



Financial Statements  
January 31, 2016

**PetSmart Charities, Inc.**

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## Independent Auditor's Report

To the Board of Directors  
PetSmart Charities, Inc.  
Phoenix, Arizona

### Report on the Financial Statements

We have audited the accompanying financial statements of PetSmart Charities, Inc., which comprise the statement of financial position as of January 31, 2016, and the related statements of activities and changes in net assets, 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 PetSmart Charities, Inc. as of January 31, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Report on Summarized Comparative Information**

We have previously audited the PetSmart Charities, Inc. 2015 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated July 9, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended February 1, 2015 is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Eide Bailly LLP*

Phoenix, Arizona  
June 30, 2016

PetSmart Charities, Inc.  
Statement of Financial Position  
January 31, 2016

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

|  | January 31,<br>2016 | February 1,<br>2015 |
|--|---------------------|---------------------|
| <b>Assets</b>                                |                     |                     |
| Cash and cash equivalents                    | \$ 7,797,652        | \$ 3,410,781        |
| Investments                                  | 31,189,154          | 31,921,448          |
| Receivable from PetSmart, Inc.               | 3,089,817           | 2,931,986           |
| Receivable from PetSmart Charities of Canada | 101,040             | 82,476              |
| Other receivables                            | -                   | 219,835             |
| Other assets                                 | 614,565             | 269,679             |
| Total current assets                         | 42,792,228          | 38,836,205          |
| Property and equipment, net                  | 4,234,633           | 5,038,712           |
| Total assets                                 | \$ 47,026,861       | \$ 43,874,917       |
| <b>Liabilities and Net Assets</b>            |                     |                     |
| <b>Liabilities</b>                           |                     |                     |
| Accounts payable and accrued expenses        | \$ 3,311,978        | \$ 3,567,423        |
| Due to PetSmart, Inc.                        | 2,489,625           | 731,482             |
| Due to PetSmart Charities of Canada          | 252                 | 11,324              |
| Deferred revenue                             | -                   | 12,500              |
| Total current liabilities                    | 5,801,855           | 4,322,729           |
| <b>Net Assets</b>                            |                     |                     |
| Unrestricted                                 | 41,199,606          | 39,002,919          |
| Temporarily restricted                       | 25,400              | 549,269             |
| Total net assets                             | 41,225,006          | 39,552,188          |
| Total liabilities and net assets             | \$ 47,026,861       | \$ 43,874,917       |

PetSmart Charities, Inc.  
Statement of Activities and Changes in Net Assets  
January 31, 2016

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

|   | Unrestricted         | Temporarily<br>Restricted | Totals               |                      |
|---|----------------------|---------------------------|----------------------|----------------------|
|   |                      |                           | January 31,<br>2016  | February 1,<br>2015  |
| Revenue, Public Support, and Gains:   |                      |                           |                      |                      |
| Individual contributions  | \$ 44,572,650        | \$ 37,000                 | \$ 44,609,650        | \$ 40,583,460        |
| PetSmart, Inc. contributions (including<br>contributed rent, goods and services,<br>royalty income, and sponsorships) | 16,644,407           | -                         | 16,644,407           | 17,395,670           |
| Corporate, foundations, and vendor<br>contributions   | 2,383,381            | -                         | 2,383,381            | 3,979,513            |
| Investment income (loss), net   | (949,124)            | -                         | (949,124)            | 2,019,615            |
| Revenue, public support, and gains  | <u>62,651,314</u>    | <u>37,000</u>             | <u>62,688,314</u>    | <u>63,978,258</u>    |
| Special events:   |                      |                           |                      |                      |
| Special events revenue  | 1,054,700            | -                         | 1,054,700            | 1,460,975            |
| Less costs of direct donor benefits   | (197,492)            | -                         | (197,492)            | (263,239)            |
| Gross profit on special events  | <u>857,208</u>       | <u>-</u>                  | <u>857,208</u>       | <u>1,197,736</u>     |
| Net assets released from restrictions   | <u>560,869</u>       | <u>(560,869)</u>          | <u>-</u>             | <u>-</u>             |
| Total revenue, public support, and gains  | <u>64,069,391</u>    | <u>(523,869)</u>          | <u>63,545,522</u>    | <u>65,175,994</u>    |
| Expenses:   |                      |                           |                      |                      |
| Program services:   |                      |                           |                      |                      |
| Adoptions   | 26,142,059           | -                         | 26,142,059           | 30,311,792           |
| Spay/neuter   | 20,869,980           | -                         | 20,869,980           | 19,579,248           |
| Rescue Waggin'® program   | 7,793,064            | -                         | 7,793,064            | 5,781,430            |
| Emergency relief and other  | 2,075,376            | -                         | 2,075,376            | 3,313,387            |
| Total program services  | <u>56,880,479</u>    | <u>-</u>                  | <u>56,880,479</u>    | <u>58,985,857</u>    |
| Supporting services:  |                      |                           |                      |                      |
| Fundraising   | 2,673,540            | -                         | 2,673,540            | 3,216,437            |
| Management and general  | 2,318,685            | -                         | 2,318,685            | 2,176,991            |
| Total support services  | <u>4,992,225</u>     | <u>-</u>                  | <u>4,992,225</u>     | <u>5,393,428</u>     |
| Total expenses  | <u>61,872,704</u>    | <u>-</u>                  | <u>61,872,704</u>    | <u>64,379,285</u>    |
| Change in Net Assets  | <u>2,196,687</u>     | <u>(523,869)</u>          | <u>1,672,818</u>     | <u>796,709</u>       |
| Net Assets, Beginning of Year   | <u>39,002,919</u>    | <u>549,269</u>            | <u>39,552,188</u>    | <u>38,755,479</u>    |
| Net Assets, End of Year   | <u>\$ 41,199,606</u> | <u>\$ 25,400</u>          | <u>\$ 41,225,006</u> | <u>\$ 39,552,188</u> |

**PetSmart Charities, Inc.**  
**Statement of Functional Expenses**  
**January 31, 2016**

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

|  | Program Services     |                      |                     |                            | Supporting Services  |                     |                        | Total               |                      |                      |
|--|----------------------|----------------------|---------------------|----------------------------|----------------------|---------------------|------------------------|---------------------|----------------------|----------------------|
|  | Adoptions            | Spay/Neuter          | Rescue Waggin®      | Emergency Relief and Other | Total                | Fundraising         | Management and General | Total               | January 31, 2016     | February 1, 2015     |
| Grants and allocations   | \$ 7,711,282         | \$ 18,023,977        | \$ 2,820,316        | \$ 716,941                 | \$ 29,272,516        | \$ -                | \$ -                   | \$ -                | \$ 29,272,516        | \$ 31,334,739        |
| Donated services   | 11,561,414           | 872,244              | 822,495             | 434,149                    | 13,690,302           | 756,728             | 1,004,962              | 1,761,690           | 15,451,992           | 15,393,482           |
| Management services  | 2,973,300            | 1,410,084            | 1,295,236           | 701,852                    | 6,380,472            | 386,672             | 494,479                | 881,151             | 7,261,623            | 6,032,461            |
| Advertising  | 1,938,977            | 116,274              | 38,207              | 22,416                     | 2,115,874            | 21,491              | -                      | 21,491              | 2,137,365            | 4,029,250            |
| Other professional services  | -                    | -                    | 2,417,191           | -                          | 2,417,191            | -                   | -                      | -                   | 2,417,191            | 2,137,503            |
| Consulting   | 514,224              | 269,053              | 129,892             | 57,280                     | 970,449              | 288,789             | 232,114                | 520,903             | 1,491,352            | 1,595,375            |
| Office expenses  | 47,566               | 22,558               | 20,721              | 11,228                     | 102,073              | 43,031              | 83,627                 | 126,658             | 228,731              | 223,535              |
| Supplies   | 11,734               | -                    | -                   | -                          | 11,734               | -                   | -                      | -                   | 11,734               | 26,135               |
| Printing and publications  | -                    | -                    | -                   | -                          | -                    | 194,203             | -                      | 194,203             | 194,203              | 390,147              |
| Depreciation   | 1,175,876            | 17,800               | 43,787              | 14,228                     | 1,251,691            | 14,848              | 52,755                 | 67,603              | 1,319,294            | 1,141,703            |
| Bank fees  | -                    | -                    | -                   | -                          | -                    | 520,556             | -                      | 520,556             | 520,556              | 486,178              |
| Postage and shipping   | -                    | 42,893               | 2,850               | 16,829                     | 62,572               | 194,669             | -                      | 194,669             | 257,241              | 260,564              |
| Information technology   | 100,918              | 47,860               | 43,962              | 23,822                     | 216,562              | 183,262             | 103,618                | 286,880             | 503,442              | 293,231              |
| Conferences, conventions, and meetings   | 7,747                | 10,341               | 124,519             | 1,829                      | 144,436              | 3,746               | 51,109                 | 54,855              | 199,291              | 435,381              |
| Travel   | 77,793               | 36,896               | 33,888              | 19,308                     | 167,885              | 22,138              | 42,984                 | 65,122              | 233,007              | 295,636              |
| Special event costs  | -                    | -                    | -                   | -                          | -                    | 240,899             | -                      | 240,899             | 240,899              | 291,767              |
| Equipment rental and maintenance   | 21,228               | -                    | -                   | 55,494                     | 76,722               | -                   | -                      | -                   | 76,722               | 72,359               |
| Legal fees   | -                    | -                    | -                   | -                          | -                    | -                   | 218,637                | 218,637             | 218,637              | 163,005              |
| Accounting fees  | -                    | -                    | -                   | -                          | -                    | -                   | 34,400                 | 34,400              | 34,400               | 40,073               |
| <b>Total expenses</b>  | <b>26,142,059</b>    | <b>20,869,980</b>    | <b>7,793,064</b>    | <b>2,075,376</b>           | <b>56,880,479</b>    | <b>2,871,032</b>    | <b>2,318,685</b>       | <b>5,189,717</b>    | <b>62,070,196</b>    | <b>64,642,524</b>    |
| Less expenses included with revenues on the statement of activities special events   | -                    | -                    | -                   | -                          | -                    | (197,492)           | -                      | (197,492)           | (197,492)            | (263,239)            |
| <b>Total expenses included in the expense section on the statement of activities</b> | <b>\$ 26,142,059</b> | <b>\$ 20,869,980</b> | <b>\$ 7,793,064</b> | <b>\$ 2,075,376</b>        | <b>\$ 56,880,479</b> | <b>\$ 2,673,540</b> | <b>\$ 2,318,685</b>    | <b>\$ 4,992,225</b> | <b>\$ 61,872,704</b> | <b>\$ 64,379,285</b> |

PetSmart Charities, Inc.

Statement of Cash Flows

January 31, 2016

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

|   | January 31<br>2016   | February 1,<br>2015  |
|---|----------------------|----------------------|
| Cash Flows from Operating Activities  |                      |                      |
| Change in net assets  | \$ 1,672,818         | \$ 796,709           |
| Adjustments to reconcile change in net assets to net cash provided by operating activities        |                      |                      |
| Stock donation  | (29,419)             | (12,715)             |
| Proceeds from sale of stock donation  | 28,823               | 12,538               |
| Realized gains on investments   | (419,421)            | (469,196)            |
| Unrealized (gains) losses on investments  | 1,842,240            | (886,568)            |
| Depreciation  | 1,319,294            | 1,141,703            |
| Loss on disposal of assets  | -                    | 9,367                |
| Changes in operating assets and liabilities:  |                      |                      |
| Decrease (increase) in:   |                      |                      |
| Receivable from PetSmart, Inc.  | (157,831)            | 86,174               |
| Receivable from PetSmart Charities of Canada  | (18,564)             | (21,347)             |
| Other receivables   | 219,835              | 4,926                |
| Other assets  | (344,886)            | (45,638)             |
| Increase (decrease) in:   |                      |                      |
| Accounts payable and accrued expenses   | (255,445)            | 511,880              |
| Due to PetSmart, Inc.   | 1,758,143            | 104,556              |
| Due to PetSmart Charities of Canada   | (11,072)             | 10,169               |
| Deferred revenue  | (12,500)             | 12,500               |
| Net Cash from Operating Activities  | <u>5,592,015</u>     | <u>1,255,058</u>     |
| Cash Flows from Investing Activities  |                      |                      |
| Proceeds from sale of investments   | 39,351,611           | 13,552,171           |
| Purchase of investments   | (40,041,540)         | (10,803,223)         |
| Purchase of property and equipment  | <u>(515,215)</u>     | <u>(2,062,982)</u>   |
| Net Cash (used for) from Investing Activities   | <u>(1,205,144)</u>   | <u>685,966</u>       |
| Net Increase in Cash  | 4,386,871            | 1,941,024            |
| Cash, Beginning of Year   | <u>3,410,781</u>     | <u>1,469,757</u>     |
| Cash, End of Year   | <u>\$ 7,797,652</u>  | <u>\$ 3,410,781</u>  |
| Non-Cash Transactions   |                      |                      |
| PetSmart, Inc. contributions (including contributed rent, goods and services, and royalty income) | \$ 15,017,672        | \$ 15,342,949        |
| Corporate and vendor contributions (including sponsorship and royalty income)                     | <u>1,743,535</u>     | <u>2,052,721</u>     |
| Total   | <u>\$ 16,761,207</u> | <u>\$ 17,395,670</u> |

## Note 1 - Nature of Operations

PetSmart Charities, Inc. (“PetSmart Charities” or “Organization”) is a nonprofit animal welfare organization that saves the lives of homeless pets. Founded in 1994, the Organization envisions a world in which every pet has a lifelong, loving home. The Organization’s mission is to find lifelong, loving homes for all pets by supporting programs and thought leadership that bring people and pets together.

More than 490,000 dogs and cats find homes each year through the Organization’s adoption program in most of the 1,300 plus PetSmart® stores (the PetSmart stores are owned and operated by PetSmart, Inc. (“PetSmart”), a retailer of pet food, pet supplies, accessories and professional pet services throughout North America), and sponsored adoption events. PetSmart Charities grants more money to directly help pets in need than any other animal welfare group in North America, with a focus on funding spay/neuter services that help communities solve pet overpopulation. PetSmart Charities is a 501(c)(3) organization, independent from PetSmart, Inc.

The Organization’s major program areas include:

- **Adoptions** - PetSmart Charities is a leader in pet adoptions. Most of the 1,300 plus PetSmart stores host PetSmart Charities Cat Adoption Centers and more than twenty stores have PetSmart Charities Everyday Dog and Cat Adoption Centers. PetSmart Charities also sponsors events like National Adoption Weekend and community-wide adoption events.
- **Spay/Neuter** - PetSmart Charities provides millions of dollars in grants annually that help spay/neuter clinics and animal welfare groups to perform more surgeries and educate communities.
- **Rescue Waggin’® Program** - PetSmart Charities’ Rescue Waggin’® program saves thousands of lives every year by relocating homeless pets from shelters in overpopulated communities to adoption centers in areas where dogs and puppies are in high demand.
- **Emergency Relief** - PetSmart Charities’ Emergency Relief program delivers much-needed supplies to animal rescue groups saving pets from large-scale man-made and natural disasters.

## Note 2 - Summary of Significant Accounting Policies

The Financial Accounting Standards Board (the “FASB”) sets generally accepted accounting principles in the United States of America (“GAAP”) to ensure consistent reporting. References to GAAP issued by the FASB in the accompanying footnotes are to the FASB Accounting Standards Codification (the “ASC”).

### Basis of Presentation

The accompanying financial statements are presented in accordance with FASB ASC 958, *Not-For-Profit Organizations*. Under FASB ASC 958-205, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Temporarily restricted net assets are those whose use by the Organization has been limited by donors to a specific time period or purpose. Permanently restricted net assets are restricted by donors to be maintained by the Organization in perpetuity. There were no permanently restricted net assets at January 31, 2016 and February 1, 2015.

### **Prior-Year Summarized Information**

The accompanying financial statements include certain prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended February 1, 2015, from which the summarized information was derived.

### **Fiscal Year**

The Organization's fiscal year ends on the Sunday nearest January 31st. The fiscal years ended in 2016 and 2015 comprised of 52 weeks.

### **Management's Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

### **Cash and Cash Equivalents**

Cash includes cash deposits in banks. The Organization considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents. Deposits at each financial institution are insured in limited amounts by the Federal Deposit Insurance Corporation ("FDIC"). There was approximately \$7,500,000 of uninsured deposits as of January 31, 2016. The Organization's cash accounts were placed with high credit quality financial institutions, and accordingly, the Organization does not expect to experience non-performance.

### **Other Receivables**

Other receivables consist of a qualified sponsorship and accrued interest on investments at February 01, 2015. Other receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Management considers other receivables to be fully collectible, and accordingly, an allowance for doubtful accounts is not considered necessary at January 31, 2016 and February 1, 2015.

### Property and Equipment and Related Depreciation

Purchased property and equipment is recorded at cost. Donated property and equipment is recorded at fair value at the date of contribution to the Organization. Maintenance and repairs are charged to operations when incurred. Betterments or renewals in excess of \$3,000 and which have a useful life greater than one year are capitalized. When property and equipment is sold or otherwise disposed of, the asset and related accumulated depreciation accounts are relieved, and any gain or loss is included in operations. Depreciation is computed using the straight-line method over the following estimated useful lives:

|                        | <u>Estimated<br/>Useful Lives</u> |
|------------------------|-----------------------------------|
| Store fixtures         | 3 - 7 years                       |
| Software               | 3 years                           |
| Computers              | 3 years                           |
| Leasehold improvements | 3 - 14 years                      |

### Impairment of Long-Lived Assets

The Organization accounts for long-lived assets in accordance with the provisions of FASB ASC 360, *Property, Plant, and Equipment*. FASB ASC 360 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No impairment charges were recorded in fiscal years ended January 31, 2016 and February 1, 2015.

### Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP has established a framework for measuring fair value and established a fair value hierarchy based on the inputs used to measure fair value. This framework maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

**Level 1** - Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

**Level 2** - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.

**Level 3** - Securities that have little to no pricing observability as of the report date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors.

### **Contributions**

The Organization accounts for contributions in accordance with FASB ASC 958-605, *Not-for-Profit Entities – Revenue Recognition*. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Contributions with temporary restrictions that are received and used within the year are included in unrestricted activities. When a 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 accompanying statement of activities and changes in net assets as net assets released from restrictions.

The Organization also accepts assets from a donor where it agrees to use those assets on behalf of another specified beneficiary. These transactions do not impact the Organization's recognition of revenues or expenses unless it has variance power or is financially interrelated to the specified beneficiary. Therefore, these assets are not recognized as a contribution but as a liability until remitted to the specified beneficiary. For the years ended January 31, 2016 and February 1, 2015, the Organization remitted \$233,169 and \$244,376, respectively, to other specified beneficiaries for which it did not recognize a contribution or expense in its financial statements. As of January 31, 2016 and February 1, 2015, the Organization held \$99,418 and \$82,928 respectively, recorded in accounts payable and accrued expenses.

### **Contributed Goods and Services**

Contributed materials and store space that would otherwise have to be purchased is recognized in accordance with FASB ASC 958-605 as revenue and a corresponding expense. Contributed services are recognized as contributions in accordance with FASB ASC 958-605 if the services (a) create or enhance nonfinancial assets, or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased. For the years ended January 31, 2016 and February 1, 2015, the Organization recorded contributed rent, goods and services of \$14,664,035 and \$15,042,059 from PetSmart Inc., respectively. Refer to Note 5 for more details on the relationship between the Organization and PetSmart, Inc.

For the years ended January 31, 2016 and February 1, 2015, the Organization received goods and services of \$788,940 and \$2,052,721, respectively, and primarily relates to pet food supplies and advertising from entities other than PetSmart, Inc. Contributed goods are reported as contributions in the financial statements at their estimated fair value at date of receipt. Contributed services are reported in the financial statements at the fair value of the services received. The contribution of services is recognized if the service received creates or enhances nonfinancial assets or requires specialized skills that are provided by individuals possessing those skills that would typically need to be purchased if not provided by donation.

### **Special Events Revenue**

The Organization conducts special events in which a portion of the gross proceeds paid by the participant represents payment for the direct cost of the benefits received by the participant at the event. Unless a verifiable, objective means exists to demonstrate otherwise, the fair value of meals and entertainment provided at special events is measured at the actual cost to the Organization. The direct costs of the special events, which ultimately benefit the donor rather than the Organization, are recorded as costs of direct donor benefits in the accompanying statement of activities and changes in net assets.

### **Royalty Revenue**

The Organization earns royalty income from certain campaigns in which intellectual property of the Organization is licensed.

### **Functional Expenses**

The costs of providing the various programs and other activities of the organization have been summarized on a functional basis in the accompanying statement of activities and changes in net assets.

### **Advertising**

Advertising costs are charged to operations when incurred. Advertising expense charged to operations was \$2,137,365 and \$4,029,250 for fiscal years ended January 31, 2016 and February 1, 2015, respectively.

### **Income Tax Status**

The Organization has been recognized by the Internal Revenue Services as a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and is exempt from federal and state income taxes. In addition, the Organization qualifies for the charitable contribution deduction under Section 170 of the Code and has been recognized by the Internal Revenue Service as an organization that is not a private foundation. Income determined to be unrelated business income ("UBI") would be taxable.

The Organization evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts. Management must also assess whether uncertain tax positions could result in the recognition of a liability for possible interest and penalties if any. The Organization's policy is to include interest and penalties related to uncertain tax positions in management and general expense. As of January 31, 2016 and February 1, 2015, there were no uncertain tax positions, and the Organization does not anticipate a change in its tax position in the 12 months following January 31, 2016.

### **Note 3 - Investments**

The Organization accounts for its investments in accordance with FASB ASC 958-320, *Not-for-Profit Entities – Investments – Debt and Equity Securities*. Under FASB ASC 958-320, the Organization reports investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value.

The fair values are based on quoted market prices.

PetSmart Charities, Inc.

Notes to Financial Statements

January 31, 2016

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

Investments consist of:

|                                 | January 31,<br>2016  | February 1,<br>2015  |
|---------------------------------|----------------------|----------------------|
| Equities                        | \$ -                 | \$ 11,727,199        |
| Mutual funds                    | 29,967,512           | 5,847,610            |
| Corporate bonds                 | -                    | 3,109,373            |
| US treasuries                   | -                    | 5,506,985            |
| US agency mortgage pass-through | -                    | 2,974,630            |
| Investments subtotal            | <u>29,967,512</u>    | <u>29,165,797</u>    |
| Money market fund               | <u>1,221,642</u>     | <u>2,755,651</u>     |
| Total investments               | <u>\$ 31,189,154</u> | <u>\$ 31,921,448</u> |

Investment income consists of:

|  | January 31,<br>2016 | February 1,<br>2015 |
|--|---------------------|---------------------|
| Unrealized gains (losses) on investments | \$ (1,842,240)      | \$ 886,568          |
| Realized gains on investments            | 419,421             | 469,196             |
| Interest and dividend income             | 662,051             | 893,416             |
| Investment fees                          | <u>(188,356)</u>    | <u>(229,565)</u>    |
| Total investment income, net             | <u>\$ (949,124)</u> | <u>\$ 2,019,615</u> |

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

The following table summarizes the valuation of the Organization's financial instruments by the categories described in Note 2 as of January 31, 2016:

|                   | Level 1              | Level 2     | Level 3     | Total                |
|-------------------|----------------------|-------------|-------------|----------------------|
| Mutual funds      | \$ 29,967,512        | \$ -        | \$ -        | \$ 29,967,512        |
| Money market fund | <u>1,221,642</u>     | <u>-</u>    | <u>-</u>    | <u>1,221,642</u>     |
| Total             | <u>\$ 31,189,154</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 31,189,154</u> |

(With Summarized Comparative Totals for the Year Ended February 1, 2015)

The following table summarizes the valuation of the Organization's financial instruments by the categories described in Note 2 as of February 1, 2015:

|                                 | <u>Level 1</u>              | <u>Level 2</u>     | <u>Level 3</u>     | <u>Total</u>                |
|---------------------------------|-----------------------------|--------------------|--------------------|-----------------------------|
| Equities                        | \$ 11,727,199               | \$ -               | \$ -               | \$ 11,727,199               |
| Mutual funds                    | 5,847,610                   | -                  | -                  | 5,847,610                   |
| Corporate bonds                 | 3,109,373                   | -                  | -                  | 3,109,373                   |
| US treasuries                   | 5,506,985                   | -                  | -                  | 5,506,985                   |
| US agency mortgage pass-through | 2,974,630                   | -                  | -                  | 2,974,630                   |
| Money market fund               | 2,755,651                   | -                  | -                  | 2,755,651                   |
| <b>Total</b>                    | <b><u>\$ 31,921,448</u></b> | <b><u>\$ -</u></b> | <b><u>\$ -</u></b> | <b><u>\$ 31,921,448</u></b> |

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Organization. The Organization considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Organization's perceived risk of that instrument.

Management determined the valuation inputs for investments in active markets are its quoted prices and therefore, classified these investments as Level 1 within the fair value hierarchy.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although management believes the 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.

#### Note 4 - Property and Equipment

Property and equipment consists of:

|                                    | <u>January 31,<br/>2016</u> | <u>February 1,<br/>2015</u> |
|------------------------------------|-----------------------------|-----------------------------|
| Cost or donated value:             |                             |                             |
| Store fixtures                     | \$ 536,704                  | \$ 536,704                  |
| Software                           | 749,360                     | 749,360                     |
| Computers                          | 78,118                      | 46,118                      |
| Leasehold improvements             | 7,627,300                   | 7,144,085                   |
| Total cost or donated value        | <u>8,991,482</u>            | <u>8,476,267</u>            |
| Less accumulated depreciation      | <u>(4,756,849)</u>          | <u>(3,437,555)</u>          |
| <b>Property and equipment, net</b> | <b><u>\$ 4,234,633</u></b>  | <b><u>\$ 5,038,712</u></b>  |

The increase in leasehold improvements are attributed to the build-out of Everyday Dog and Cat Adoption Centers within certain PetSmart stores.

Depreciation expense charged to operations was \$1,319,294 for the year ended January 31, 2016 and \$1,141,703 for the year ended February 1, 2015.

**Note 5 - Transactions with PetSmart, Inc. and PetSmart Charities of Canada**

The following amounts have been contributed by PetSmart. The revenue amounts are included in revenue, public support and gains in the accompanying statement of activities and changes in net assets. Contributed rent, goods and services are included in functional expenses under donated services and grants.

|   | January 31,<br>2016  | February 1,<br>2015  |
|---|----------------------|----------------------|
| Contributed rent, goods and services for adoption centers,<br>supplies, office space, utilities, and management personnel | \$ 14,701,035        | \$ 15,042,059        |
| Emergency relief grant supplies   | 154,778              | 300,890              |
| Royalties   | 1,788,594            | 2,052,721            |
|   | <u>\$ 16,644,407</u> | <u>\$ 17,395,670</u> |

The Organization is highly dependent upon the viability of PetSmart as this is the primary source of donated revenue received in the stores from customers and from PetSmart employees. Royalty income is generated on specific campaigns where the Organization receives a percentage of the purchase price on selected merchandise items sold in PetSmart stores that bear its trademark during a certain timeframe. Emergency Relief grant supplies revenue is the difference of fair market value and cost of goods purchased from PetSmart and then granted to animal welfare groups. Receivables from PetSmart of \$3,089,817 and \$2,931,986 at January 31, 2016 and February 1, 2015, respectively, represent cash contributions received from PetSmart customers and PetSmart employees not yet remitted in cash to the Organization as of the fiscal year-end dates.

The Organization entered into a management services agreement with PetSmart to cost-effectively outsource certain business and administrative management services. The fees paid to PetSmart are capped annually and the value of contributed rent, services, products and supplies received by the Organization under the agreement overwhelmingly exceeds the payments made to PetSmart.

The Organization incurred approximately \$7,400,000 and \$6,200,000 of expenses under the management services agreement for the years ended January 31, 2016 and February 1, 2015, respectively. At January 31, 2016 and February 1, 2015, the Organization had \$2,489,625 and \$731,482, respectively, due to PetSmart for reimbursable expenses and management services.

In addition to providing space, supplies and labor in the adoption centers in the stores, PetSmart also supplies the Organization with items such as office supplies, postage and travel services, which are reimbursed by the Organization on a monthly basis.

The Organization entered into a formal management services agreement with PetSmart Charities of Canada (“PCC”) consistent with prior years’ practice of providing business management, finance, strategy and other services. Receivables from PCC of \$101,040 at January 31, 2016 and \$82,476 at February 1, 2015, respectively, represent management fees billed quarterly and miscellaneous reimbursable costs.

At January 31, 2016 and February 1, 2015, the Organization had \$252 and \$11,324, respectively, due to PCC for reimbursable revenue and other items.

Management provides for probable uncollectible receivables through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to receivables. Management considers the PetSmart, Inc. and the PetSmart Charities of Canada receivables to be fully collectible as of January 31, 2016 and February 1, 2015, and accordingly, an allowance for doubtful accounts is not considered necessary.

**Note 6 - Temporarily Restricted Net Assets**

Temporarily restricted net assets consist of purpose-restricted contributions from donors as follows:

|   | January 31,<br>2016         | February 1,<br>2015         |
|---|-----------------------------|-----------------------------|
|   | <u>                    </u> | <u>                    </u> |
| Alliance for Companion Animals of Maricopa County | \$ -                        | \$ 536,269                  |
| Rescue Waggin’® Program Heartworm Treatment Fund  | 25,400                      | 13,000                      |
|   | <u>\$ 25,400</u>            | <u>\$ 549,269</u>           |

These amounts are included within cash in the accompanying statement of financial position.

**Note 7 - Commitments and Contingencies**

The Organization makes commitments to certain charitable organizations for future grants, which are contingent future installments of a current grant. The grants are contingent upon the continued fulfillment of the original conditions in the grant request. As of January 31, 2016, the Organization has approximately \$2,384,000 in commitments for future contingent grants.

**Note 8 - Subsequent Events**

The Organization has evaluated subsequent events through June 30, 2016, which is the date these financial statements were available to be issued. Management is not aware of any events that have occurred subsequent to the statement of financial position date that would require adjustment to, or disclosure in, the accompanying financial statements.