, to maintain a shelter for animals and to promote the reduction of animal over-population through spaying and neutering. The Society provides these services throughout Pima County and all of Southern Arizona. Its main campus is located in central Tucson, Arizona. The Society also offers two additional adoption sites and operates a thrift store to help fund animal services. Funding for the Society comes primarily from contributions, bequests and trusts, and animal services.

2. Summary of Significant Accounting Policies

Financial Statement Presentation and Contributions

The Society reports information regarding its financial position and activities according to the following net asset classifications:

- **Unrestricted net assets** – Net assets that are not subject to donor-imposed stipulations. The Board of Directors has designated net assets to establish an endowment fund. The balance of these board-designated endowment funds, including accumulated earnings, as of June 30, 2018 and 2017 is \$251,817 and \$244,405, respectively. As of June 30, 2018 and 2017, the balance of the board designated net assets for the capital campaign was \$-0- and \$1,000,000, respectively.
- **Temporarily restricted net assets** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Society and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.
- **Permanently restricted net assets** – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Society. Generally, the donors of these assets permit the Society to use all or part of the income earned on any related investments for general or specific purposes.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increase those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, if a restriction is fulfilled in the same time period in which the contribution is received, the Society reports the support as unrestricted.

Use of Estimates

The preparation 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Society considers cash and highly liquid investments with a maturity of three months or less to be cash equivalents. The Society maintains its cash in brokerage accounts and in bank deposit accounts which may exceed federally insured limits. The Federal Deposit Insurance Corporation (FDIC) insures cash accounts at banks up to \$250,000 per institution. It is the opinion of management that the solvency of the referenced financial institutions is not of concern at this time. At June 30, 2018 and 2017, the Society had \$1,908,444 and \$1,207,871, respectively, on deposit in excess of FDIC limitations.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

2. Summary of Significant Accounting Policies, Continued

Income Tax Status

The Society is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code (IRC) and from Arizona income tax under Arizona Revised Statute section 43-1201(4). Therefore, no provision has been made for income taxes in the accompanying financial statements. In addition, the Society qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization other than a private foundation under Section 509(a)(2). There were no taxes paid by the Society during the years ended June 30, 2018 and 2017.

The Society's policy is to disclose or recognize income tax positions based on management's estimate of whether it is reasonably possible or probable, respectively, that a liability has been incurred for unrecognized income tax positions. As of June 30, 2018, there were no uncertain tax positions that are potentially material.

Reclassifications

Certain items in the 2017 financial statements have been reclassified to conform to the presentation in the 2018 financial statements.

Bequests Receivable

Bequests are recognized as contribution revenue when the Society has an irrevocable right to the gift as determined by applicable court declarations, and the amount can be reasonably estimated. The revenue and related receivable are recorded at the present value of the amount which management estimates it will collect. Bequests receivable that are expected to be collected within one year are recorded at their net realizable value and classified as current. Bequests receivable that are expected to be collected in future years are recorded at the estimated net realizable value and classified as non-current.

Unconditional Promises to Give

Unconditional promises to give that are expected to be collected within one year are recorded at their net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows. For the years ended June 30, 2018 and 2017, the discounts on these amounts are computed using a risk-free interest rate of 3.75% and 3.5%, respectively. Amortization of the discount is included in contribution revenue. Management uses the allowance method to account for uncollectible unconditional promises to give. The allowance for uncollectible promises to give is \$53,894 and \$55,449 at June 30, 2018 and 2017, respectively.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are stated at their fair values in the statements of financial position. Unrealized gains and losses are included in the change in net assets in the accompanying statements of activities.

The Securities Investor Protection Corporation (SIPC) protects investments up to \$500,000 per institution. However, SIPC does not protect against losses in market value. At June 30, 2018 and 2017, the Society had \$3,570,101 and \$8,034,319, respectively, on deposit in excess of SIPC limitations. It is the opinion of management that the solvency of the referenced brokerage institutions is not of concern at this time.

Property Held for Sale

Property held for sale is recorded at its estimated realizable value and consists of land and a building that was part of the Society's previous location.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

2. Summary of Significant Accounting Policies, Continued

Inventory

Inventories consist primarily of medical supplies and retail pet items (sold at offsite adoption centers and shelter) and are stated at the lower of cost or market determined by the average cost method. Inventory for the thrift store is valued using a rolling three month average of sales.

Property and Equipment

Expenditures in excess of \$2,500, for major improvements or items that benefit future periods, are capitalized at cost if purchased or at fair market value at the date of gift if donated. Depreciation is computed using the straight-line method over the estimated useful life of the assets as follows:

Buildings and improvements	10 - 50 years
Vehicles	5 years
Equipment	3 - 10 years

Donated Services and Materials

Contributions of donated non-cash assets are recorded at their fair values in the period received. Contributions of donated services that create or enhance non-financial assets or that require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation, are recorded at their fair values in the period received.

Although the Society utilizes the services of many outside volunteers, the fair value of these services is not recognized in the accompanying financial statements since they do not meet the criteria for recognition under accounting principles generally accepted in the United States of America.

Advertising

Advertising costs are expensed as incurred. The Society does not participate in direct-response advertising which requires the capitalization and amortization of related costs. Advertising expense for the years ended June 30, 2018 and 2017 was \$337,257 and \$372,224, respectively.

3. Unconditional Promises to Give

During the year ended June 30, 2011, a capital campaign was launched to raise money for the Society's new facility. The balances due related to this campaign are scheduled to be repaid in future years as follows:

	2018	2017
2018	\$ -	\$ 258,540
2019	168,740	118,292
2020	94,790	88,024
2021	31,344	29,628
2022	11,000	60,011
2023 and beyond	50,000	-
Total unconditional promises to give	355,874	554,495
Less discount to present value at 3.75% and 3.50%	(16,935)	(22,691)
Less allowance for uncollectible promises	(53,894)	(55,449)
Unconditional promises to give, net	285,045	476,355
Less current portion	(168,740)	(258,540)
Non-current portion	\$ 116,305	\$ 217,815

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

4. Investments

Investments, stated at fair value, consist of the following at June 30,:

	2018	2017
Fixed income	\$ 2,620,573	\$ 6,349,711
Equities	705,887	1,035,709
Mutual funds	661,248	234,419
Other marketable investments	42,875	52,815
Total investments	4,030,583	7,672,654
Less permanently restricted endowments	(91,596)	(91,596)
Less board-designated endowments	(250,000)	(250,000)
Investments available for operations	\$ 3,688,987	\$ 7,331,058

Investment gain is comprised of the following for the years ended June 30,:

	2018	2017
Interest and dividends	\$ 126,016	\$ 171,270
Realized and unrealized gain, net	27,854	72,816
Trust income	165,285	137,602
Investment management fees	(46,551)	(46,888)
Total investment gain, net	\$ 272,604	\$ 334,800

5. Fair Value Measurements

The Financial Accounting Standards Board has established a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Society has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

5. Fair Value Measurements, Continued

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2018 and 2017.

- *Common stock, fixed income, other marketable assets:* Valued at fair value based on national trade listing.
- *Mutual and exchange funds:* Valued at the net asset value ("NAV") of shares held by the Society at year end.
- *Beneficial interest in trusts held by third parties:* Valued at the fair value of the underlying investments as reported by the third parties.

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

Fair values of assets measured on a recurring basis are:

Investments at Fair Value as of June 30, 2018				
	Level 1	Level 2	Level 3	Total
Common stocks	\$ 705,887	\$ -	\$ -	\$ 705,887
Mutual and exchange funds:				-
Bond funds	556,463	-	-	556,463
Fixed income	104,785	-	-	104,785
Corporate and government bonds	2,620,573	-	-	2,620,573
Other assets	42,875	-	-	42,875
Total investments	<u>\$ 4,030,583</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,030,583</u>
Beneficial interest in perpetual trusts	<u>\$ -</u>	<u>\$ 3,350,799</u>	<u>\$ -</u>	<u>\$ 3,350,799</u>
Beneficial interest in charitable remainder trust	<u>\$ -</u>	<u>\$ 428,206</u>	<u>\$ -</u>	<u>\$ 428,206</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

5. Fair Value Measurements, Continued

	Investments at Fair Value as of June 30, 2017			
	Level 1	Level 2	Level 3	Total
Common stocks:	\$ 1,035,709	\$ -	\$ -	\$ 1,035,709
Mutual and exchange funds:				
Bond funds	179,614	-	-	179,614
Fixed income	54,805	-	-	54,805
Corporate and government bonds	6,349,711	-	-	6,349,711
Other assets	52,815	-	-	52,815
Total investments	<u>\$ 7,672,654</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,672,654</u>
Beneficial interest in perpetual trusts	<u>\$ -</u>	<u>\$ 3,330,207</u>	<u>\$ -</u>	<u>\$ 3,330,207</u>
Beneficial interest in charitable remainder trust	<u>\$ -</u>	<u>\$ 421,640</u>	<u>\$ -</u>	<u>\$ 421,640</u>

6. Trusts, Bequests and Memorials

The Society is a remainder beneficiary in certain trusts. Upon the death of the income beneficiaries, the assets of the trusts will be distributed, and the Society's share of the assets will be recognized as revenue. Because the Society is a remainder beneficiary, and the remainder amounts cannot be estimated, the assets of the trusts are not reflected in the accompanying financial statements.

The Society is also the beneficiary of estates which can be reasonably estimated. The net balance of these bequests and memorials receivable is \$1,442,825 and \$820,486 at June 30, 2018 and 2017, respectively. Management uses the allowance method to account for uncollectible bequests and memorials receivable. The allowance for uncollectible bequests and memorials receivable is \$18,184 and \$43,184 at June 30, 2018 and 2017, respectively.

The Society is the sole income beneficiary of one perpetual charitable trust and a 1.5% income beneficiary of another perpetual trust. Both of the trusts are held by third parties. The Society recognizes permanently restricted contribution revenue equal to its proportionate share of the fair value of the trust assets upon notification and determination that its right to receive benefits is unconditional and irrevocable. Changes in the fair value of the Society's interest in the trust assets are reflected as gains or losses in the statement of activities in the period they occur. Distributions received from these trusts are recorded as unrestricted investment income. The value of the Society's beneficial interest in these trust assets is \$3,350,799 and \$3,330,207 at June 30, 2018 and 2017, respectively.

The Society is a beneficiary of three charitable remainder trusts held by third parties with beneficial interests of 50%, 25% and 9%. The 9% beneficial interest, in the amount of \$91,580, was contributed to the Society during the year ended June 30, 2017. The Society recognizes temporarily restricted contribution revenue equal to its proportionate share of the fair value of the trust assets upon notification and determination that its right to receive benefits is unconditional and irrevocable. Changes in the fair value of the Society's interests in the trust assets are reflected as gains or losses in the statement of activities in the period they occur. Distributions received from the trusts are recorded as a reduction of the beneficial interest in the trust assets. The value of the Society's beneficial interests in the trust assets is \$428,206 and \$421,640 at June 30, 2018 and 2017, respectively.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

6. Trusts, Bequests and Memorials, Continued

During the year ended June 30, 2004, the Society received a charitable gift annuity agreement of \$50,000, discounted at 6%. The beneficiary obligation liability under this agreement at June 30, 2018 and 2017 was \$7,521 and \$9,977, respectively. During the year ended June 30, 2010, the Society received another charitable gift annuity agreement from the same donor in the amount of \$50,000, discounted at 6%. The beneficiary obligation liability under this agreement at June 30, 2018 and 2017 was \$13,223 and \$15,349, respectively. During the year ended June 30, 2011, the Society received a third charitable gift annuity agreement from the same donor in the amount of \$50,000, discounted at 6%. The beneficiary obligation liability under this agreement at June 30, 2018 and 2017 was \$14,027 and \$17,192, respectively.

7. Property and Equipment

Property and equipment consists of the following at June 30,:

	2018	2017
Construction in progress	\$ -	\$ 2,961,394
Buildings and improvements	8,859,610	2,125,307
Land	1,015,457	1,300,537
Furniture, fixtures and equipment	1,175,909	1,064,047
Vehicles	243,837	312,752
Total property and equipment	11,294,813	7,764,037
Less accumulated depreciation	(747,065)	(2,806,382)
Property and equipment, net	\$ 10,547,748	\$ 4,957,655

8. Capital Lease Payable

During the year ended June 30, 2018, the Society entered into a capital lease for computer equipment. The total cost of the equipment under this lease was \$44,260 and accumulated depreciation was \$2,213 at June 30, 2018. The capital lease payable consists of the following at June 30, 2018:

	2018	2017
Cisco Capital, \$1,229 per month including interest through March 2021; collateralized by computer equipment.	\$ 40,823	\$ -
Less current portion	(13,541)	-
Non-current portion	\$ 27,282	\$ -

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2018 and 2017

8. Capital Lease Payable, Continued

The future maximum lease payments due under the capital lease at June 30, 2018 are:

Year ending June 30,	
2019	\$ 14,976
2020	14,976
2021	12,042
Total lease payments	41,994
Less imputed interest	(1,171)
Net minimum lease payments	<u>\$ 40,823</u>

9. Note Payable

	2018	2017
Note payable to Wells Fargo Bank, due in monthly installments of \$11,016, including interest at 3.75% through April 15, 2027; collateralized by a deed of trust on property. The Society is subject to certain financial covenants in connection with the note agreement. As of June 30, 2018, the Society was in compliance with those covenants.	\$ 992,188	\$ -
Less current portion	(96,125)	-
Non-current portion	<u>\$ 896,063</u>	<u>\$ -</u>

Principal maturities of the note payable are:

Year ending June 30,	
2019	\$ 96,125
2020	99,756
2021	103,703
2022	107,716
2023	111,883
Thereafter	473,005
	<u>\$ 992,188</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

10. Temporarily Restricted Net Assets

Temporarily restricted net asset activity consists of the following during the year ended June 30, 2018:

	Beginning Balance	Additions/ Earnings	Releases	Transfers/ Other	Ending Balance
Endowment earnings	\$ (5,595)	\$ 7,412	\$ -	\$ -	\$ 1,817
Pet visitation program	72,605	49,104	(39,524)	-	82,185
Education fund	426	-	(178)	-	248
Rescue fund	26,950	26,015	(32,975)	-	19,990
Special needs (2nd Chance)	20,596	119,908	(70,722)	-	69,782
Shelter food fund	14,744	-	(246)	-	14,498
Spay and neuter fund	61,699	82,428	(72,635)	-	71,492
Supported (Indigent) Care	4,974	2,965	(260)	-	7,679
Capital improvement fund	11,588	-	-	-	11,588
Capital campaign fund	1,873,067	1,128,605	(3,001,672)	-	-
Beneficial interest in charitable remainder trust	421,640	6,566	-	-	428,206
New beginnings	-	50,553	(17,120)	-	33,433
Wellness program	-	50,000	-	-	50,000
Other	32,403	74,806	(56,419)	-	50,790
	<u>\$ 2,535,097</u>	<u>\$ 1,598,362</u>	<u>\$ (3,291,751)</u>	<u>\$ -</u>	<u>\$ 841,708</u>

Temporarily restricted net asset activity consists of the following during the year ended June 30, 2017:

	Beginning Balance	Additions/ Earnings	Releases	Transfers/ Other	Ending Balance
Endowment earnings	\$ (13,422)	\$ 7,827	\$ -	\$ -	\$ (5,595)
Pet visitation program	81,368	29,365	(38,128)	-	72,605
Education Fund	-	10,000	(9,574)	-	426
Rescue fund	25,000	20,000	(18,050)	-	26,950
Special needs (2nd Chance)	95,026	59,348	(138,668)	4,890	20,596
Shelter food fund	7,966	15,020	(276)	(7,966)	14,744
Spay and neuter fund	79,231	30,875	(48,609)	202	61,699
Supported (Indigent) Care	13,176	2,000	(10,202)	-	4,974
Capital improvement fund	11,588	-	-	-	11,588
Capital campaign fund	2,871,185	1,606,269	(2,604,387)	-	1,873,067
Beneficial interest in charitable remainder trust	306,592	91,580	(8,537)	32,005	421,640
Other	38,376	54,367	(63,214)	2,874	32,403
	<u>\$ 3,516,086</u>	<u>\$ 1,926,651</u>	<u>\$ (2,939,645)</u>	<u>\$ 32,005</u>	<u>\$ 2,535,097</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

11. Endowment Funds

Endowments

The Society's endowments consist of two permanently restricted funds and a board-designated endowment fund. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds (including funds designated by the Board of Directors to function as endowments) are classified and reported based on the existence or absence of donor imposed restrictions. The Society is the beneficiary of two perpetual trusts as discussed in Note 6. The perpetual trusts are administered by a third party, and the assets are not accessible by the Society at any time. They do not meet the definition of an endowment and are classified as permanently restricted net assets in accordance with accounting principles generally accepted in the United States of America.

The State of Arizona adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) (the Act). The Board of Directors of the Society has interpreted the Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Society classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by the Act.

In accordance with the Act, the Society considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the organization
- The investment policies of the organization.

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Act requires the Society to retain as a fund of perpetual duration. There were no deficiencies of this nature to be reported as of June 30, 2018 or 2017.

The Society has adopted investment policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s) and board-designated endowment assets. Under this policy, as approved by the Board of Directors, the endowment assets are to be invested in a combination of fixed income, equities, commodities and cash equivalents, and the maximum allocation by investment type shall be 90%, 40%, 5% and 50%, respectively, of the total investment portfolio. Actual returns in any given year may vary.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

11. Endowment Funds, Continued

Investment Strategies

To satisfy its long-term rate-of-return objectives, the Society relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The primary purpose of the Society's endowment funds is to provide additional funding for programs and operations while increasing the investment base.

Spending Policy

The Society's policy allows the Board of Directors to appropriate for expenditure four percent of an endowment fund's average fair market value over the prior year. Accumulated earnings on endowment funds that are not otherwise restricted by a donor will be released from temporarily restricted net assets if appropriated by the Board of Directors.

The following is the Society's endowment net asset composition, by fund type, as of June 30,:

	2018	2017
Donor-restricted endowment funds	\$ 92,098	\$ 92,098
Board-designated endowment funds	250,000	250,000
Total endowment funds	<u>\$ 342,098</u>	<u>\$ 342,098</u>

The Society had the following endowment-related activities during the years ended June 30, 2018 and 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance, June 30, 2016	\$ 250,000	\$ (13,422)	\$ 92,098	\$ 328,676
Contributions	-	-	-	-
Earnings	-	7,827	-	7,827
Balance, June 30, 2017	250,000	(5,595)	92,098	336,503
Contributions	-	-	-	-
Earnings	-	7,412	-	7,412
Balance, June 30, 2018	<u>\$ 250,000</u>	<u>\$ 1,817</u>	<u>\$ 92,098</u>	<u>\$ 343,915</u>

12. Special Events

The Society's special events during the year ended June 30, 2018 consists of:

	Revenue	Expenses	Net
Puttin' on the Dog (includes in-kind contributions in the amount of \$74,913)	\$ 185,161	\$ 79,417	\$ 105,744
Sweat For Pets	49,180	7,037	42,143
Telethon	15,469	16,054	(585)
Other events	99,942	21,428	78,514
Total special events	<u>\$ 349,752</u>	<u>\$ 123,936</u>	<u>\$ 225,816</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

12. Special Events, Continued

Special event expenses for the year ended June 30, 2018 include \$78,727 of direct donor benefit costs as reported on the statement of activities, and the remaining \$45,209 of other special event expenses are allocated on the statement of functional expenses as fundraising.

The Society's special events during the year ended June 30, 2017 consists of:

	Revenue	Expenses	Net
Puttin' on the Dog (includes in-kind contributions in the amount of \$88,812)	\$ 223,724	\$ 87,341	\$ 136,383
Sweat For Pets	64,501	6,896	57,605
Telethon	40,684	8,008	32,676
Other events	83,895	27,221	56,674
Total special events	<u>\$ 412,804</u>	<u>\$ 129,466</u>	<u>\$ 283,338</u>

Special event expenses for the year ended June 30, 2017 include \$78,488 of direct donor benefit costs as reported on the statement of activities, and the remaining \$50,978 of other special event expenses are allocated on the statement of functional expenses as fundraising.

13. Donated Supplies and Services

Donated supplies and services consist of the following for the years ended June 30,:

	2018	2017
Property and equipment	\$ 108,371	\$ 101,400
Rent	31,541	34,459
Food	20,243	23,438
Professional services	33,750	9,060
Shelter and clinic	11,410	8,886
Operating supplies and materials	11,673	8,400
Total donated supplies and services	<u>\$ 216,988</u>	<u>\$ 185,643</u>

14. Thrift Store and Merchandise Sales

Thrift store and merchandise sales activity for the year ended June 30, 2018 consists of:

	Thrift Store	Merchandise Sales
Revenue	\$ 369,766	\$ 243,387
Expenses, including depreciation of \$1,056	<u>(367,347)</u>	<u>(119,311)</u>
Net revenue	<u>\$ 2,419</u>	<u>\$ 124,076</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

14. Thrift Store and Merchandise Sales, Continued

Thrift store and merchandise sales activity for the year ended June 30, 2017 consists of:

	Thrift Store	Merchandise Sales
Revenue	\$ 404,132	\$ 301,655
Expenses, including depreciation of \$1,094	(356,876)	(151,541)
Net revenue	<u>\$ 47,256</u>	<u>\$ 150,114</u>

15. Retirement Plan

The Society sponsors a 401(k) retirement plan for the benefit of its employees. Employees 21 years of age or older can participate in the plan after completing one year of service. The Society contributes an amount up to three percent of the respective participating employee's salary. For the years ended June 30, 2018 and 2017, pension expense totaled \$38,302 and \$40,222, respectively.

16. Commitments

The Society is self-insured for state unemployment purposes. Total expense for unemployment for the years ended June 30, 2018 and 2017 was \$2,214 and \$4,065, respectively.

17. Line of Credit

During the year ended June 30, 2018, the Society established a construction loan with Wells Fargo Bank for an amount not to exceed the principal sum of \$4,000,000. The initial funding was through a revolving line of credit upon which advances were made solely for the construction costs related to construction of the Society's new animal welfare center. The advances were available until the conversion date, which was during May 2018. The balance due on the line of credit at June 30, 2017 was \$2,175. During the year ended June 30, 2018, the animal welfare center was completed, and the line of credit was converted to a term loan in the initial amount of \$1,000,000. See Note 9.

18. Operating Leases

The Society has several non-cancelable operating leases for equipment and facilities that expire at various dates ranging between December 2018 and December 2021. Rental expense related to these leases for the years ended June 30, 2018 and 2017, including in-kind rent expense, was \$154,824 and \$159,710, respectively. Future minimum lease payments under these agreements are:

<u>Year ending June 30,</u>	
2019	\$ 89,116
2020	30,732
2021	<u>29,683</u>
Total future minimum lease payments	<u>\$ 149,531</u>

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

19. Joint Cost Allocations

The Society sends out newsletters that include requests for contributions, information about fundraising events and advertising, as well as program components. During the year ended June 30, 2018, the Society incurred joint costs of \$30,429 which are not specifically attributable to particular components of the publications. The Society allocated \$22,857 to program services not including public education and \$7,572 to fund-raising.

During the year ended June 30, 2017, the Society incurred joint costs of \$35,590 which are not specifically attributable to particular components of the publications. The Society allocated \$27,255 to program services not including public education and \$8,335 to fund-raising.

20. Related Party Transactions

Members of the board of directors make contributions and volunteer their time to support the Society. Members of the board of directors contributed \$31,150 and \$38,702 for the years ended June 30, 2018 and 2017, respectively.

Unconditional promises to give at June 30, 2018 includes \$10,878 due from four of the Society's board members and \$5,790 from various employees. Unconditional promises to give at June 30, 2017 includes \$39,615 due from seventeen of the Society's board members and \$4,937 from various employees.

During March 2016, the Society entered into a contract with Diversified Design and Construction, Inc. (DDC) for the construction of the Society's new animal welfare center. The president of DDC is a member of the Society's board of directors. The construction contract's maximum value is \$7,402,844. During the years ended June 30, 2018 and 2017, total payments made to DDC were \$5,881,227 and \$1,429,335, respectively, and amounts due, including a 10% retainage, were \$92,067 and \$635,984, at June 30, 2018 and 2017, respectively.

During July 2016, the Society entered into a contract with Spendiarian and Willis Acoustics and Noise Control, LLC (S&W) for acoustical analysis and audio and video systems design at the Society's new animal welfare center. One of the owners of S&W is a member of the Society's board of directors. In lieu of fees for services valued at \$10,000, S&W will perform the work and contribute all fees back as in-kind services. Donated property and equipment for the years ended June 30, 2018 and 2017 includes \$4,250 and \$5,750, respectively, related to this contract.

During December 2016, the Society entered into real estate property listing agreements with Venture West Real Estate Services, LLC (Venture West) for brokerage services for the sale of the Society's properties located at 3450 N. Kelvin Blvd and 3465 E. Kleindale Road in Tucson, Arizona. The vice-president and partner of Venture West is a member of the Society's board of directors. Upon the sale of the properties, Venture West will be compensated for brokerage fees totaling \$2,000, and the remaining portion of the brokerage fees will be donated to the Society. During the years ended June 30, 2018 and 2017, brokerage fees of \$500 and \$-0-, respectively had been paid to Venture West. Donated professional services for the years ended June 30, 2018 and 2017 includes \$16,900 and \$-0-, respectively, related to these agreements.

In connection with the sale of the Kleindale property during the year ended June 30, 2018, \$17,400 in commissions were earned by a member of the Society's finance committee. Of the total, \$8,700 was donated to the Society and is included with donated professional services.

See independent auditor's report.

HUMANE SOCIETY OF SOUTHERN ARIZONA

NOTES TO FINANCIAL STATEMENTS For the years ended June 30, 2018 and 2017

21. Supplemental Cash Flow Disclosures

Supplemental disclosure of cash flow information:

	2018	2017
Donated property and equipment	\$ 74,350	\$ 101,400
Contribution of interest in charitable remainder trust	\$ -	\$ 91,580
Reinvested dividends	\$ 1,640	\$ 4,274
Construction line of credit converted to permanent loan	\$ 2,175	\$ -
Purchase of computer equipment with capital lease	\$ 44,260	\$ -
Property and equipment converted to held for sale	\$ 275,863	\$ -
Cash paid for interest	\$ 3,955	\$ -

22. Subsequent Events

Effective July 1, 2018, the Board of Directors established a policy to designate unrestricted net assets for an operating reserve equal to 50% of the operating budget for the fiscal year. As a result, the Board of Directors designated net assets in the amount of \$3,206,885 as an operating reserve on July 1, 2018.

The Society was unaware of any additional subsequent events as of September 25, 2018, the date the financial statements were available to be issued.

See independent auditor's report.