

Morris Animal Foundation

Financial Statements

June 30, 2016

(With Independent Auditor's Report Thereon)

Kundinger, Corder & Engle, P.C.

Certified Public Accountants

Independent Auditor's Report

**Board of Directors
Morris Animal Foundation**

We have audited the accompanying financial statements of Morris Animal Foundation, which comprise the statement of financial position as of June 30, 2016, 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 Morris Animal Foundation as of June 30, 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.

Board of Directors
Morris Animal Foundation

Emphasis of Matter

As discussed in Note 12 to the financial statements, the Foundation's beginning net assets have been restated to reflect grants approved in prior years that should have been recorded as an expense and a liability in the year the grants were approved, and to restate temporarily and permanently restricted net assets to correct endowment balances at June 30, 2015. Our opinion is not modified with respect to these matters.

Kuendinger, Corder & Engle, P.C.

November 29, 2016

Morris Animal Foundation
Statement of Financial Position
June 30, 2016

Assets:	
Cash and cash equivalents	\$ 2,088,434
Prepaid expenses	13,338
Contributions receivable (note 2)	515,487
Investments (notes 3 and 4)	75,681,411
Property and equipment, net (note 5)	<u>231,559</u>
Total assets	<u><u>\$ 78,530,229</u></u>
 Liabilities and Net Assets:	
Accounts payable	\$ 542,128
Accrued liabilities	106,448
Grants payable (note 6)	8,703,824
Charitable gift annuities payable (note 7)	<u>920,930</u>
Total liabilities	<u>10,273,330</u>
 Net assets (notes 8 and 9):	
Unrestricted:	
Board designated	15,585,359
Undesignated	<u>5,191,968</u>
Total unrestricted	<u>20,777,327</u>
Temporarily restricted	5,935,268
Permanently restricted	<u>41,544,304</u>
Total net assets	68,256,899
Commitments (notes 3, 4, 10 and 11)	<u> </u>
Total liabilities and net assets	<u><u>\$ 78,530,229</u></u>

See the accompanying notes to the financial statements.

Morris Animal Foundation
Statement of Activities
Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, Gains and Support:				
Contributions	\$ 4,392,498	3,711,399	211,500	8,315,397
Donated professional services	1,536,915	267,518	-	1,804,433
Investment return, net (note 3)	(3,385,131)	(605,691)	(4,279,030)	(8,269,852)
Other income	10,499	-	-	10,499
Net assets released from restrictions due to satisfaction of program and time restrictions (note 8)	7,086,496	(5,561,436)	(1,525,060)	-
Total revenue, gains and support	<u>9,641,277</u>	<u>(2,188,210)</u>	<u>(5,592,590)</u>	<u>1,860,477</u>
Expenses:				
Program services:				
Scientific programs	10,713,768	-	-	10,713,768
Canine Lifetime Health Project (CLHP)	2,032,618	-	-	2,032,618
Program awareness	1,055,533	-	-	1,055,533
Total program services	<u>13,801,919</u>	<u>-</u>	<u>-</u>	<u>13,801,919</u>
Supporting services:				
Management and general	1,316,328	-	-	1,316,328
Development and fund raising	2,109,406	-	-	2,109,406
Total supporting services	<u>3,425,734</u>	<u>-</u>	<u>-</u>	<u>3,425,734</u>
Total expenses	<u>17,227,653</u>	<u>-</u>	<u>-</u>	<u>17,227,653</u>
Change in net assets	(7,586,376)	(2,188,210)	(5,592,590)	(15,367,176)
Net assets at beginning of year, as originally reported	28,490,927	9,710,591	47,071,031	85,272,549
Adjustment for restatement of beginning net assets (note 12)	(127,224)	(1,587,113)	65,863	(1,648,474)
Net assets at beginning of year, as restated	<u>28,363,703</u>	<u>8,123,478</u>	<u>47,136,894</u>	<u>83,624,075</u>
Net assets at end of year	<u>\$ 20,777,327</u>	<u>5,935,268</u>	<u>41,544,304</u>	<u>68,256,899</u>

See the accompanying notes to the financial statements.

Morris Animal Foundation
Statement of Functional Expenses
Year Ended June 30, 2016

	Program Services			Supporting Services		Total
	Scientific Programs	CLHP	Program Awareness	Management and General	Development	
Grant awards	\$ 8,478,864	5,000	28,276	-	-	8,512,140
Salaries, benefits and taxes	448,878	581,803	601,151	738,048	844,485	3,214,365
Professional services	1,531,685	274,652	220	29,772	4,256	1,840,585
Contract services	31,785	978,676	274,216	78,630	213,313	1,576,620
Printing and promotion	4,465	42,082	4,150	2,834	338,072	391,603
Travel	52,998	34,547	5,851	63,586	222,411	379,393
Miscellaneous expense	13,772	18,422	42,200	105,935	179,565	359,894
Supplies	94,670	44,542	58,385	21,676	88,325	307,598
Conferences and meetings	35,145	10,002	18,139	210,986	5,270	279,542
Occupancy	15,865	14,275	17,349	27,006	54,798	129,293
Postage and shipping	4,596	21,012	2,025	3,733	96,623	127,989
Professional development	1,000	7,205	2,992	4,041	20,066	35,304
Depreciation	-	-	-	28,801	-	28,801
Special events	-	-	-	125	24,198	24,323
Equipment rental and maintenance	-	-	-	765	17,280	18,045
Telephone	45	400	579	390	744	2,158
Total	\$ 10,713,768	2,032,618	1,055,533	1,316,328	2,109,406	17,227,653

See the accompanying notes to the financial statements.

Morris Animal Foundation
Statement of Cash Flows
Year Ended June 30, 2016

Cash flows from operating activities:

Change in net assets	\$ (15,367,176)
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Depreciation	28,801
Realized and unrealized loss on investments	8,047,617
Contributions restricted for endowment	(211,500)
(Increase) decrease in operating assets:	
Prepaid expenses	10,280
Contributions receivable	(33,204)
Increase (decrease) in operating liabilities:	
Accounts payable	330,694
Accrued liabilities	(80,240)
Grants payable	2,472,590
Charitable gift annuities payable	11,150
Net cash used in operating activities	(4,790,988)

Cash flows from investing activities:

Purchases of property and equipment	(48,515)
Proceeds from sales of investments, net of purchases	4,644,901
Net cash provided by investing activities	4,596,386

Cash flows from financing activities:

Contributions restricted for endowment	211,500
Net cash provided by financing activities	211,500

Net increase in cash and cash equivalents 16,898

Cash and cash equivalents, beginning of year 2,071,536

Cash and cash equivalents, end of year \$ 2,088,434

See the accompanying notes to the financial statements.

Morris Animal Foundation

Notes to Financial Statements

June 30, 2016

(1) Summary of Significant Accounting Policies

(a) General

Morris Animal Foundation (the Foundation) was founded as a nonprofit organization in 1948. The Foundation is a global leader in supporting scientific research that advances veterinary medicine. This research has improved the health and quality of life for dogs, cats, horses and wildlife around the world by leading to better preventions, diagnostic tools, treatment protocols and cures. The Foundation is funded by contributions and investment earnings from those contributions.

(b) Basis of Accounting

The accompanying financial statements of the Foundation have been prepared on the accrual basis of accounting, and accordingly reflect all significant receivables, payables, and other liabilities.

(c) Financial Statement Presentation

Information regarding the financial position and activities of the Foundation is reported according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

(d) Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and /or nature of any donor restrictions.

All donor-restricted support, including pledges, is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. 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 statement of activities as net assets released from restrictions. Conditional pledges are recognized as receivables and revenue when the conditions on which they depend are substantially met.

Morris Animal Foundation

Notes to Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

(e) Contributions Receivable

Unconditional contributions receivable are recognized as revenue in the period the pledge is received. Contributions receivable are recorded at net realizable value if expected to be collected in one year and at fair value if expected to be collected in more than one year. Conditional contributions receivable are recognized when the conditions on which they depend are substantially met.

The Foundation uses the direct write-off method to recognize bad debt expense on uncollectible amounts. No amounts were written-off in 2016.

(f) Cash and Cash Equivalents

The Foundation considers all unrestricted highly liquid investments with an initial maturity of three months or less, and that are not held as part of an investment portfolio, to be cash equivalents.

(g) Investments

Investments are reported at fair value. Fair value is determined as more fully described in note 4.

Investments in marketable equity and fixed income securities with readily determinable market values are reported at fair value based on quoted prices in active markets. The market values for alternative investments represent the Foundation's pro-rata interest in the net assets of each investment and are based on financial information determined and reported by investment managers or on the basis of other information evaluated periodically by management. Alternative investments are not publicly traded on national security market exchanges, are generally illiquid and may be valued differently than if readily available markets existed for such investments. Because of inherent uncertainties of valuation of alternative investments, the reported market values of such investments may differ significantly from realizable values. Management is responsible for the fair value measurement of investments reported in the financial statements and believes that the reported values are reasonable.

Investment return consists of the Foundation's distributive share of any interest, dividends, capital gains and losses generated from investments, as well as the change in fair value of the investments. Gains and losses attributable to investments are realized and reported upon a sale or disposition of the investment. Unrealized gains and losses are included in the change in net assets in the statement of activities.

Morris Animal Foundation

Notes to Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

(g) Investments, Continued

At June 30, 2016, the Foundation elected early implementation of ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This standard removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share.

(h) Concentrations of Credit Risk

Financial instruments that potentially subject the Foundation to concentrations of credit risk consist principally of cash and investments.

The Foundation places its cash and temporary investments with creditworthy, high-quality financial institutions. At times, a significant portion of the funds are not insured by the Federal Deposit Insurance Corporation. Investments are under the guidance of the Foundation's investment committee and an independent advisor. Though the market value of investments is subject to fluctuations on a year-to-year basis, management believes that the investment policy is prudent for the long-term welfare of the Foundation.

(i) Property and Equipment

Property and equipment is stated at cost or, if donated, at the approximate fair market value at the date of donation. The Foundation capitalizes all expenditures for property and equipment in excess of \$3,000 and with a useful life exceeding one year. Depreciation is computed using the straight-line method over the estimated useful lives of the assets (3 to 10 years).

(j) Grants Payable

Grants authorized but unpaid at year-end are reported as liabilities. Grants scheduled for payments more than one year in the future have not been discounted to net present value because the discount is not significant.

(k) Use of Estimates

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

Morris Animal Foundation

Notes to Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

(l) Donated Services

Donated services are recorded as contributions and corresponding expenses at their estimated fair values at the date of donation. Included in donated professional service revenue and program service expense are services donated by volunteer scientists who evaluate, select and monitor the animal health studies chosen to receive Foundation funding. The estimated value of these services in 2016 was \$1,804,433.

(m) Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the accompanying financial statements. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

(n) Income Tax Status

The Foundation is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code, and contributions received qualify for the charitable contribution deduction. Income from activities not directly related to the Foundation's tax-exempt purpose is subject to taxation as unrelated business income. At times, certain of the Foundation's investment funds incur unrelated business income. The Foundation incurred unrelated business taxable income totaling approximately \$123,000 during 2016 related to these investments.

The Foundation is required to determine whether a tax position (and the related tax benefit) is more likely than not to be sustained upon examination by the applicable taxing authority, based solely on the technical merits of the position. The Foundation believes it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are significant to the financial statements. The Foundation's *Return of Organization Exempt from Income Tax* (Form 990) for 2013 through 2015 are subject to examination by the IRS, generally for three years after they were filed.

(o) Subsequent Events

Management is required to evaluate, through the date the financial statements are issued or available to be issued, events or transactions that may require recognition or disclosure in the financial statements, and to disclose the date through which subsequent events were evaluated. The Foundation's financial statements were available to be issued on November 29, 2016 and this is the date through which subsequent events were evaluated.

Morris Animal Foundation

Notes to Financial Statements, Continued

(2) Contributions Receivable

At June 30, 2016, unconditional contributions receivable total \$515,487 and are due within one year. Management has determined that all contributions receivable are collectible.

(3) Investments

The Foundation's investment assets, which include private and publicly held investments, are dedicated to providing the financial resources needed to meet the Foundation's grant making and other charitable objectives. The Foundation's investments are held in various investment structures which may include foreign domiciled funds and pooled investments.

Marketable and private alternative investments are exposed to various risks that may cause the reported value of the Foundation's investment assets to fluctuate from period to period and result in a material change to the net assets of the Foundation. Investments in equity securities fluctuate in value in response to many factors such as the activities and financial condition of individual companies, business and industry market conditions and the general economic environment. The value of bond investments and other fixed income securities fluctuate in response to changing interest rates, credit worthiness of issuers and overall economic policies that impact market conditions. Some investment managers retained by the Foundation are permitted to use various investment strategies and techniques that are designed to achieve higher investment returns with lower volatility and low correlations to major market indices and other asset classes. Strategies and techniques, such as the use of leverage, futures and forward contracts, option agreements, and other derivative instruments, create special risks and could increase the impact of adverse security price movements on the Foundation's investment portfolio.

Investments consist of the following at June 30, 2016:

Private investments	\$ 29,339,409
Global equity funds	21,227,299
Global opportunistic funds	14,192,463
Fixed income	3,656,912
Equities	959,392
Real assets	13,065
Cash and cash equivalents	<u>6,292,871</u>
Total investments	\$ <u>75,681,411</u>

Morris Animal Foundation

Notes to Financial Statements, Continued

(3) Investments, Continued

Investment return for the year ended June 30, 2016 is summarized as follows:

Interest and dividend income	\$ 37,680
Net realized and unrealized loss	(8,047,617)
Less investment expenses	<u>(259,915)</u>
Total investment return	\$ <u>(8,269,852)</u>

Certain of the Foundation's investments require that the Foundation commit to investing additional funds. At June 30, 2016, the Foundation had unfunded commitments totaling \$5,930,000.

(4) Fair Value Measurements

The carrying amount reported in the statement of financial position for cash and cash equivalents, contributions receivable, accounts payable, accrued liabilities and grants payable, approximate fair value because of the immediate or short term maturities of these financial instruments.

The Foundation reports its investments in accordance with fair value standards. Fair value is 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. This standard requires an entity to maximize the use of observable inputs (such as quoted prices in active markets) and to minimize the use of unobservable inputs (such as appraisals or other valuation techniques) to determine fair value. In addition, the Foundation reports certain investments using the "practical expedient" method. The practical expedient allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met.

Fair value measurement standards also require the Foundation to classify financial instruments, with the exception of investments valued using the practical expedient method, into a three-level hierarchy based on the priority of inputs to the valuation technique. Investments required to be included in the hierarchy are classified and disclosed in one of the following categories:

Level 1 – Quoted prices are available in active markets for identical investments as of the reporting date. The types of investments included in Level 1 are certificates of deposit, money market and mutual funds.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category include corporate and government bonds, less liquid and restricted equity securities and certain over-the-counter derivatives.

Morris Animal Foundation

Notes to Financial Statements, Continued

(4) Fair Value Measurements, Continued

Level 3 – Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation. Investments that are included in this category generally include limited partnership interests in corporate private equity and real estate funds, funds of hedge funds, and distressed debt.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. These classifications (Level 1, 2 and 3) are intended to reflect the observability of inputs used in the valuation of investments and are not necessarily an indication of risk or liquidity.

The following table summarizes the valuation of the Foundation's investments by the above fair value hierarchy levels as of June 30, 2016:

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Private investments	\$ 29,339,409	–	–	–
Global equity funds	21,227,299	–	–	–
Global opportunistic funds	14,192,463	–	–	–
Fixed income	3,656,912	743,280	–	–
Equities	959,392	959,392	–	–
Real assets	13,065	13,065	–	–
Cash and cash equivalents	<u>6,292,871</u>	<u>6,292,871</u>	<u>–</u>	<u>–</u>
Total	<u>\$ 75,681,411</u>	<u>8,008,608</u>	<u>–</u>	<u>–</u>

All Level 1 investments have been valued using a market approach. All other investments are valued at net asset value per share (or its equivalent) as permitted under the practical expedient rule. As allowed under ASU 2015-07, these investments are not classified in the hierarchy table. There were no changes in valuation techniques during the current year.

Morris Animal Foundation

Notes to Financial Statements, Continued

(4) Fair Value Measurements, Continued

The following table summarizes the significant information related to investments valued at net asset value per share (or its equivalent) as of June 30, 2016:

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Private investments (a)	\$ 29,339,409	5,930,000	None	N/A
Global equity funds (b)	\$ 21,227,299	–	Monthly- Annually	30-90 days
Global opportunistic (c)	\$ 14,192,463	–	Monthly- Quarterly	45-90 days
Fixed income (d)	\$ 2,913,632	–	Quarterly	90 days

(a) This category consists of seventeen private investment funds, all of which are illiquid. Approximately 86% of this category is comprised of ten Morgan Creek Partners funds totaling \$25,151,957. The majority of the funds specialize in fund of fund investments that invest primarily in energy and natural resources, buyouts, venture capital and real estate. Unfunded commitments related to these funds total \$5,930,000 at June 30, 2016. Approximately 5% of this category is in a special opportunities partnership that focuses on investments in private technology companies. Approximately 4% of this category is in a partnership fund that targets managers whose investment strategies include growth equity, cross-over, multi-stage venture, seed-stage and early-stage investing in venture type companies. Another 4% of this category consists of a partnership fund that specializes in early stage investments in U.S.-based companies. The remaining 1% of this category consists primarily of a partnership fund that invests in companies that derive at least 50% of their revenue from the natural resource industry including publicly traded corporations, publicly traded partnerships, private partnerships and LLCs, and royalty trusts. The fair value of all funds in this category has been estimated using net asset value per share (or its equivalent).

(b) This category consists of eight funds with varying liquidity features. Approximately 12% of this category consists of a long/short domestic equity hedge fund focused on healthcare subsectors. Approximately 8% of this category consists of a global long/shore equity hedge fund, specifically focusing on Europe, but also North America and Asia. The fund specifically seeks to capture the value gap between market price and intrinsic value independent of market performance and the economic cycle. Approximately 14% of this category consists of a fund dedicated to exploiting opportunity in industries driven by technological innovation, specifically in the technology, d-commerce, internet media, traditional media, alternative energy and telecom industries.

Morris Animal Foundation

Notes to Financial Statements, Continued

(4) Fair Value Measurements, Continued

(b) Continued

Approximately 30% of this category consists of two Morgan Creek Partners global equity long/short institutional funds which seek managers with a fundamentally different risk/return profile than what is offered by the market. Approximately 8% of this category consists of a long-only fund focused on India. The fund invests in diligence-heavy, bottom-up ideas which have fundamentally strong business models with a long-only bias. Approximately 13% of this category consists of a long/short Japanese equity hedge fund with a directional approach to investing focusing on stock selection. The portfolio is enhanced with index and currency derivative overlays for hedging and investment purposes when appropriate. The remaining 15% of this category consists of a fund aimed at capturing long and short opportunities in Chinese companies listed globally across market caps. It is typically one-third financial services, one-third TMT, 20% consumer and the balance in other sectors. The fair value of all funds in this category has been estimated using net asset value per share (or its equivalent).

(c) This category consists of six funds with varying liquidity features. Approximately 43% of this category consists of a globally diversified, multi-strategy hedge fund. The fund consists of multiple portfolio managers operating within core investment strategies, including sector fundamental long/short, discretionary global macro and equity trading. Approximately 10% of this category consists of a global hedge fund that seeks to provide absolute returns to investors primarily by investing both long and short in equities on a global basis. The primary focus is on investing in equities in the developed markets. Approximately 36% of this category consists of two global long/short equity hedge funds with a value orientation and a fundamental bias. Approximately 9% of this category consists of a fundamentally driven, value-based directional long/short fund that invests in global equities with a focus in the industrials, basic materials, energy, transportation, and consumer sectors with opportunistic commodities investments. The remaining 2% of this category consists of a fund dedicated to exploiting asymmetric risk-reward opportunities in investments that range across geographies, industries, themes and strategies. The fair value of all funds in this category has been estimated using net asset value per share (or its equivalent).

(d) This category consists of an enhanced fixed income fund which invests in corporate bonds, convertible bonds, bank debt, and senior bankruptcy claims. The fund is exposed to credit risk to the extent any financial institution with which it conducts business is unable to fulfill contractual obligations on its behalf. The fund also invests in the securities of foreign issuers and is subject to risks that include devaluation of currencies, less reliable information about issuers, and adverse political and economic developments. The fair value of the fund in this category has been estimated using net asset value per share.

Morris Animal Foundation

Notes to Financial Statements, Continued

(5) Property and Equipment

Property and equipment consists of the following at June 30, 2016:

Office furniture and equipment	\$ 301,078
Computer hardware and software	179,804
Leasehold improvements	<u>116,599</u>
	597,481
Accumulated depreciation	<u>(365,922)</u>
Property and equipment, net	\$ <u>231,559</u>

(6) Grants Payable

Grants which have been approved but not paid are due in the following years ended June 30:

2017	\$ 6,346,225
2018	1,619,520
2019	556,292
2020	143,144
2021	25,000
2022	<u>13,643</u>
Total grants payable	\$ <u>8,703,824</u>

(7) Charitable Gift Annuities Payable

Charitable gift annuities are arrangements between a donor and the Foundation in which the donor contributes assets to the Foundation in exchange for a promise for the Foundation to pay the donor a fixed amount for a specified period of time. Assets received have been recognized at fair value, and an annuity payment liability of \$920,930 at June 30, 2016 has been recognized at the present value of the future cash flows projected to be paid. The liability has been calculated by discounting the future cash flows using rates obtained from the Internal Revenue Code mortality tables and the applicable federal rate.

(8) Net Assets

Unrestricted net assets include board designated endowment funds totaling \$15,585,359 at June 30, 2016. The funds are subject to the endowment spending policy (see note 9).

Morris Animal Foundation

Notes to Financial Statements, Continued

(8) Net Assets, Continued

Temporarily restricted net assets at June 30, 2016 consist of the following:

Term endowments and unappropriated earnings on permanently restricted endowment funds (note 9)	\$ 1,499,972
Gifts restricted for specific purposes	<u>4,435,296</u>
Total temporarily restricted net assets	<u>\$ 5,935,268</u>

Temporarily restricted net assets are available for funding the various interest areas of animal health studies. Temporarily restricted net assets totaling \$5,561,436 were released during 2016 as donor restrictions were met or endowment earnings were appropriated for expenditure.

Permanently restricted net assets consist of thirteen donor restricted endowment funds totaling \$41,544,304 at June 30, 2016. Permanently restricted net assets totaling \$1,525,060 were released during 2016 in accordance with the terms of the endowment agreements.

(9) Endowment Funds

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

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

Morris Animal Foundation

Notes to Financial Statements, Continued

(9) Endowment Funds, Continued

In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purpose of the Foundation and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other Foundation resources
- (7) The investment policies of the Foundation

As required by generally accepted accounting principles, net assets associated with these endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's endowment net assets consisted of the following as of June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Board designated endowments	\$ 15,585,359	-	-	15,585,359
Donor restricted endowments	<u> -</u>	<u>1,499,972</u>	<u>41,544,304</u>	<u>43,044,276</u>
Total endowment assets	<u>\$ 15,585,359</u>	<u>1,499,972</u>	<u>41,544,304</u>	<u>58,629,635</u>

Following are the changes in the endowment net assets for the year ended June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets at July 1, 2015	\$ 20,526,994	2,315,797	47,136,894	69,979,685
Investment return	(2,782,644)	(579,442)	(4,279,030)	(7,641,116)
Contributions	-	100,000	211,500	311,500
Appropriated for expenditure	<u>(2,158,991)</u>	<u>(336,383)</u>	<u>(1,525,060)</u>	<u>(4,020,434)</u>
Endowment net assets at June 30, 2016	<u>\$ 15,585,359</u>	<u>1,499,972</u>	<u>41,544,304</u>	<u>58,629,635</u>

Morris Animal Foundation

Notes to Financial Statements, Continued

(9) Endowment Funds, Continued

Return Objectives and Risk Parameters

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a reasonable, predictable, stable and sustainable level of distribution that supports current needs while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to maximize utilization of investments which preserve principal, maximize income commensurate with risk, provide liquidity to help ensure adequate reserves, and fit within the Foundation's preference of acceptable principal and interest risk. The overall portfolio volatility is expected to remain in a range of 6% to 12%. The Foundation's goal is to achieve a net average annual total return of at least 6% plus inflation per year over rolling five and ten-year periods.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). While preservation of capital is important, the Foundation also believes that varying degrees of investment risk are generally rewarded with compensating returns.

Spending Policy and How the Investment Objectives Relate to Distribution Policy

Distributions from the endowment funds are based on 4% or 5% of the twelve quarter trailing average of each separate endowment fund, depending on donor instructions. It is the expectation that on average, over the long term, the overall draw will be generally lower than 5% of the assets of the investment pool.

(10) Retirement Plan

The Foundation provides a tax sheltered annuity plan (the Plan) for all eligible employees. Employees are able to make elective deferrals beginning on their date of hire, and are eligible for matching contributions after 90 days of service. Participants may elect to defer up to 100% of their compensation, not to exceed a certain dollar limit set by law. The Foundation makes matching contributions equal to 100% of the participant's elective deferral, up to 6% of the participant's compensation. All contributions to the Plan vest immediately. Employer contributions in 2016 were \$95,813.

Morris Animal Foundation

Notes to Financial Statements, Continued

(11) Commitments

Office Lease

The Foundation leases its office space under non-cancelable operating lease agreements. The leases expire in October 2022. Future minimum lease payments required under the lease agreements are as follows for years ending June 30:

2017	\$ 171,193
2018	176,320
2019	181,447
2020	186,574
2021	191,408
2022	<u>194,535</u>
Total	\$ <u>1,101,477</u>

Rent expense in 2016 was \$119,306.

Canine Lifetime Health Project

The Foundation launched the Canine Lifetime Health Project (CLHP) in 2011 to identify genetic, environmental and nutritional risk factors leading to the development of cancer and other health conditions in dogs. The project enrolls golden retrievers and follows them for up to 13 years. The Foundation expects to spend roughly \$32 million on CLHP-related costs over the life of the project.

(12) Prior Period Restatement

Prior to the year ended June 30, 2015, the expense for the unpaid portion of multi-year grant commitments was not reported as a grant payable until such time as the scheduled grant payment was due, on the basis that future payments were conditional. During 2015, upon further review of the grant agreements, management determined that the future grant commitments were not conditional. Accordingly, payments due on multi-year grants identified as approved prior to June 30, 2015 were accrued at June 30, 2015. During 2016, management identified additional grants approved prior to June 30, 2015 that should have been accrued but were not. Accordingly, beginning net assets were restated by \$1,648,474 to correct the understatement of expense reported in prior years. In addition, certain endowment balances were incorrectly reported by net asset class at June 30, 2015, and accounts receivable were slightly overstated at June 30, 2015.

Morris Animal Foundation

Notes to Financial Statements, Continued

(12) Prior Period Restatement, Continued

The effect of the above on the individual accounts was as follows:

	June 30, 2015 as <u>Originally Reported</u>	Effect of <u>Correction</u>	Endowment <u>Reclasses</u>	June 30, 2015 <u>as Restated</u>
Accounts receivable	490,688	(8,458)	-	482,230
Grants payable	4,591,218	1,640,016	-	6,231,234
Grants expense	9,224,944	1,648,474	-	10,873,418
Change in net assets	3,273,514	(1,648,474)	-	1,625,040

The effect of the above on beginning net assets was as follows:

	June 30, 2015 as <u>Originally Reported</u>	Effect of <u>Correction</u>	Endowment <u>Reclasses</u>	June 30, 2015 <u>as Restated</u>
Unrestricted	\$ 28,490,927	(1,648,474)	1,521,250	28,363,703
Temporarily restricted	9,710,591	-	(1,587,113)	8,123,478
Permanently restricted	<u>47,071,031</u>	<u>-</u>	<u>65,863</u>	<u>47,136,894</u>
Total	\$ <u>85,272,549</u>	<u>(1,648,474)</u>	<u>-</u>	<u>83,624,075</u>