

EARNEY & COMPANY

L.L.P.

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
paws4people, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of paws4people, Inc. (a nonprofit organization), which comprise the statement of financial position as of December 31, 2012, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements. This was our initial engagement.

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 paws4people, Inc. as of December 31, 2012, 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.

Eany & Company, L.L.P.

Wilmington, North Carolina
November 4, 2013

PAWS4PEOPLE, INC.
STATEMENT OF FINANCIAL POSITION

	As of December 31, 2012			
	Operations	Canines	Temporarily Restricted	Total
Assets				
Current Assets				
Cash	\$ 74,622	\$ -	\$ -	\$ 74,622
Total Current Assets	<u>74,622</u>	<u>-</u>	<u>-</u>	<u>74,622</u>
Canines				
In training	-	325,376	-	325,376
In service				
Service canines	-	1,488,218	-	1,488,218
Assistance canines	-	654,861	-	654,861
Less: accumulated depreciation	<u>-</u>	<u>(701,516)</u>	<u>-</u>	<u>(701,516)</u>
Total Canines	<u>-</u>	<u>1,766,939</u>	<u>-</u>	<u>1,766,939</u>
Property				
Vehicles and equipment	26,011	-	-	26,011
Less: accumulated depreciation	<u>(22,277)</u>	<u>-</u>	<u>-</u>	<u>(22,277)</u>
Net Property	<u>3,734</u>	<u>-</u>	<u>-</u>	<u>3,734</u>
Total Assets	<u>\$ 78,356</u>	<u>\$ 1,766,939</u>	<u>\$ -</u>	<u>\$ 1,845,295</u>
Liabilities and Net Assets				
Current Liabilities				
Accounts payable	\$ 6,580	\$ -	\$ -	\$ 6,580
Notes payable (Note 4)	<u>-</u>	<u>92,616</u>	<u>-</u>	<u>92,616</u>
Total Current Liabilities/Total Liabilities	<u>6,580</u>	<u>92,616</u>	<u>-</u>	<u>99,196</u>
Net Assets				
Unrestricted	71,776	1,674,323	-	1,746,099
Temporarily restricted	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Net Assets	<u>71,776</u>	<u>1,674,323</u>	<u>-</u>	<u>1,746,099</u>
Total Liabilities and Net Assets	<u>\$ 78,356</u>	<u>\$ 1,766,939</u>	<u>\$ -</u>	<u>\$ 1,845,295</u>

The accompanying notes are an integral part of these financial statements

PAWS4PEOPLE, INC.
STATEMENT OF ACTIVITIES

	For the Year Ended December 31, 2012			
	Operations	Canines	Temporarily Restricted	Total
Public Support & Revenue				
Grants, contributions, & bequests	\$ 187,513	\$ -	\$ -	\$ 187,513
Fundraising, net	19,885	-	-	19,885
Interest	81	-	-	81
In kind gifts & contributions	24,585	-	-	24,585
In kind canine training	-	325,376	-	325,376
Miscellaneous	268	-	-	268
Total Public Support & Revenue	232,332	325,376	-	557,708
Expenses				
Program	151,856	217,913	-	369,769
Administrative	9,968	-	-	9,968
Fund raising	21,746	-	-	21,746
Total Expenses	183,570	217,913	-	401,483
Change in Net Assets	48,762	107,463	-	156,225
Net Assets:				
Beginning of year, as previously reported	(61,197)	-	-	(61,197)
Prior period adjustment (Note 2)	84,211	1,566,860	-	1,651,071
Beginning of year, as restated	23,014	1,566,860	-	1,589,874
End of year	\$ 71,776	\$ 1,674,323	\$ -	\$ 1,746,099

The accompanying notes are an integral part of these financial statements

PAWS4PEOPLE, INC.
STATEMENT OF FUNCTIONAL EXPENSES

	For the Year Ended December 31, 2012			
	Program	Administrative	Fund-raising	Total
EXPENSES				
Payroll & related	\$ 7,236	\$ -	\$ -	\$ 7,236
Program expense	14,520	-	-	14,520
Canine care and feeding	40,925	-	-	40,925
Kennel operations	5,728	-	-	5,728
In kind supplies & other	24,585	-	-	24,585
Transportation	3,495	-	-	3,495
Travel	40,337	-	-	40,337
Office	320	4,912	-	5,232
Advertising	-	-	19,311	19,311
Insurance	5,828	-	-	5,828
Bank charges	-	156	2,435	2,591
Telephone and internet	4,342	-	-	4,342
Occupancy	4,540	-	-	4,540
Professional & contract fees	-	4,900	-	4,900
Total direct expenses	151,856	9,968	21,746	183,570
Depreciation	217,913	-	-	217,913
Total expenses	<u>\$ 369,769</u>	<u>\$ 9,968</u>	<u>\$ 21,746</u>	<u>\$ 401,483</u>

The accompanying notes are an integral part of these financial statements

PAWS4PEOPLE, INC.
STATEMENT OF CASH FLOWS

	For the Year Ended December 31, 2012			
	Operations	Canines	Temporarily Restricted	Total
Cash Flows Provided by (used in)				
Operating Activities				
Cash collections for:				
Contributions & other	\$ 207,666	\$ -	\$ -	\$ 207,666
Investment income	81	-	-	81
Less: cash payments for:				
Total expenses	<u>(183,570)</u>	<u>-</u>	<u>-</u>	<u>(183,570)</u>
Net cash provided by (used in) operating activities	<u>24,177</u>	<u>-</u>	<u>-</u>	<u>24,177</u>
Cash Flows Provided by (used in)				
Investing Activities				
Purchase of property and equipment	<u>(4,000)</u>	<u>-</u>	<u>-</u>	<u>(4,000)</u>
Net cash provided by (used in) investing activities	<u>(4,000)</u>	<u>-</u>	<u>-</u>	<u>(4,000)</u>
Cash Flows Provided by (used in)				
Financing Activities				
Payments on notes payable	<u>(3,821)</u>	<u>-</u>	<u>-</u>	<u>(3,821)</u>
Net cash provided by (used in) financing activities	<u>(3,821)</u>	<u>-</u>	<u>-</u>	<u>(3,821)</u>
Net Increase (Decrease) in Cash and Equivalents	16,356	-	-	16,356
Cash and Cash Equivalents				
Beginning of the year	<u>58,266</u>	<u>-</u>	<u>-</u>	<u>58,266</u>
End of the year	<u>\$ 74,622</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 74,622</u>
Reconciliation of Change in Net Assets to Cash Provided by (used in) Operations:				
Changes in net assets	\$ 48,762	\$ 107,463	\$ -	\$ 156,225
Depreciation	-	217,913	-	217,913
In-kind donations	(24,585)	(325,376)	-	(349,961)
Increase (decrease) in:				
Accounts payable	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net cash provided by (used in) operating activities	<u>\$ 24,177</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,177</u>
Interest paid				<u>\$ -</u>

The accompanying notes are an integral part of these financial statements

PAWS4PEOPLE, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012

1. ORGANIZATION

paws4people, Inc. (the "Organization") is a nonprofit corporation incorporated in the State of Virginia on July 6, 1999, and operating in Wilmington, North Carolina.

The Organization's mission is to enhance the lives of active-duty military service members, veterans, inmates (Federal and State), children/students, and senior citizens by using the "special powers" of canine companionship and service displayed by highly trained assistance dogs, through specialized educational, private placement, therapeutic and visitation programs. The Organization achieves its mission through the efforts of a network of over 230 volunteers and over 200 trained, certified and insured assistance canines. These volunteers and canines are trained and certified to provide educational, therapeutic, training, advocacy and visitation programs to people with disabilities throughout the mid-Atlantic and southeast regions of the United States. paws4people, Inc. specializes in clients under the age of 14 in need of physical and/or educational assistance and military veterans with Post Traumatic Stress Syndrome.

All paws4people, Inc. assistance canines receive their basic and advanced Assistance Dog Training in the Organization's paws4prisons Assistance Dog Training Program. This program provides male and female federal inmates with an opportunity to train assistance canines, experience the human-animal bond, and to give back to society in a very important and meaningful way. The program also provides significant rehabilitative benefits, re-entry opportunities, and helps to decrease recidivism rates.

To date paws4people, Inc. has conducted over 900,000 educational and therapeutic contacts during more than 53,600 visits.

paws4people, Inc. is exempt from federal income tax under Section 501(a) of Internal Revenue Code as an organization described in Section 501(c)(3). Accordingly, contributions to the Organization may be deductible by donors and related purpose income is exempt from income tax. The Organization files an information income tax return, IRS Form 990; generally the return is subject to examination for a period of three years from the date filed. Management believes the oldest open tax year is 2009.

2. SIGNICANT ACCOUNTING POLICIES

The organization prepares its financial statements in accordance with generally accepted accounting principles promulgated in the United States of America (U.S. GAAP) for not-for-profits. Accordingly, revenue is recorded when earned and expenses when incurred. The significant accounting policies followed are described below to enhance the usefulness and understandability of the financial statements.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. On an ongoing basis, the organization's management evaluates the estimates and assumptions based upon historical experience and various other factors and circumstances. The organization's management believes that the estimates and assumptions are reasonable in the circumstances; however, the actual results could differ from those estimates.

Net Assets

The financial statements report net assets and changes in net assets in three classes that are based upon the existence of absence of restrictions on use that are placed by its donors as follows:

- a) **Unrestricted Net Assets** are resources available to support operations and the canines. The only limits on the use of unrestricted net assets are the broad limits resulting for the nature of the organization, the environment in which it operates, the purposes specified in it corporate documents and its application for tax-exempt status, and any limits resulting from contractual agreements with creditors and others that are entered into in the course of its operations.
- b) **Temporarily Restricted Net Assets** are resources that are restricted by a donor for use for a particular purpose or in a particular future period. The organization's unspent contributions are classified in this class if the donor limited their use, as are the unspent appreciation of its donor-restricted endowment funds.

When a donor's restriction is satisfied, either by using the resources in the manner specified by the donor or by the passage of time, the expiration of the restriction is reported in the financial statements by reclassifying the net assets from temporarily restricted to unrestricted net assets. Net assets restricted for acquisition of buildings or equipment (or less commonly, the contribution of those assets directly) are reported as temporarily restricted until the specified asset is placed in service by the organization unless the donor provides more specific directions about the period of its use. There was no temporarily restricted activity in 2012.

Prior Period Adjustments

Prior to January 1, 2012, the Organization did not record the canines as an asset. Effective January 1, 2012, management determined the cost of the canines and recorded a prior period adjustment of \$1,651,071 for the net value of the Canines.

The accounting treatment is discussed below and in Note 3.

The Organization maintains ownership of its canines during their service life. Thus management has taken a cost approach in determining the fair value measurement of its canine assets due to the specialized nature of service and assistance canines and the multitude of variables that affect an individual canine's training requirements. The cost of preparing a canine for service or assistance is based on management's estimates of the hours required to acquire and train canines for various levels of specialized service or assistance. These estimates are derived from the Organization's experience and observation over the past five years of training canines through a variety of paws4people, Inc. programs and through comparison with other canine training organizations. Market data was considered in estimating the cost per hour of required training.

Contributions

Unrestricted contributions are recognized when cash or ownership of donated assets is unconditionally promised to the Organization.

Contributions, including unconditional promises to give, are recognized when received. All contributions are reported as increases in unrestricted net assets unless use of the contributed assets is specifically restricted by the donor. Amounts received that are restricted by the donor to use in future periods or for specific purposes are reported as increases in either temporarily restricted or permanently restricted net assets, consistent with the nature of the restriction. Unconditional promises with payments due in future years have an implied restriction to be used in the year the payment is due, and therefore are reported as temporarily restricted until the payment is due unless the contribution is clearly intended to support activities of the current fiscal year or is received with permanent restrictions. Conditional promises, such as matching grants, are not recognized until they become unconditional, that is, until all conditions on which they depend are substantially met. Contributions from bequests are recognized as contributions receivable when the probate court declares that the will is valid and the organization has an irrevocable right to the bequest.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash held in checking, savings, money market accounts and short-term certificates of deposits with maturities of three months or less. Cash and equivalents are as follows at December 31:

	<u>2012</u>
Operating - checking	\$ 69,231
Savings	\$ 5,170
Petty cash	<u>221</u>
Total	<u>\$ 74,622</u>

Property and Depreciation

Equipment, furniture and fixtures are recorded in the statement of financial position at cost if purchased and at estimated market value at date of gift if donated. Equipment is capitalized if it has a cost of \$500 or more and a useful life when acquired of more than 1 year. Repairs and maintenance that do not significantly increase the useful life of the asset are expensed as incurred. Depreciation is computed on a straight line basis over the estimated useful lives of the assets from 5-7 years.

Expense Recognition & Allocation

The cost of providing the organization's programs and other activities is summarized on a functional basis in the statement of activities and statement of functional expenses. Expenses that can be identified with a specific program or support service are charged directly to that program or support service. Costs common to multiple functions have been allocated among the various functions benefitted using objective basis such as time spent.

General and administrative expenses include those costs that are not directly identifiable with any specific program, but which provide for the overall support and direction of the organization. General and administrative activities include those that provide governance (Board of Directors), oversight, business management, financial recordkeeping, budgeting, legal services, human resource management, and similar activities that ensure an adequate working environment and an equitable employment program.

Fundraising activities include publicizing and conducting fundraising campaigns; maintaining donor lists; conducting special fundraising events; and other activities involved with soliciting contributions from corporations, foundations, individuals, and others.

Fundraising and advertising costs are expensed as incurred, even though they may result in contributions received in future years. The organization generally does not conduct its fundraising activities in conjunction with its other activities. In the few cases in which it does, such as when the annual report or donor acknowledgements contain requests for contributions, joint costs have been allocated between fundraising and management and general expenses in accordance with standards for accounting for costs of activities that include fundraising.

Subsequent Events

Management considered the inclusion of subsequent events in the disclosures of the footnotes through November 4, 2013, if such disclosures were required. That date was both the financial issuance date and the date the financials were available to be issued.

3. GIFTS-IN-KIND CONTRIBUTIONS - CANINES

The Organization is dependent on in-kind contributions in the form of donated materials and personal services. Donated supplies are recorded as contributions at the date of gift and are expensed when the donated items are placed into service or distributed.

As indicated in Note 1, personal services are provided by a substantial number of volunteers. Those volunteers have donated significant amounts of time and services in the organization's program operations. The majority of those contributed services meet the criteria for recognition in the financial statements. GAAP allows recognition of contributed services if (a) the services create or enhance nonfinancial assets or (b) the services would have been purchased if not provided by contribution, require specialized skills, and are provided by individuals possessing those skills. Management has determined that donated services with an estimated fair value of \$325,376 met those criteria and are included in in-kind contributions in the statement of activities. The following paragraphs discuss the accounting for donated services related to canines.

The cost to acquire and train assistance and service canines are capitalized and depreciated over the service life of each canine – 3 years for assistance canines and 8 years for service canines. The cost of food, housing, veterinary services, medication, grooming, training aids such as collars and leashes, and annual re-certifications are considered incidental to the cost of training and are expensed as incurred.

Acquisition, whelping and initial training costs (first 4 months of the canine's life) range from \$1,414 to \$4,078 per canine depending on whether the canine was bred within the paws4people breeding program, purchased from an outside breeder, adopted from a shelter.

For the next 20 months the canines undergo standard and specialized training which varies depending on whether the canine will become an assistance canine or a service canine.

Assistance canines are trained to provide general assistance and companionship in schools, nursing homes and other community settings. They are typically placed in service at the end of a 2-year training period and are retired after 3 years of service. The cost to train assistance canines ranges from \$2,016 to \$9,672 depending on the source of acquisition and the type of assistance the canine will provide when placed in service. Assistance canines receive up to 1,205 hours of training at hourly rates ranging from \$3.75 for prison inmates to \$75.00 for certified canine trainers.

Service canines are trained to provide highly specialized service to individuals with physical or psychological impairments. They are typically placed in service at the end of a 2-year training program and are retired after 8 years of service. The cost to train service canines ranges for \$29,277 to \$31,984 depending on the source of acquisition and the type of service the canine will provide when placed in service. Service canines receive up to 2,106 hours training at hourly training rates from \$3.75 for prison inmates to \$75.00 for certified canine trainers.

As of December 31, 2012, paws4people, Inc. had 41 canines in various stages of training, 72 assistance canines in service and 44 service canines in service.

Individual canines are reviewed for asset impairment when a significant change in its use or another indicator of possible impairment is present. No impairment losses were recognized in the financial statements in the current period.

4. NOTES PAYABLE TO RELATED PARTIES

As of December 31, 2012, the Organization had notes payable totaling \$92,616 which were made by nine paws4people, Inc. board members and volunteers. The loans have no stated interest rate and no due date.

In January 2012 the Organization's board of directors passed a resolution stating that donations received from individuals or organizations in support of a named paws4people, Inc. program shall not be used to repay these notes. Loan payments shall only be made using funds specifically designated as unrestricted.