HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS

(A Non-Profit Organization)

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2011

GAINER DONNELLY & DESROCHES

HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS
(A Non-Profit Organization)

TABLE OF CONTENTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Houston Society for the Prevention of Cruelty to Animals
Houston, Texas

We have audited the accompanying statement of financial position of Houston Society for the Prevention of Cruelty to Animals (a non-profit organization) (the "Organization") as of December 31, 2011, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Houston Society for the Prevention of Cruelty to Animals' management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Houston Society for the Prevention of Cruelty to Animals as of December 31, 2011, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedule of functional expenses on page 13 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

As discussed in Note 3 to the financial statements, the 2011 financial statements have been restated to correct rent income and various misclassifications of contributions and pledge receivables in prior years.

Gainer Donnelly & Desroches LLP

October 3, 2012

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HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS
(A NONPROFIT ORGANIZATION)
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2011

ASSETS

CURRENT ASSETS:	
Cash and Cash Equivalents	$ 3,044,310
Pledges Receivable, Current	611,966
Other Receivables	286,312
Prepaid Expenses	74,605
Total Current Assets	4,017,193
PROPERTY AND EQUIPMENT:	
Land	10,889,771
Buildings and Improvements	3,632,109
Property Improvements	1,165,846
Equipment	1,156,231
Accumulated Depreciation	(2,869,331)
Property and Equipment, Net	13,974,626
LONG-TERM ASSETS:	
Marketable Securities	17,672,258
Pledges Receivable, Noncurrent	124,750
Total Long-Term Assets	17,797,008
TOTAL ASSETS	$ 35,788,827

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:	
Accounts Payable	$ 268,990
Accrued Payroll and Benefits	86,211
Total Current Liabilities	355,201
LONG-TERM DEBT	3,850,500
TOTAL LIABILITIES	4,205,701
COMMITMENTS AND CONTINGENCIES	
NET ASSETS:	
Unrestricted	24,745,931
Temporarily Restricted	6,837,195
Total Net Assets	31,583,126
TOTAL LIABILITIES AND NET ASSETS	$ 35,788,827

The accompanying notes are an integral part of these financial statements.

HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS
(A NONPROFIT ORGANIZATION)
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2011

	Unrestricted	Temporarily Restricted	Total
REVENUE:			
Adoptions	$ 900,073	$ -	$ 900,073
Admissions	271,486	-	271,486
Contributions	1,068,926	41,610	1,110,536
Online Contributions	611,358	-	611,358
Direct Mail	1,584,152	35	1,584,187
Trusts and Bequests	1,676,283	85,000	1,761,283
Foundations	95,314	19,750	115,064
Capital Campaign	-	491,103	491,103
Fundraising	285,658	-	285,658
Investment Income	275,976	76,965	352,941
Fees for Services	175,520	-	175,520
Other	10,616	-	10,616
Net Assets Released from Restrictions	51,305	(51,305)	-
TOTAL REVENUE	7,006,667	663,158	7,669,825
EXPENSES:			
Program Services	6,542,240	-	6,542,240
Management and General	455,270	-	455,270
Fundraising	712,632	-	712,632
TOTAL EXPENSES	7,710,142	-	7,710,142
CHANGES IN NET ASSETS	(703,475)	663,158	(40,317)
NET ASSETS AT BEGINNING OF YEAR, PREVIOUSLY REPORTED	28,836,536	1,776,047	30,612,583
PRIOR PERIOD ADJUSTMENTS	(3,387,130)	4,397,990	1,010,860
NET ASSETS AT BEGINNING OF YEAR, AS RESTATED	25,449,406	6,174,037	31,623,443
NET ASSETS AT END OF YEAR	$ 24,745,931	$ 6,837,195	$ 31,583,126

The accompanying notes are an integral part of these financial statements.

HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS
(A NONPROFIT ORGANIZATION)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011

CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in Net Assets	$	(40,317)
Adjustments to Reconcile Changes in Net Assets to Net Cash		
Provided by Operating Activities:		
Net Realized and Unrealized Losses on Investments		86,538
Depreciation		319,291
Loss on Disposal of Property and Equipment		12,384
Changes in Operating Assets and Liabilities:		
Pledges Receivable		558,349
Other Receivables		214,032
Prepaid Expenses		(1,148)
Accounts Payable		(216,002)
Accrued Payroll and Benefits		86,211
Net Cash Provided by Operating Activities		1,019,338
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from Sales of Investments		14,946,394
Purchases of Investments		(14,888,038)
Purchases of Property and Equipment		(95,472)
Net Cash Used in Operating Activities		(37,116)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of Long-Term Debt		(326,400)
NET CHANGE IN CASH AND CASH EQUIVALENTS		655,822
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		2,513,238
CASH AND CASH EQUIVALENTS AT END OF YEAR	$	3,169,060
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash Paid for Interest	$	246,294
NONCASH INVESTING ACTIVITIES:		
Write-off of Fully Depreciated Property and Equipment	$	107,431

The accompanying notes are an integral part of these financial statements.

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

Houston Society for the Prevention of Cruelty to Animals (the "Organization"), a Texas non-profit organization, was founded in 1924. The Organization is the oldest and largest animal protection agency in the Gulf Coast area, providing sheltering, adoption, humane education, and cruelty relief services to more than 100,000 animals a year. The Organization is funded entirely by donations.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

The Organization's financial records have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted, based on the existence or absence of donor imposed restrictions. The Organization has no permanently restricted net assets as of December 31, 2011.

Cash Equivalents

The Organization considers all highly liquid investments with initial maturities of three months or less at the time of purchase to be cash equivalents.

Pledges Receivable and Unconditional Promises to Give

Pledges receivable and unconditional promises to give are recorded when the Organization receives notification of the pledge or promise to give. Amounts that are expected to be collected within one year are recorded at net realizable value. Amounts that are expected to be collected in future years are discounted to estimate the present value of future cash flows, if material.

Investments

Investments in marketable securities are recorded at fair value. Investment return includes interest, dividends, and realized and unrealized gains or losses. Investment return is reported in the statement of activities and changes in net assets as an increase in unrestricted net assets unless the use of the income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported as an increase in temporarily restricted net assets until expended in accordance with the donor-imposed restrictions.

Concentration of Credit Risk

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

At times throughout the year, the Organization may maintain certain bank accounts in excess of the Federal Deposit Insurance Corporation insured limits. The Organization has not experienced any losses from maintaining cash accounts in excess of the federally insured limit. Management believes that it is not exposed to any significant credit risk on cash accounts due the strength of the financial institutions in which the funds are held.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Property and Equipment

Property and equipment are recorded at cost if purchased, or in the case of donated property, at the estimated fair market value at the date of donation. The Organization capitalizes all expenditures for property and equipment in excess of $1,000. Depreciation is computed by use of the straight-line method for financial reporting purposes. Depreciation is provided by the straight-line method over the following useful lives:

Building and Improvements	30-40 years
Property Improvements	20 years
Equipment	6-10 years

Routine maintenance, repair, renewal and replacement costs are charged against operations in the year incurred. Expenditures, which materially increase values or extend useful lives of property and equipment, are capitalized.

Depreciation expense totaled $319,291 for the year ended December 31, 2011.

Impairment of Long-Lived Assets

The Organization's long-lived assets are evaluated for impairment in accordance with generally accepted accounting principles which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. This review requires significant judgments both in assessing events and circumstances as well as estimating future cash flows. Should events indicate that any of the assets are impaired, the amount of such impairment will be measured as the difference between the carrying value and the fair value of the impaired asset and the impairment will be recorded in earnings during the period of such impairment. Management believes no impairment has occurred with respect to long-lived assets at December 31, 2011.

Fair Value Considerations

The Organization uses fair value to measure certain financial and nonfinancial assets and liabilities. Fair value is defined as the price that would be received to sell and asset or paid to transfer a liability in an orderly transaction between market participants. The fair value hierarchy established and prioritized fair value measurements into three levels based on the nature of the inputs. The hierarchy gives the highest priority to inputs based on market data from independent sources (observable inputs-Level 1) and the lowest priority to a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable (unobservable inputs-Level 3).

The fair value option allows entities to choose, at specified election dates, to measure eligible financial assets and financial liabilities at fair value that are not otherwise required to be measured at fair value. If an organization elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. The Organization did not elect the fair value option for the measurement of any eligible assets or liabilities.

The Organization's remaining financial instruments (primarily cash and cash equivalents, receivables, payables and borrowings) are carried in the accompanying financial statements at amounts which reasonably approximate fair value.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Compensated Absences

Compensated absences for sick, personal, and vacation time have not been accrued since they cannot be reasonably estimated. The Organization's policy is to recognize these costs when actually paid.

Donated Services

The Organization recognizes donated services at their fair value in the period received if the services received create or enhance nonfinancial assets that require specialized skills and are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. The Organization recognized no donated services during the year ended December 31, 2011.

A substantial number of unpaid volunteers make significant contributions of their time to develop the Organization's programs. The value of the contributed time is not reflected in these statements because it does not require a specialized skill or create or enhance a nonfinancial asset.

Functional Expenses

The majority of expenses can generally be directly identified with the program or supporting services to which they relate and are charged accordingly. Other expenses have been allocated among the programs and supporting services benefited based on various determinations by management.

Advertising Costs

The Organization uses advertising through billboards to promote its programs in the area it serves. Advertising costs are expensed as incurred. Advertising expense for the year ended December 31, 2011 totaled $220,649.

Federal Income Taxes

The Organization is a not-for-profit organization that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Therefore, no provision for federal income tax has been made in these financial statements.

The Organization accounts for uncertain tax positions, when it is more likely than not, that such an asset or a liability will be realized. As of December 31, 2011, management believes there were no uncertain tax positions.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the amounts of reported revenues and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used. Estimates that have the most impact on financial position and results of operations primarily relate to the collectability of receivables, useful lives and recoverability of property and equipment, and allocation of expenses by function. Management believes these estimates and assumptions provide a reasonable basis for the fair presentation of the financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Subsequent Events

The Organization has evaluated subsequent events through the date the financial statements were available for issuance on October 3, 2012. No matters were identified affecting the accompanying financial statements and related disclosures.

NOTE 3 – PRIOR PERIOD ADJUSTMENTS

The 2011 financial statements have been restated for several transactions that were either recorded in error or not recorded at all in the previous period. The first restatement was to record $90,912 as other receivables for rent income under lease agreements with the Wildlife Center that were previously unrecognized as of December 31, 2010. The effect of the restatement was to increase other receivables and increase unrestricted net assets by $90,912 as of January 1, 2011.

The second restatement was to record $954,948 of capital campaign contributions to be collected in future years as temporarily restricted contributions rather than deferred pledges. The effect of this restatement was to reduce deferred pledges and increase temporarily restricted net assets by $954,948 as of January 1, 2011.

The third restatement was to properly record receipt of a pledge receivable that was recorded as unrestricted revenue in a prior year. The effect of the restatement was to reduce pledges receivable and decrease unrestricted net assets by $35,000 as of January 1, 2011.

The final restatement was to reflect earnings from capital campaign contributions as temporarily restricted net assets that were misclassified and reported as unrestricted net assets in the prior year. The effect of the restatement was to reduce unrestricted net assets and increase temporarily restricted net assets by $3,478,042 as of January 1, 2011.

The total impact of all prior period adjustments was to increase net assets by $1,010,860 as of January 1, 2011.

NOTE 4 – PLEDGES RECEIVABLE

Pledges receivable at December 31, 2011 are as follows:

Receivable in Less than One Year	$	611,966
Receivable in One to Five Years		124,750
Total Pledges Receivable	$	736,716

NOTE 5 – FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The three tier fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

NOTE 5 – FAIR VALUE MEASUREMENTS – CONTINUED

The three levels of inputs that may be used to measure fair value are as follows:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Inputs other than Level 1 inputs that are either directly or indirectly observable such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or other inputs not directly observable, but derived principally from, or corroborated by, observable market data.

Level 3: Unobservable inputs that are supported by little or no market activity.

The Organization holds certain investments with UBS Financial Services, Inc. to be held for the exclusive benefit of the Organization. The Organization retains all rights to these funds and paid administrative fees totaling $232,343. Level 1 investments consist of equity and fixed income securities and mutual funds. Level 2 investments consist of asset-backed securities which are valued by the custodian using pricing models that utilize variables such a yield curves, prepayment speeds, default rates, loss severity, interest rate volatilities and spreads.

The value of assets measured at fair value on a recurring basis as of December 31, 2011 is as follows:

	Quoted Market Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total
Corporate Stocks	$ 6,875,928	$ -	$ -	$ 6,875,928
Asset-backed Securities	-	3,134,270	-	3,134,270
Mutual Funds	5,008,805	-	-	5,008,805
U.S. Government or Agency Obligations	2,653,255	-	-	2,653,255
Total	$ 14,537,988	$ 3,134,270	$ -	$ 17,672,258

The following summarizes the investment return in the statement of activities and changes in net assets:

Interest and Dividend Income	$ 691,114
Management and Consulting Fees	(251,635)
Net Realized and Unrealized Loss	(86,538)
Investment Return, Net	$ 352,941

Investments are exposed to various risks such as interest rate risk, market and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the statements of financial position and the statements of activities and changes in net assets.

NOTE 6 – LONG-TERM DEBT

The Organization entered into a note payable agreement with JP Morgan Chase totaling $4,176,900 in a prior year. The loan is collateralized by 5.3 acres of land located at 7007 Katy Rd. During 2011, the loan was refinanced at the current principal amount of $3,850,500 with an annual interest rate of 3%. Interest only payments are due monthly through October 2013 at which point monthly principal and interest payments totaling $24,683 begin. The loan matures August 1, 2018.

The following is a summary of future minimum principal payments of notes payable:

Year Ending December 31,		
2012	$	-
2013		74,048
2014		296,192
2015		296,192
2016		296,192
Thereafter		2,887,876
Total	$	3,850,500

NOTE 7 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets totaling $51,305 were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of events specified by the donors for the year ended December 31, 2011.

NOTE 8 – TEMPORARY RESTRICTIONS ON NET ASSETS

Temporarily restricted net assets are available for the following purposes at December 31, 2011:

Capital Campaign	$	6,674,577
Restricted to periods ending after December 31, 2011		85,000
Programs		77,618
Total	$	6,837,195

NOTE 9 – RELATED PARTY TRANSACTIONS

The Organization contracts with the Wildlife Center of Texas ("Wildlife Center") to provide organizational and personnel support. The Wildlife Center reimburses the Organization for personnel, veterinary services, and administrative support. For the year ended December 31, 2011, the Organization incurred $257,077 in expenses for these support services provided to the Wildlife Center.

Additionally, the Wildlife Center leases office space from the Organization under an operating lease that expires in December 2014. The lease terms require the Wildlife Center to reimburse the Organization for the costs of operating and maintaining the leased portion of the building. As a result of this arrangement, the Organization earned rent totaling $23,000 in 2011. Minimum future rental receipts under this operating lease total $27,000 each year for years ending December 31, 2012, 2013, and 2014.

NOTE 9 – RELATED PARTY TRANSACTIONS – CONTINUED

As discussed in Note 3, certain related party rent was not recorded in prior years. As a result, other receivables increased $90,912 for these rental charges.

During 2011, the Wildlife Center paid $333,814 to the Organization. As of December 31, 2011, the Wildlife Center owed the Organization $201,062 for charges incurred on their behalf and is included in other receivables in the accompanying statement of financial position.

NOTE 10 – OPERATING LEASES

The Organization leases office equipment and property under noncancellable operating leases expiring in various years through 2013. Future minimum rental payments for the noncancellable leases are as follows:

Year Ending December 31,	
2012	$ 68,756
2013	11,278
Total	$ 80,034

Rental expense totaled $104,985 for the year ended December 31, 2011.

NOTE 11 – DEFINED CONTRIBUTION PLAN

The Organization provides a defined contribution plan under Section 403(b) of the Internal Revenue Code. Under the plan, eligible employees may contribute up to eighty-five percent of their salary but not to exceed the legal limit. The Organization's match is equal to one hundred percent of employee contributions up to three percent of participant compensation. Organization contributions totaled $25,964 for the year ended December 31, 2011.

SUPPLEMENTARY INFORMATION

HOUSTON SOCIETY FOR THE PREVENTION OF CRUELTY TO ANIMALS
(A NONPROFIT ORGANIZATION)
SCHEDULE OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2011

	Program Services	Management and General	Fundraising	Total
EXPENSES:				
Salaries	$ 2,749,340	$ 203,750	$ 199,856	$ 3,152,946
Benefits, Training, and Taxes	351,526	95,386	22,240	469,152
Total Personnel Expenses	3,100,866	299,136	222,096	3,622,098
Health Care and Supplies	1,019,755	166	85	1,020,006
Contract Veterinary and Deputy Services	243,331	-	-	243,331
Humane Education and Marketing	276,103	-	399,089	675,192
Technology and Other Administrative Support	144,108	111,455	55,012	310,575
Maintenance and Security	383,204	-	-	383,204
Insurance	216,365	11,209	4,793	232,367
Depreciation	319,291	-	-	319,291
Property Taxes	20,435	-	-	20,435
Other Expenses	263,491	-	-	263,491
Utilities	395,111	33,304	31,557	459,972
Vehicles	160,180	-	-	160,180
TOTAL EXPENSES	$ 6,542,240	$ 455,270	$ 712,632	$ 7,710,142

See Independent Auditor's Report.