

OPERATION KINDNESS

Financial Statements
with
Independent Auditor's Report

June 30, 2016 and 2015

OPERATION KINDNESS

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Operation Kindness

We have audited the accompanying financial statements of Operation Kindness (a Texas not-for-profit corporation) (the Organization), which are comprised of the statements of financial position as of June 30, 2016 and 2015, 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 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 Operation Kindness as of June 30, 2016 and 2015, 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.

Travis Wolff, LLP

Certified Public Accountants
December 23, 2016
Dallas, Texas

OPERATION KINDNESS
 Statements of Financial Position
 June 30, 2016 and 2015

| | 2016 | 2015 |
|--|----------------------------|----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents - unrestricted | \$ 1,778,626 | \$ 1,808,433 |
| Cash and cash equivalents - temporarily restricted | 78,519 | 108,494 |
| Certificates of deposit | 200,046 | - |
| Investments, at fair value | 2,520,601 | 2,531,866 |
| Other receivables | 647 | 1,379 |
| Prepaid expenses | 53,036 | 47,085 |
| Total current assets | 4,631,475 | 4,497,257 |
| Other investments | 5,486 | 5,486 |
| Property and equipment, net | 1,891,909 | 1,982,813 |
| Total assets | \$ <u>6,528,870</u> | \$ <u>6,485,556</u> |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Accounts payable | \$ 100,558 | \$ 115,377 |
| Accrued liabilities | 27,221 | 19,093 |
| Total current liabilities | 127,779 | 134,470 |
| Net assets: | | |
| Unrestricted net assets | 6,322,572 | 6,242,592 |
| Temporarily restricted net assets | 78,519 | 108,494 |
| Total net assets | 6,401,091 | 6,351,086 |
| Total liabilities and net assets | \$ <u>6,528,870</u> | \$ <u>6,485,556</u> |

See accompanying notes to financial statements.

OPERATION KINDNESS
 Statements of Activities
 Years Ended June 30, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|---------------------|---------------------|
| Change in unrestricted net assets: | | |
| Revenues and support: | | |
| Contributions | \$ 2,770,187 | \$ 2,494,594 |
| In-kind donations | 185,748 | 176,039 |
| Adoption income | 717,977 | 650,829 |
| Event income | 474,201 | 446,185 |
| Merchandise income | 10,598 | 10,344 |
| Other income | 159,982 | 143,052 |
| Interest and dividend income | 48,262 | 43,389 |
| Realized gain on sale of investments, net | 50,309 | 304,494 |
| Unrealized loss on investments, net | (110,292) | (252,055) |
| Net assets released from restrictions | 30,000 | 15,000 |
| Total unrestricted revenues and support | 4,336,972 | 4,031,871 |
| Expenses: | | |
| Program - animal care | 2,964,884 | 2,694,945 |
| Management and administration | 371,698 | 462,162 |
| Fundraising | 920,410 | 787,179 |
| Total expenses | 4,256,992 | 3,944,286 |
| Change in unrestricted net assets | 79,980 | 87,585 |
| Change in temporarily restricted net assets: | | |
| Contributions | - | 45,000 |
| Interest income | 25 | 2 |
| Net assets released from restrictions | (30,000) | (15,000) |
| Change in temporarily restricted net assets | (29,975) | 30,002 |
| Change in net assets | 50,005 | 117,587 |
| Net assets at beginning of year | 6,351,086 | 6,233,499 |
| Net assets at end of year | \$ 6,401,091 | \$ 6,351,086 |

See accompanying notes to financial statements.

OPERATION KINDNESS
Statement of Functional Expenses
Year Ended June 30, 2016

| | <u>Program Services</u> | | <u>Supporting Services</u> | | <u>Total</u> |
|------------------------------------|-------------------------|--|----------------------------|-----------|------------------|
| | <u>Animal Care</u> | <u>Management and Administration</u> | <u>Fundraising</u> | | |
| Salaries and wages | \$ 1,418,011 | \$ 252,765 | \$ 262,768 | \$ | 1,933,544 |
| Employee benefits | 252,128 | 31,516 | 31,516 | | 315,160 |
| Payroll taxes | 113,769 | 20,070 | 19,919 | | 153,758 |
| Professional fees | 6,759 | 24,867 | 86,095 | | 117,721 |
| Supplies | 10,634 | 1,796 | 1,796 | | 14,226 |
| Utilities and telephone | 61,814 | 8,578 | 9,713 | | 80,105 |
| Postage/shipping/letter production | 157 | 1,296 | 121,704 | | 123,157 |
| Occupancy | 8,402 | 1,172 | - | | 9,574 |
| Equipment rental and maintenance | 1,339 | 1,379 | 8,274 | | 10,992 |
| Merchandise for resale | - | - | 12,074 | | 12,074 |
| Printing and publications | 2,995 | 1,245 | 18,226 | | 22,466 |
| Travel | 1,938 | 576 | 3,272 | | 5,786 |
| Conference and conventions | 12,013 | 751 | 2,252 | | 15,016 |
| Direct animal care | 766,671 | - | - | | 766,671 |
| Bank and credit card fees | 11,383 | 3,658 | 26,559 | | 41,600 |
| Advertising | 5,155 | 286 | 105,603 | | 111,044 |
| Dues and subscriptions | 760 | 1,091 | - | | 1,851 |
| Office expense/technology | 56,397 | 12,085 | 29,270 | | 97,752 |
| Building repairs and maintenance | 36,696 | - | - | | 36,696 |
| Insurance | 31,241 | 2,408 | - | | 33,649 |
| Vehicle expense | 5,686 | - | - | | 5,686 |
| Uniforms and badges | 7,404 | - | - | | 7,404 |
| Other expenses | 4,732 | 2,243 | 22,582 | | 29,557 |
| Direct event expenses | - | - | 154,871 | | 154,871 |
| Depreciation and amortization | 148,800 | 3,916 | 3,916 | | 156,632 |
| Total expenses | \$ 2,964,884 | \$ 371,698 | \$ 920,410 | \$ | 4,256,992 |

See accompanying notes to financial statements.

OPERATION KINDNESS
Statement of Functional Expenses
Year Ended June 30, 2015

| | <u>Program Services</u> | | <u>Supporting Services</u> | | <u>Total</u> |
|------------------------------------|-------------------------|--|----------------------------|-----------|------------------|
| | <u>Animal Care</u> | <u>Management and Administration</u> | <u>Fundraising</u> | | |
| Salaries and wages | \$ 1,211,480 | \$ 271,314 | \$ 249,265 | \$ | 1,732,059 |
| Employee benefits | 225,740 | 28,217 | 28,217 | | 282,174 |
| Payroll taxes | 101,110 | 20,242 | 19,252 | | 140,604 |
| Professional fees | 6,899 | 21,372 | 64,851 | | 93,122 |
| Supplies | 10,884 | 1,867 | 1,867 | | 14,618 |
| Utilities and telephone | 62,923 | 9,628 | 8,670 | | 81,221 |
| Postage/shipping/letter production | 238 | 1,701 | 133,175 | | 135,114 |
| Occupancy | 4,283 | 7,189 | - | | 11,472 |
| Equipment rental and maintenance | 1,661 | 1,661 | 8,296 | | 11,618 |
| Merchandise for resale | - | - | 10,830 | | 10,830 |
| Printing and publications | 3,370 | 843 | 14,012 | | 18,225 |
| Travel | 1,165 | 709 | 1,869 | | 3,743 |
| Conference and conventions | 13,635 | 1,704 | 1,704 | | 17,043 |
| Direct animal care | 791,827 | - | - | | 791,827 |
| Bank and credit card fees | - | 3,654 | 48,079 | | 51,733 |
| Advertising | 27,967 | 297 | 30,091 | | 58,355 |
| Dues and subscriptions | 1,452 | 1,126 | - | | 2,578 |
| Office expense/technology | - | 82,157 | 12,961 | | 95,118 |
| Building repairs and maintenance | 35,859 | - | - | | 35,859 |
| Insurance | 28,494 | 2,408 | - | | 30,902 |
| Vehicle expense | 3,698 | - | - | | 3,698 |
| Uniforms and badges | 9,864 | 31 | - | | 9,895 |
| Other expenses | 10,668 | 2,312 | 16,781 | | 29,761 |
| Direct event expenses | - | - | 133,529 | | 133,529 |
| Depreciation and amortization | 141,728 | 3,730 | 3,730 | | 149,188 |
| Total expenses | \$ 2,694,945 | \$ 462,162 | \$ 787,179 | \$ | 3,944,286 |

See accompanying notes to financial statements.

OPERATION KINDNESS
Statements of Cash Flows
Years Ended June 30, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|----------------------------|----------------------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ 50,005 | \$ 117,587 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 156,632 | 149,188 |
| Realized gain on sale of investments, net | (50,309) | (304,494) |
| Unrealized loss on investments, net | 110,292 | 252,055 |
| Change in operating assets and liabilities: | | |
| Other receivables | 732 | 691 |
| Prepaid expenses | (5,951) | (6,472) |
| Accounts payable | (14,819) | 33,357 |
| Accrued liabilities | 8,128 | 5,392 |
| | <u>254,710</u> | <u>247,304</u> |
| Net cash provided by operating activities | 254,710 | 247,304 |
| Cash flows from investing activities: | | |
| Change in cash and cash equivalents - temporarily restricted | 29,975 | (30,002) |
| Purchases of investments | (365,051) | (1,020,761) |
| Proceeds from sale of investments | 316,333 | 1,360,440 |
| Purchases of certificates of deposit, net | (200,046) | - |
| Purchases of property and equipment | (65,728) | (123,156) |
| Proceeds from sale of property and equipment | - | 2,500 |
| | <u>(284,517)</u> | <u>189,021</u> |
| Net cash provided (used) by investing activities | (284,517) | 189,021 |
| Net increase (decrease) in cash and cash equivalents | (29,807) | 436,325 |
| Cash and cash equivalents at beginning of year | 1,808,433 | 1,372,108 |
| Cash and cash equivalents at end of year | \$ <u>1,778,626</u> | \$ <u>1,808,433</u> |

See accompanying notes to financial statements.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 1 - General Information and Summary of Significant Accounting Policies

General information

Operation Kindness (the Organization), located in Carrollton, Texas, was incorporated in June 1977 in the state of Texas, for the purpose of providing quality care for homeless or unwanted cats and dogs in a compassionate, no-kill environment until they are adopted into responsible, loving homes, and to be a leader in the community in promoting humane values through education and awareness.

Basis of presentation

The financial statements are presented in conformity with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying notes. Significant estimates affecting the financial statements include the depreciable lives of property and equipment as well as the allocation of expenses by function. Actual results could differ from those estimates.

Not-for-profit organizations are required to report information regarding their financial position and activities based on the existence or absence of donor imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

Unrestricted net assets - Net assets not subject to donor imposed restrictions.

Temporarily restricted net assets - Net assets subject to donor imposed restrictions that will be met by expenditure in accordance with the donors' requests and/or the passage of time.

Permanently restricted net assets - Net assets subject to donor imposed restrictions that will be maintained permanently. Generally the donors of these assets permit distribution of all or part of the income earned on related investments for general or specific purposes. There were no permanently restricted net assets as of June 30, 2016 and 2015.

Cash and cash equivalents

The Organization classifies all unrestricted demand deposits, money market funds and highly liquid investments with a maturity of three months or less when purchased as cash equivalents. The Organization holds investments in several certificates of deposit with various maturity dates. As the instruments mature, the amounts are invested in a money market account until a new certificate of deposit is purchased.

Investment allocation

On February 24, 2015, the Board of Directors unanimously approved to adopt a more conservative investment approach whereby the allocation of Operation Kindness' investable funds would be 50% in equities, 35% in bonds, and 15% in alternative investments (hedge funds that are not correlated to the stock market). The investment allocation mix for 2016 was 52% in equities, 35% in bonds, and 13% in alternative investments.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 1 - General Information and Summary of Significant Accounting Policies - (Continued)

Investment valuation

Investments are recorded at their estimated fair value on the date of the financial statements. Realized and unrealized gains and losses are recorded in the accompanying statements of activities.

Debt and equity mutual funds are valued at the closing market price reported by the exchange or market on which they are traded. Fixed income securities are valued by the Organization's investment managers using prices obtained from valuation services.

Alternative investments have no readily determinable market value and are valued at estimated values provided by fund managers, which management has determined to be reasonable. These estimated values do not necessarily represent the amounts that may ultimately be realized due to the occurrence of future events and circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation estimates, the reported values may be materially higher or lower than the values that would have been used had an active market for the securities existed.

Fair value measurements

The Organization is required to classify its assets and liabilities that are reported at fair value into three levels based on the method used to value the assets or liabilities. Level 1 values are based on quoted prices in active markets for identical securities. Level 2 values are based on significant other observable market inputs, such as quoted prices for similar securities and quoted prices in inactive markets. Level 3 values are based on significant unobservable inputs that reflect management's determination of assumptions that market participants might reasonably use in valuing the securities. The valuation levels are not necessarily an indication of risk or liquidity associated with the underlying investments. These valuation levels are presented in note 5.

Investment transactions and investment income

Investment transactions are recorded on the trade date. Realized gains and losses are determined using the specific identification method. Interest income is recognized on the accrual basis and dividends are recognized on the ex-dividend date.

The Organization pays management fees related to its investments. Fees paid to various money managers are allocated between the Organization's investment accounts.

Risks and uncertainties

The Organization invests in debt and equity mutual funds and alternative investments. These investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment mutual funds and alternative investments, it is at least reasonably possible that changes in the values of mutual funds and alternative investments will occur in the near term and that such changes could materially affect the amounts reported in future financial statements.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 1 - General Information and Summary of Significant Accounting Policies - (Continued)

Contributions

Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support depending on the existence or nature of any donor imposed restrictions. The Organization reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

The Organization reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used as well as gifts of cash or other assets that must be used in the acquiring of long-lived assets are reported as restricted support. Contributions with explicit donor stipulations, in regards to how long-lived assets are to be maintained, are reported by the Organization upon expiration of donor restrictions when the long-lived assets are placed in service.

Property and equipment

Depreciation is provided for using the straight-line method over the remaining estimated useful lives of the respective assets as follows:

| | |
|----------------------------|---------------|
| Software | 3 years |
| Intellectual property | 5 years |
| Furniture and fixtures | 8 years |
| Vehicles | 3 - 5 years |
| Equipment | 5 - 15 years |
| Buildings and improvements | 10 - 39 years |

Depreciation expense was \$156,632 in fiscal year 2016 and \$149,188 in fiscal year 2015.

Maintenance and repairs are charged to expenses as incurred, whereas major renewals and betterments which extend the estimated useful lives of the property and equipment are capitalized.

Donations of property and equipment are recorded as contributions at their estimated fair value at the date of donation.

When property or equipment is sold or disposed of, the related cost and accumulated depreciation are removed and any gain or loss is included in other revenue or expense.

Functional allocation of expenses

The costs of providing programs and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain expenses have been allocated among program, management and administration and fundraising functions.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 1 - General Information and Summary of Significant Accounting Policies - (Continued)

Income tax status

The Organization is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code and therefore no provision has been made for federal income taxes in the financial statements. In addition, the Organization has been classified as an entity that is not a private foundation within the meaning of section 509(a) of the Internal Revenue Code. The Organization is also exempt from state income taxes. Management has evaluated the Organization's federal and state tax positions and believes there are no significant uncertain tax positions. The Organization is generally not subject to examination by federal tax authorities for tax years before 2013.

Note 2 - Property and Equipment

Property and equipment consists of the following:

| | <u>2016</u> | <u>2015</u> |
|--|----------------------------|----------------------------|
| Buildings and improvements | \$ 2,554,505 | \$ 2,548,555 |
| Construction in progress | 45,205 | 19,495 |
| Computers and software | 160,056 | 158,927 |
| Office furniture, fixtures and equipment | 24,145 | 21,645 |
| Cages | 193,693 | 193,693 |
| Medical equipment | 140,598 | 122,860 |
| Vehicles | 117,118 | 113,309 |
| Other furniture and equipment | <u>111,415</u> | <u>111,415</u> |
| Total property and equipment | 3,346,735 | 3,289,899 |
| Less accumulated depreciation | (1,668,422) | (1,520,682) |
| Land | <u>213,596</u> | <u>213,596</u> |
| Total property and equipment, net | \$ <u>1,891,909</u> | \$ <u>1,982,813</u> |

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 3 - Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following:

| | <u>2016</u> | <u>2015</u> |
|--|-------------------------|--------------------------|
| Reward for capture of individuals guilty of cruelty to animals | \$ 8,589 | \$ 8,585 |
| Grants reserve | <u>69,930</u> | <u>99,909</u> |
| Total temporarily restricted net assets | \$ <u>78,519</u> | \$ <u>108,494</u> |

Net assets released from restrictions consist of the following:

| | | |
|--|-------------------------|-------------------------|
| Grants reserve | \$ <u>30,000</u> | \$ <u>15,000</u> |
| Total net assets released from restrictions | \$ <u>30,000</u> | \$ <u>15,000</u> |

Note 4 - Defined Contribution Plan

The Organization sponsors a defined contribution 403(b) thrift plan covering part-time and full-time employees and is available immediately upon employment. Under this plan, participants may defer up to 100 percent of their compensation each plan year. The Organization makes a matching contribution for participating employees who have been with the Organization for one year. The matched contribution is equal to the lesser of an employee's total contribution for the year or 3 percent of the employee's compensation for the year. The total contribution by the Organization was \$17,720 and \$18,093 in 2016 and 2015, respectively.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2016 and 2015

Note 5 - Fair Value Measurement

The fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2016 and 2015 is as follows:

| | <u>Fair Value</u> | | <u>Level 1</u> | | <u>Level 2</u> | | <u>Level 3</u> |
|----------------------------|----------------------------|-----------|-------------------------|-----------|-----------------|-----------|---------------------|
| June 30, 2016: | | | | | | | |
| Equity mutual funds | \$ 1,410,682 | \$ | 1,410,682 | \$ | - | \$ | - |
| Bond mutual funds | 1,074,672 | | 1,074,672 | | - | | - |
| Short-term funds | 35,247 | | 35,247 | | - | | - |
| Investment in partnerships | <u>5,486</u> | | <u>-</u> | | <u>-</u> | | <u>5,486</u> |
| Total | \$ <u>2,526,087</u> | \$ | <u>2,520,601</u> | \$ | <u>-</u> | \$ | <u>5,486</u> |
| | | | | | | | |
| June 30, 2015: | | | | | | | |
| Equity mutual funds | \$ 1,491,111 | \$ | 1,491,111 | \$ | - | \$ | - |
| Bond mutual funds | 1,019,015 | | 1,019,015 | | - | | - |
| Short-term funds | 21,740 | | 21,740 | | - | | - |
| Certificate of deposits | - | | - | | - | | - |
| Investment in partnerships | <u>5,486</u> | | <u>-</u> | | <u>-</u> | | <u>5,486</u> |
| Total | \$ <u>2,537,352</u> | \$ | <u>2,531,866</u> | \$ | <u>-</u> | \$ | <u>5,486</u> |

Assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) are as follows:

As the Organization's ownership percentage is less than 5 percent, the Organization accounts for its investment in partnerships using the equity method which approximates its cost basis. The fair value of this investment is \$5,486, and \$5,486, as of June 30, 2016 and 2015, respectively

Note 6 - Concentrations

In 2016, no contributor provided support to the Organization exceeding ten percent of total contributions. In 2015, one contributor provided support to the Organization exceeding ten percent of total contributions. Contributions from this donor equaled approximately 20 percent of 2015 contributions.

The Organization maintains its cash and cash equivalents in bank accounts which, at times, exceed federally insured limits. As of June 30, 2016, uninsured balances totaled \$1,346,756. As of June 30, 2015, uninsured balances total \$1,666,927. The organization has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Note 7 - Subsequent Events

Management has evaluated subsequent events for recognition or disclosure in the financial statements through December 23, 2016, the date the financial statements were available to be issued. Management's review discovered no subsequent events that should be recognized or that are deemed significant enough for disclosure.