

OPERATION KINDNESS

Financial Statements
with
Independent Auditor's Report

June 30, 2017 and 2016



OPERATION KINDNESS

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Operation Kindness
Carrollton, Texas

We have audited the accompanying financial statements of Operation Kindness (a Texas not-for-profit corporation) (the Organization), which are comprised of the statement of financial position as of June 30, 2017, and the related statements of activities, functional expenses 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 Operation Kindness as of June 30, 2017, 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.

Other Matter - 2016 Financial Statements

The financial statements as of and for the year ended June 30, 2016 were audited by Travis Wolff LLP, whose practice became part of Armanino^{LLP} as of January 1, 2017, and whose report dated December 23, 2016, expressed an unmodified opinion on those statements.

Armanino LLP

Certified Public Accountants
March 8, 2017
Dallas, Texas

OPERATION KINDNESS
 Statements of Financial Position
 June 30, 2017 and 2016

	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents-unrestricted	\$ 4,035,243	\$ 1,857,145
Certificates of deposit	-	200,046
Investments, at fair value	746,974	2,520,601
Other receivables	1,275	647
Prepaid expenses	48,749	53,036
	4,832,241	4,631,475
Total current assets		
Restricted cash - acquisition of property	315,751	-
Other investments	5,486	5,486
Property and equipment, net	1,942,518	1,891,909
	7,095,996	6,528,870
Total assets	\$ 7,095,996	\$ 6,528,870
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 148,743	\$ 100,558
Accrued liabilities	38,309	27,221
	187,052	127,779
Total current liabilities		
Net assets:		
Unrestricted net assets	6,728,918	6,322,572
Temporarily restricted net assets	180,026	78,519
	6,908,944	6,401,091
Total net assets		
Total liabilities and net assets	\$ 7,095,996	\$ 6,528,870

See accompanying notes to financial statements.

OPERATION KINDNESS
 Statements of Activities
 Years Ended June 30, 2017 and 2016

	2017	2016
Change in unrestricted net assets:		
Revenues and support:		
Contributions	\$ 3,246,786	\$ 2,770,187
In-kind donations	223,567	185,748
Adoption income	741,323	717,977
Event income	526,921	474,201
Merchandise income	9,720	10,598
Other income	199,507	159,982
Interest and dividend income	46,281	48,262
Realized gain on sale of investments, net	249,541	50,309
Unrealized loss on investments, net	(52,901)	(110,292)
Loss on sale of property and equipment	(16,074)	-
Net assets released from restrictions	48,543	30,000
	5,223,214	4,336,972
Expenses:		
Program - animal care	3,300,700	2,964,884
Management and administration	453,582	371,698
Fundraising	1,062,586	920,410
	4,816,868	4,256,992
Change in unrestricted net assets	406,346	79,980
Change in temporarily restricted net assets:		
Contributions	150,029	-
Interest income	21	25
Net assets released from restrictions	(48,543)	(30,000)
	101,507	(29,975)
Change in temporarily restricted net assets	101,507	(29,975)
Change in net assets	507,853	50,005
Net assets at beginning of year	6,401,091	6,351,086
Net assets at end of year	\$ 6,908,944	\$ 6,401,091

See accompanying notes to financial statements.

OPERATION KINDNESS
Statement of Functional Expenses
Year Ended June 30, 2017

	<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	\$ 1,581,482	\$ 258,184	\$ 305,168	\$	2,144,834
Employee benefits	278,868	34,858	34,858		348,584
Payroll taxes	121,054	19,390	23,277		163,721
Professional fees	11,398	96,331	16,578		124,307
Supplies	11,718	1,978	1,978		15,674
Utilities and telephone	65,927	7,561	8,747		82,235
Postage/shipping/letter production	108	992	202,281		203,381
Occupancy	8,240	1,231	1,331		10,802
Equipment rental and maintenance	1,507	1,553	8,532		11,592
Merchandise for resale	-	-	5,238		5,238
Printing and publications	3,703	1,524	15,570		20,797
Travel	2,124	573	1,682		4,379
Conference and conventions	10,292	520	1,040		11,852
Direct animal care	863,222	-	-		863,222
Bank and credit card fees	11,829	3,840	27,600		43,269
Advertising	7,070	393	116,028		123,491
Dues and subscriptions	2,009	701	-		2,710
Office expense/technology	59,145	11,771	30,634		101,550
Building repairs and maintenance	40,176	-	-		40,176
Insurance	34,117	2,339	-		36,456
Vehicle expense	6,133	-	-		6,133
Uniforms and badges	9,166	-	-		9,166
Other expenses	17,314	5,788	33,197		56,299
Direct event expenses	-	-	157,905		157,905
Depreciation and amortization	154,098	4,055	4,055		162,208
Capital Campaign	-	-	66,887		66,887
Total expenses	\$ 3,300,700	\$ 453,582	\$ 1,062,586	\$	4,816,868

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
Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ 507,853	\$ 50,005
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	162,208	156,632
Value of contributed securities	(5,657)	-
Realized gain on sale of investments, net	(249,541)	(50,309)
Unrealized loss on investments, net	52,901	110,292
Loss on sale of property and equipment	16,074	-
Contributions restricted for capital	(315,751)	-
Change in operating assets and liabilities:		
Other receivables	(628)	732
Prepaid expenses	4,287	(5,951)
Accounts payable	48,185	(14,819)
Accrued liabilities	11,088	8,128
	<u>231,019</u>	<u>254,710</u>
Cash flows from investing activities:		
Purchases of investments	(3,701,710)	(365,051)
Proceeds from sale of investments	5,677,634	316,333
Purchases of certificates of deposit, net	-	(200,046)
Proceeds from sale of certificates of deposit	200,046	-
Purchases of property and equipment	(228,891)	(65,728)
	<u>1,947,079</u>	<u>(314,492)</u>
Cash flows from financing activities:		
Proceeds from contributions restricted for capital	315,751	-
	<u>315,751</u>	-
Net increase (decrease) in cash and cash equivalents	2,493,849	(59,782)
Cash and cash equivalents at beginning of year	1,857,145	1,916,927
Cash and cash equivalents at end of year	\$ <u>4,350,994</u>	\$ <u>1,857,145</u>
Supplemental disclosure of cash flow information:		
Cash and cash equivalents	\$ 4,035,243	\$ 1,857,145
Restricted cash	315,751	-
Total cash and cash equivalents	\$ <u>4,350,994</u>	\$ <u>1,857,145</u>

See accompanying notes to financial statements.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2017 and 2016

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, 2017 and 2016.

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. Cash and cash equivalents restricted or designated for capital asset purchases or debt reduction are classified as restricted cash within noncurrent assets in the accompanying statements of financial position.

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 2017 was 57% in equities, 42% in bonds, and 1% in alternative investments. In April 2017, BNY Mellon began managing the investment assets for the Organization. Approximately \$4,000,000 was liquidated and transferred to BNY Mellon. A large part of the cash transferred had not been reinvested as of June 30, 2017, causing the allocation of investments compared to cash to not be comparable to amounts at June 30, 2016. As of September 2017, the cash transferred to BNY Mellon has been invested according to investment policy.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2017 and 2016

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, 2017 and 2016

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	3-5 years
Furniture and fixtures	8 years
Vehicles	3 - 5 years
Equipment	5 - 15 years
Buildings and improvements	10 - 39 years

Depreciation expense was \$162,208 in fiscal year 2017 and \$156,632 in fiscal year 2016.

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, 2017 and 2016

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>2017</u>	<u>2016</u>
Buildings and improvements	\$ 2,580,666	\$ 2,554,505
Construction in progress	144,128	45,205
Computers and software	162,376	160,056
Office furniture, fixtures and equipment	24,145	24,145
Cages	208,458	193,693
Medical equipment	149,474	140,598
Vehicles	117,118	117,118
Other furniture and equipment	125,874	111,415
Intangible Asset	38,950	-
	<u>3,551,189</u>	<u>3,346,735</u>
Total property and equipment		
Less accumulated depreciation	(1,822,267)	(1,668,422)
Land	<u>213,596</u>	<u>213,596</u>
Total property and equipment, net	\$ <u>1,942,518</u>	\$ <u>1,891,909</u>

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2017 and 2016

Note 3 - Net Assets

Net assets consist of the following:

	2017	2016
Unrestricted:		
Undesignated	\$ 6,453,167	\$ 6,322,572
Board designated-capital campaign	275,751	-
	6,728,918	6,322,572
Total unrestricted net assets		
Reward for capture of individuals guilty of cruelty to animals	8,549	8,589
Grants reserve	146,477	69,930
Capital campaign	25,000	-
	180,026	78,519
Total temporarily restricted net assets		
Total net assets	\$ 6,908,944	\$ 6,401,091

Net assets released from restrictions consist of the following:

Grants reserve	\$ 48,543	\$ 30,000
Total net assets released from restrictions	\$ 48,543	\$ 30,000

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 \$22,060 and \$17,720 in 2017 and 2016, respectively.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2017 and 2016

Note 5 - Fair Value Measurement

The fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2017 and 2016 is as follows:

	<u>Fair Value</u>		<u>Level 1</u>		<u>Level 2</u>		<u>Level 3</u>
June 30, 2017:							
Equity mutual funds	\$ 430,955	\$	430,955	\$	-	\$	-
Fixed income securities	316,019		-		316,019		-
Investment in partnerships	5,486		-		-		5,486
Total	\$ 752,460	\$	430,955	\$	316,019	\$	5,486
	<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	5,486		-		-		5,486
Total	\$ 2,526,087	\$	2,520,601	\$	-	\$	5,486

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, as of June 30, 2017 and 2016.

Note 6 - Concentrations

In 2017, one contributor provided support to the Organization exceeding ten percent of total contributions. Contribution from this donor equaled approximately 11 percent of 2017 contributions. No contributor provided support to the Organization exceeding ten percent of total contribution in 2016.

The Organization maintains its cash and cash equivalents in bank accounts which, at times, exceed federally insured limits. As of June 30, 2017, uninsured balances totaled \$887,533. As of June 30, 2016, uninsured balances total \$1,346,756. 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.

OPERATION KINDNESS
Notes to Financial Statements
June 30, 2017 and 2016

Note 7 - Commitments and Contingencies

The Organization leases office space and equipment under non-cancellable operating lease agreements. Rent expense associated with these lease agreements is \$1,640 during the year ended June 30, 2017. There were no long-term leases in 2016. The following represents the remaining future minimum lease payments under these leases as of June 30, 2017:

	<u>Amount</u>
Years ending June 30:	
2018	\$ 62,002
2019	<u>22,782</u>
Total future minimum lease payments	\$ <u>84,784</u>

Note 8 - Subsequent Events

Management has evaluated subsequent events for recognition or disclosure in the financial statements through March 8, 2017, 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.