

**NATIONAL CUTTING
HORSE ASSOCIATION**

FINANCIAL STATEMENTS

**Nine Months Ended September 30, 2015 and
Year Ended December 31, 2014
with Report of Independent Auditors**

**NATIONAL CUTTING
HORSE ASSOCIATION**

FINANCIAL STATEMENTS

**Nine Months Ended September 30, 2015 and
Year Ended December 31, 2014**

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors of the
National Cutting Horse Association

We have audited the accompanying financial statements of the National Cutting Horse Association, a not-for-profit organization, which comprise the statements of financial position as of September 30, 2015 and December 31, 2014, and the related statements of activities and changes in net assets and cash flows for the nine-month and twelve-month periods 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 audits. We conducted our audits 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 the National Cutting Horse Association as of September 30, 2015 and December 31, 2014, and the results of its activities and changes in its net assets and its cash flows for the nine-month and twelve-month periods then ended in conformity with accounting principles generally accepted in the United States of America.

Whitley Penn LLP

Fort Worth, Texas
December 30, 2015

NATIONAL CUTTING HORSE ASSOCIATION

STATEMENTS OF FINANCIAL POSITION

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---|---|---|
| | <u>2015</u> | <u>2014</u> |
| Assets | | |
| Cash and cash equivalents (Note C) | \$ 1,936,879 | \$ 2,177,917 |
| Accounts receivable, net of allowance for doubtful accounts of \$12,617 and \$13,745, respectively | 107,110 | 411,744 |
| Accounts receivable - State of Texas incentives | 2,955,496 | 1,618,339 |
| Accrued interest receivable | 57,436 | 52,735 |
| Investments (Note D) | 5,585,883 | 4,226,486 |
| Inventories | 22,491 | 33,636 |
| Prepaid expenses and other assets | 403,018 | 136,070 |
| Property and equipment, net (Note E) | 3,005,460 | 2,417,739 |
| | <u>3,005,460</u> | <u>2,417,739</u> |
| Total assets | <u>\$ 14,073,773</u> | <u>\$ 11,074,666</u> |
| Liabilities and Net Assets | | |
| Liabilities: | | |
| Accounts payable | \$ 456,111 | \$ 1,115,924 |
| Accounts payable - related party | 16,410 | 78,625 |
| Other accrued liabilities | 325,570 | 105,937 |
| Deferred revenue for future shows | 4,023,676 | 481,207 |
| Deferred revenue for stallion/ foal fees (Note K) | 1,963,054 | 1,841,304 |
| Deferred membership dues | 514,906 | 811,126 |
| Deferred revenue, other | 70,884 | 28,750 |
| Youth scholarship awards (Note F) | 896,172 | 861,420 |
| | <u>896,172</u> | <u>861,420</u> |
| Total liabilities | 8,266,783 | 5,324,293 |
| Commitments and contingencies (Note Q) | | |
| Net assets: | | |
| Unrestricted: | | |
| Undesignated | 3,985,487 | 4,291,106 |
| Board designated for youth funds (Note F) | 296,311 | 258,546 |
| | <u>296,311</u> | <u>258,546</u> |
| Total unrestricted | 4,281,798 | 4,549,652 |
| Temporarily restricted - State of Texas incentives (Note G) | 1,525,192 | 1,200,721 |
| | <u>1,525,192</u> | <u>1,200,721</u> |
| Total net assets | 5,806,990 | 5,750,373 |
| | <u>5,806,990</u> | <u>5,750,373</u> |
| Total liabilities and net assets | <u>\$ 14,073,773</u> | <u>\$ 11,074,666</u> |

See accompanying notes to financial statements.

NATIONAL CUTTING HORSE ASSOCIATION

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---|---|---|
| | | |
| Unrestricted Net Assets | | |
| Operating revenues and support: | | |
| Show revenues and support: | | |
| Entry fees | \$ 4,831,481 | \$ 7,132,786 |
| Show fees | 3,143,536 | 4,095,321 |
| Stall rentals and practice pen | 1,224,868 | 1,456,097 |
| Purse sponsors | 14,090 | 123,461 |
| Stallion subscription fees (Note K) | - | 500,000 |
| Booth exhibit rental | 134,839 | 361,261 |
| Tickets | 50,265 | 526,568 |
| Sponsorships | 498,580 | 818,940 |
| Affiliate income | 178,377 | 187,862 |
| Event facility allowances | 312,560 | 424,132 |
| Other show income (Note I) | 82,757 | 69,775 |
| Total show revenues and support | 10,471,353 | 15,696,203 |
| Department revenues and support: | | |
| Advertising | 985,726 | 1,379,130 |
| Sponsorships | 584,082 | 961,781 |
| Affiliate income | 976,531 | 1,209,482 |
| Membership dues and fees | 698,718 | 613,026 |
| Horse auction royalties | - | 723,762 |
| Fund-raising events (Note N) | 123,791 | 110,177 |
| Marketing promotions | 6,630 | 108,091 |
| Other department income (Note I) | 257,535 | 413,007 |
| Total department revenues and support | 3,633,013 | 5,518,456 |
| Net assets released from restrictions- | | |
| State of Texas incentives (Note G) | 1,012,686 | 2,537,802 |
| Total unrestricted operating revenues and support | 15,117,052 | 23,752,461 |
| Operating expenses: | | |
| Show expenses: | | |
| Premiums, including sire awards, and NCHA Weekend | 5,065,775 | 8,400,774 |
| Premiums from State of Texas incentives | 900,000 | 2,168,500 |
| Cattle | 1,469,936 | 2,106,592 |
| Judges and show personnel | 587,049 | 910,940 |
| Awards | 862,041 | 1,237,023 |
| Equipment and facilities rent | 574,286 | 900,799 |
| Coliseum preparation | 268,431 | 349,735 |
| Stall rentals and practice pen expenses | 136,984 | 189,235 |
| Advertising | 117,169 | 169,055 |
| Other show expenses (Note I) | 302,501 | 579,285 |
| Total show expenses | 10,284,172 | 17,011,938 |

See accompanying notes to financial statements.

NATIONAL CUTTING HORSE ASSOCIATION

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS - *continued*

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|--|---|---|
| | <u> </u> | <u> </u> |
| Operating expenses - continued: | | |
| Department expenses: | | |
| Salaries and benefits | \$ 1,717,800 | \$ 2,356,124 |
| Retirement expenses (Note J) | 34,892 | 38,639 |
| Affiliate Challenge and NCHA Weekend | 98,311 | 93,619 |
| Awards | 189,315 | 263,115 |
| Printing | 207,872 | 391,608 |
| Equipment and facilities rent | 80,374 | 146,214 |
| Monitor fees and expenses | 111,094 | 148,147 |
| Sponsor advertisements (non-cash) | 452,808 | 578,652 |
| Project, promotional, and public relations (Note L) | 217,144 | 355,945 |
| Advertising | 86,166 | 217,261 |
| Postage | 110,966 | 129,406 |
| Insurance | 277,994 | 391,807 |
| Payroll and ad valorem taxes | 149,568 | 188,103 |
| Professional fees (Note H) | 304,788 | 456,640 |
| Depreciation and amortization | 93,466 | 136,762 |
| Other department expenses (Note I) | 789,290 | 1,040,881 |
| Total department expenses | <u>4,921,848</u> | <u>6,932,923</u> |
| Total unrestricted operating expenses | <u>15,206,020</u> | <u>23,944,861</u> |
| Operating revenues net of operating expenses | <u>(88,968)</u> | <u>(192,400)</u> |
| Other unrestricted income: | | |
| Interest and dividend income | 144,161 | 151,974 |
| Net realized investment losses | (22,174) | (95,230) |
| Total other unrestricted income | <u>121,987</u> | <u>56,744</u> |
| Change in unrestricted net assets from operations | <u>33,019</u> | <u>(135,656)</u> |
| Other unrestricted non-operating activities: | | |
| Net unrealized gains (losses) in market value of investments | (33,442) | 16,428 |
| Pension Plan changes other than net periodic pension cost | - | (24,885) |
| Stallion/Foal program refund (Note R) | (155,950) | - |
| IT project (Note O) | (111,481) | (43,067) |
| Total other unrestricted non-operating activities | <u>(300,873)</u> | <u>(51,524)</u> |
| Net decrease in unrestricted net assets | <u>(267,854)</u> | <u>(187,180)</u> |
| Temporarily Restricted Net Assets | | |
| Restricted contributions-State of Texas incentives (Note G) | 1,337,157 | 2,231,814 |
| Net assets released from restrictions-State of Texas incentives (Note G) | (1,012,686) | (2,537,802) |
| Net increase (decrease) in temporarily restricted net assets | <u>324,471</u> | <u>(305,988)</u> |
| Net increase (decrease) in net assets | 56,617 | (493,168) |
| Net assets at beginning of period | <u>5,750,373</u> | <u>6,243,541</u> |
| Net assets at end of period | <u><u>\$ 5,806,990</u></u> | <u><u>\$ 5,750,373</u></u> |

See accompanying notes to financial statements.

NATIONAL CUTTING HORSE ASSOCIATION

STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---|---|---|
| | <u> </u> | <u> </u> |
| Operating Activities | | |
| Net increase (decrease) in net assets | \$ 56,617 | \$ (493,168) |
| Adjustments to reconcile net increase (decrease) in net assets to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 93,466 | 136,762 |
| Provision for bad debts | 7,230 | 105,860 |
| Net realized and unrealized losses on investments | 55,616 | 78,802 |
| Restricted contributions - State of Texas incentives | (1,337,157) | (2,231,814) |
| Effect of defined benefit pension plan changes | - | (24,885) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 297,404 | 634,053 |
| Accounts receivable - State of Texas incentives | (1,337,157) | 336,436 |
| Accrued interest receivable | (4,701) | (6,422) |
| Inventories | 11,145 | (29,370) |
| Prepaid expenses and other assets | (266,948) | 74,349 |
| Accounts payable and other accrued liabilities | (440,180) | (201,262) |
| Accounts payable - related party | (62,215) | 78,625 |
| Deferred revenue for future shows | 3,542,469 | 3,687 |
| Deferred revenue for stallion/ foal fees | 121,750 | 272,054 |
| Deferred membership dues | (296,220) | 31,326 |
| Deferred revenue, other | 42,134 | (96,500) |
| Youth scholarship awards | 34,752 | 71,000 |
| Liability for pension obligation | - | (190,304) |
| Net cash provided by (used in) operating activities | <u>518,005</u> | <u>(1,450,771)</u> |
| Investing Activities | | |
| Proceeds from sales of investments | 250,000 | 1,418,839 |
| Purchases of investments | (1,665,013) | (1,670,484) |
| Purchases of property and equipment | (681,187) | (629,838) |
| Net cash used in investing activities | <u>(2,096,200)</u> | <u>(881,483)</u> |
| Financing Activities | | |
| Restricted contributions-State of Texas incentives | <u>1,337,157</u> | <u>2,231,814</u> |
| Net cash provided by financing activities | <u>1,337,157</u> | <u>2,231,814</u> |
| Net decrease in cash and cash equivalents | (241,038) | (100,440) |
| Cash and cash equivalents at beginning of period | <u>2,177,917</u> | <u>2,278,357</u> |
| Cash and cash equivalents at end of period | <u><u>\$ 1,936,879</u></u> | <u><u>\$ 2,177,917</u></u> |

See accompanying notes to financial statements.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

September 30, 2015 and December 31, 2014

A. Nature of Activities

The National Cutting Horse Association (the "Association") is a not-for-profit organization incorporated under the laws of the State of Texas. The purpose of the Association is to encourage the development of, and public interest in, livestock and ranching through the promotion and sponsorship of public cutting horse contests, the public exhibition of cutting horses in conjunction with cattle and livestock, and the presentation and participation of cutting horse events in other general livestock exhibitions, shows and expositions. The Association also sets standards for cutting horse contests; standardizes the election and appointment of judges and directors for such contests, exhibitions and expositions; and, encourages the development and breeding of finer cutting horses. The Association's corporate offices are located in Fort Worth, Texas.

B. Summary of Significant Accounting Policies

A summary of the significant accounting policies of the Association consistently applied in the preparation of the accompanying financial statements follows.

Basis of Accounting

The financial statements of the Association have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which requires the Association 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. The Association does not have any permanently restricted net assets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Fiscal Year Change

Effective October 1, 2015, the Association changed from a calendar year end of December 31 to a fiscal year end of September 30. A nine-month fiscal transition period from January 1, 2015 to September 30, 2015 preceded the start of the new fiscal year cycle.

Contributions

The Association recognizes contributions as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. Time or purpose restricted contributions are required to be reported as temporarily restricted support and are then reclassified to unrestricted net assets upon expiration of the time or purpose restriction.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS *(continued)*

B. Summary of Significant Accounting Policies – continued

Cash and Cash Equivalents

The Association considers all highly-liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Association maintains deposits primarily in two financial institutions, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation (“FDIC”). The Association has not experienced any losses related to amounts in excess of FDIC limits.

Investments

The Association follows the provisions of GAAP, which requires investments with readily determinable fair values to be stated at fair value with realized and unrealized gains and losses included in the statements of activities and changes in net assets of the respective period.

The Association’s investment strategy is generally to hold investments to maturity. If a situation arises whereby there is a substantial gain in a security and there is an opportunity to reinvest the proceeds in a manner that will produce a similar yield, the Association may make the decision to sell the security and realize the gain.

GAAP establishes a framework for measuring fair value and provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under GAAP are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Association has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the assets or liabilities;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the assets or liabilities have a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the assets or liabilities.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurements.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

B. Summary of Significant Accounting Policies – continued

Accounts Receivable

Accounts receivable is comprised primarily of current amounts due under sponsorship agreements and advertising from the Association’s magazine, *The Cutting Horse Chatter*, which are based on agreed-upon prices, as well as amounts due for the State of Texas incentives. The Association provides an allowance for doubtful collections, which is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Normal accounts receivable are due 30 days after the issuance of the invoice. Receivables past due more than 120 days are considered delinquent. Delinquent receivables are written off based on an individual credit evaluation and specific circumstances of the customer.

Inventories

Inventories consist primarily of trophies, DVDs, and videotapes, and are valued at the lower of cost or market with cost determined using the first-in, first-out method.

Property and Equipment

Property and equipment have been recorded at acquisition cost. It is the Association’s policy to capitalize property and equipment purchases over \$1,000. Lesser amounts are expensed. Maintenance, repairs, and minor replacements are charged to operations as incurred; major replacements and betterments are capitalized. The cost of assets retired and the related accumulated depreciation are removed from the accounts at the time of disposition, and any resulting gain or loss is reflected in the statements of activities and changes in net assets of the respective period.

Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which are as follows:

| | |
|--------------------------------|--------------|
| Buildings and improvements | 5 – 39 years |
| Automobiles and trailers | 5 – 7 years |
| Office furniture and equipment | 3 – 10 years |
| Software | 3 years |

Donations of property and equipment are recorded as support at their estimated fair value at the time of receipt. Such donations are reported as unrestricted support unless the donor has restricted the asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long such donated assets must be maintained, the Association reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Association reclassifies temporarily restricted net assets to unrestricted at such time.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (*continued*)

B. Summary of Significant Accounting Policies – continued

Collections

The Association's collections are comprised of artifacts of historical significance or art objects, which have been acquired through various contributions from donors since the inception of the Association. The collections are not recognized as assets in the accompanying statements of financial position. Proceeds from the deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes.

Deferred Revenues and Deferred Membership Dues

Deferred revenue for membership dues and sponsorships represents money received in advance for future periods of activity. Deferred revenue for future shows represents entry fees received in the current period relating to future shows to be sponsored by the Association. The Association recognizes the deferred revenue upon completion of the respective show or in accordance with the terms of the sponsorship agreement. It is the Association's policy to amortize lifetime membership dues over seven to fifteen years. Non-pro dues, first-class postage dues, and trainer fee dues received prior to year-end are generally amortized over one year.

Advertising

Advertising costs are expensed as incurred.

Income Taxes

The Association is a not-for-profit organization as defined in Section 501(c)(5) of the Internal Revenue Code and, accordingly, its activities are generally exempt from federal income taxes. Advertising revenue generated from *The Cutting Horse Chatter* is however considered unrelated business income and is reported as such for tax-reporting purposes. During the nine-months ended September 30, 2015 and the year ended December 31, 2014, net taxable unrelated business income was not significant and therefore, no provision for income taxes was recorded in the accompanying financial statements. The Association has net operating loss carryforwards of approximately \$185,330 that were generated in periods prior to September 30, 2015 as a result of unrelated business income and expense activity. Such loss carryforwards will expire in years 2023 through 2034, if not utilized.

At September 30, 2015, the Association's tax returns related to the years ended December 31, 2012 through December 31, 2014 remain open to possible examination by tax authorities. No tax returns are currently under examination by any tax authorities. As of September 30, 2015, the Association has not incurred any penalties or interest under GAAP.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

B. Summary of Significant Accounting Policies – continued

Donated Services

Donated services are recognized as contributions if the services, (a) create or enhance non-financial assets, or (b) require specialized skills, and are performed by people with those skills, and would otherwise be purchased by the Association. The Association pays for most services requiring specialized skills. However, a number of individuals volunteer their time and perform a variety of tasks that assist the Association with specific program functions and various other activities that are not recognized as contributions in the accompanying financial statements, because the recognition criteria was not met.

C. Cash and Cash Equivalents

Cash and cash equivalents consisted of the following:

| | <u>September 30, 2015</u> | <u>December 31, 2014</u> |
|---------------------------------|-------------------------------|------------------------------|
| Cash | \$ 1,693,361 | \$ 1,388,165 |
| Cash equivalents | <u>243,518</u> | <u>789,752</u> |
| Total cash and cash equivalents | <u>\$ 1,936,879</u> | <u>\$ 2,177,917</u> |

As of September 30, 2015 and December 31, 2014, cash equivalents were held by the Association's third-party investment advisor and were invested in short-term bond funds.

NATIONAL CUTTING HORSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS (continued)

D. Investments

The cost and market value of investments are as follows:

| | <u>September 30, 2015</u> | | <u>December 31, 2014</u> | |
|-------------------------|---------------------------|---------------------|--------------------------|---------------------|
| | <u>Cost</u> | <u>Market Value</u> | <u>Cost</u> | <u>Market Value</u> |
| Certificates of deposit | \$ - | \$ - | \$ 3,827 | \$ 3,827 |
| Corporate bonds | 4,422,576 | 4,344,479 | 3,020,428 | 2,966,682 |
| Foreign bonds | 945,402 | 937,198 | 950,883 | 945,783 |
| Municipal bonds | 314,815 | 304,206 | 314,816 | 310,194 |
| Total investments | <u>\$ 5,682,793</u> | <u>\$ 5,585,883</u> | <u>\$ 4,289,954</u> | <u>\$ 4,226,486</u> |

The market value of the Association's investments was based on Level 2 inputs, as defined by GAAP, which represent quoted prices for identical or similar assets or liabilities in inactive markets.

Net investment income, including realized and unrealized gains and losses, consisted of the following:

| | <u>Nine Months Ended September 30, 2015</u> | <u>Year Ended December 31, 2014</u> |
|---|---|-------------------------------------|
| Interest and dividend income | \$ 144,161 | \$ 151,974 |
| Net realized investment losses | (22,174) | (95,230) |
| Net unrealized gains (losses) | (33,442) | 16,428 |
| Investment management fees | (21,313) | (29,008) |
| Net investment income, including realized and unrealized gains and losses | <u>\$ 67,232</u> | <u>\$ 44,164</u> |

NATIONAL CUTTING HORSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS (continued)

E. Property and Equipment

Property and equipment consisted of the following:

| | <u>September 30, 2015</u> | <u>December 31, 2014</u> |
|--------------------------------|-------------------------------|------------------------------|
| Land | \$ 139,788 | \$ 139,788 |
| Buildings and improvements | 2,304,318 | 2,304,318 |
| Automobiles and trailers | 48,488 | 48,488 |
| Office furniture and equipment | 910,627 | 909,197 |
| Software | 1,255,261 | 575,505 |
| Total property and equipment | <u>4,658,482</u> | <u>3,977,296</u> |
| Less accumulated depreciation | <u>1,653,022</u> | <u>1,559,557</u> |
| Property and equipment, net | <u>\$ 3,005,460</u> | <u>\$ 2,417,739</u> |

At September 30, 2015, the Association capitalized in-house software development costs of \$1,255,261 which are currently still in development and therefore, no amortization of these costs was incurred during the nine-months ended September 30, 2015. These systems are expected to be placed in service during 2016 at which time amortization will commence.

F. Unrestricted Net Assets – Board Designated for Youth Funds

As of September 30, 2015 and December 31, 2014, approximately \$296,000 and \$259,000 of net assets were designated by the Board of Directors of the Association for youth funds.

Youth funds include excess revenues earned on youth activities that have been designated for future youth events. The liability for youth scholarship awards represents scholarships awarded that will be paid when the awardees enroll in college. If an awardee reaches age 25 and has not utilized the full amounts of the scholarship, the unused amounts are returned to the amount designated for youth funds.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

G. Temporarily Restricted Net Assets – State of Texas Incentives

Based on approved applications, the State of Texas provides incentives to the City of Fort Worth for Association events held in the Fort Worth area. The City of Fort Worth, in turn, provides incentives to the Association that are restricted for the purpose of enhancing Association shows that qualify for the state incentives. Funds awarded for current Triple Crown events are restricted for use in qualifying shows. The temporarily restricted amounts were held in accounts receivable – State of Texas incentives and investments at September 30, 2015 and December 31, 2014. The following represents the incentives awarded by the State of Texas and amounts released from restriction as approved by the Executive Committee:

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---------------------------------------|---|---|
| Beginning balance | \$ 1,200,721 | \$ 1,506,709 |
| Super Stakes: | | |
| State of Texas incentive contribution | 922,242 | 613,475 |
| Net assets released from restrictions | (510,900) | (733,086) |
| Derby (Summer Spectacular): | | |
| State of Texas incentive contribution | 414,915 | 762,130 |
| Net assets released from restrictions | (501,786) | (679,473) |
| Futurity: | | |
| State of Texas incentive contribution | - | 856,209 |
| Net assets released from restrictions | - | (1,125,243) |
| Ending balance | \$ 1,525,192 | \$ 1,200,721 |

The temporarily restricted amounts were held in accounts receivable – State of Texas incentives and investments at September 30, 2015 and December 31, 2014. The detail of the certified amounts recorded in accounts receivable – State of Texas incentives as of:

| | September 30, 2015 | December 31, 2014 |
|---|-------------------------------|------------------------------|
| 2014 Derby (Summer Spectacular) | \$ 762,130 | \$ 762,130 |
| 2014 Futurity | 856,209 | 856,209 |
| 2015 Super Stakes | 922,242 | - |
| 2015 Derby (Summer Spectacular) | 414,915 | - |
| Total accounts receivable – State of Texas incentives | \$ 2,955,496 | \$ 1,618,339 |

NATIONAL CUTTING HORSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS (continued)

H. Professional Fees

Professional fees were composed of the following:

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---|---|---|
| Actuarial services | \$ 6,171 | \$ 69,659 |
| Attorneys | 112,500 | 151,230 |
| Auditing, tax, and ballot counting services | 62,767 | 55,179 |
| Consulting - economic impact and review | 27,500 | 92,545 |
| Consulting - legislative | 67,979 | 78,822 |
| Consulting - marketing | 2,031 | 8,254 |
| Consulting - information technology | 2,190 | 651 |
| Consulting - other | 23,650 | 300 |
| Total professional fees | <u>\$ 304,788</u> | <u>\$ 456,640</u> |

I. Other Income and Expenses

Other income and other expenses were composed of the following:

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---------------------------|---|---|
| Other show income: | | |
| Convention tours | \$ - | \$ 3,250 |
| DVD viewing | 35,915 | 27,113 |
| Scoreboard advertising | 6,984 | 6,750 |
| Show transfer fees | 500 | 3,000 |
| Slot cutting, net | 34,346 | - |
| Webcast | 5,012 | 29,662 |
| Total other show income | <u>\$ 82,757</u> | <u>\$ 69,775</u> |

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

I. Other Income and Expenses – continued

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|--|---|---|
| Other department income: | | |
| Convention registration | \$ 60,709 | \$ 23,800 |
| Donations and other miscellaneous income | 34,534 | 89,475 |
| Electronic advertising and NCHA blog | 14,203 | 14,175 |
| Fines and protests | 19,500 | 35,059 |
| Horse records | 6,376 | 5,685 |
| Judges - seminars and fees | 16,140 | 47,470 |
| Royalties and affinity programs | 106,073 | 197,343 |
| | <u>\$ 257,535</u> | <u>\$ 413,007</u> |
| Other show expenses: | | |
| Exhibit hall and show office supplies | \$ 117,082 | \$ 205,525 |
| Hospitality | 38,326 | 112,063 |
| Show postage, printing, and tickets | 5,732 | 6,999 |
| Show promotions | 1,155 | 79,637 |
| Show sponsor cost | 4,911 | 3,960 |
| Video production | 62,401 | 63,146 |
| Veterinarian expenses and drug testing | 72,894 | 107,955 |
| | <u>\$ 302,501</u> | <u>\$ 579,285</u> |
| Other department expenses: | | |
| Bad debts | \$ 7,230 | \$ 105,860 |
| Bank fees and charges | 17,100 | 19,549 |
| Committee expenses | 90,964 | 95,587 |
| Contract labor | 63,646 | 94,444 |
| Convention expenses | 77,407 | 96,263 |
| Credit card fees | 204,699 | 193,464 |
| Dues, fees, and subscriptions | 69,334 | 42,072 |
| Feature stories | 15,396 | 19,281 |
| Investment management fees | 21,313 | 29,008 |
| Miscellaneous expenses | 10,063 | 13,094 |
| Office supplies | 30,645 | 45,696 |
| Repairs and maintenance | 21,067 | 21,705 |
| Scholarships | 30,666 | 52,959 |
| Travel | 36,329 | 86,824 |
| Utilities | 80,831 | 100,580 |
| Vehicle allowance | 12,600 | 24,495 |
| | <u>\$ 789,290</u> | <u>\$ 1,040,881</u> |
| Total other department expenses | <u>\$ 789,290</u> | <u>\$ 1,040,881</u> |

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

J. Benefit Plans

The Association sponsors a defined contribution salary deferral plan (the "Deferred Plan") covering substantially all employees. Employees can make voluntary contributions. The Association matches 50% of employee contributions up to 3% of the employee's eligible compensation, as defined in the Deferred Plan documents. The Association at its discretion may also contribute an additional amount, as it deems necessary. During the nine-months ended September 30, 2015 and year ended December 31, 2014, the Association made matching contributions of approximately \$35,000 and \$39,000, respectively. The Association made no discretionary contributions to the Deferred Plan during the nine-months ended September 30, 2015 and year ended December 31, 2014.

The Association sponsored a defined benefit pension plan (the "Pension Plan") covering all of its fulltime employees hired prior to October 31, 2003. Pension benefits were based upon years of service and average compensation. The Association's funding policy was to make annual contributions sufficient to meet at least the minimum funding standards of the Employee Retirement Income Security Act of 1974. In 2003, the Association froze the Pension Plan. During 2010, the Executive Committee approved a plan to truncate the Pension Plan over a five-year period beginning in 2010. During 2013, the Executive Committee approved a plan to begin terminating the Pension Plan with a target termination date in 2014. During 2014, the Association paid out all obligations associated with the Pension Plan.

K. Stallion/ Foal Fees

In 2011, a Stallion/ Foal fees incentive program replaced the previous Stallion Subscription program for the Super Stakes. Stallions are required to subscribe the year before the breeding season, which is six years prior to the first Super Stakes that the resulting foals would be eligible to compete. The Stallion fee is \$2,500 (not including the \$100 insurance charge). The funds are held as deferred revenue and will be disbursed into the first show of eligibility for the resulting foals of each crop. Foals are also required to be nominated in the new program in order to compete in the Super Stakes. Foal nomination money is also held as deferred revenue and is also disbursed into the first year of eligibility for those foals at age 4. The foal nomination fee chart is below:

| | | |
|-----------------------------|----|--------|
| Foaling year (by deadline) | \$ | 200 |
| Weanling year (by deadline) | | 1,250 |
| 2 year old (by deadline) | | 7,500 |
| 3 year old and up | | 10,000 |

During the interim three years between the close of the old program in 2011 and the initial foal disbursements in 2015, \$500,000 per year (for a total of \$1,500,000 over the three years) was advanced to the Super Stakes from general fund to maintain added money in the show. Those funds will be reimbursed from the program to the general fund over a period of six years (\$250,000 per year), beginning in 2017 when the initial Stallion Fee funds are disbursed.

NATIONAL CUTTING HORSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS (continued)

K. Stallion/ Foal Fees – continued

The following table shows the detail of the funds at:

| | <u>September 30, 2015</u> | <u>December 31, 2014</u> |
|---|-------------------------------|------------------------------|
| Stallion fees collected for the 2017 Super Stakes | \$ 465,548 | \$ 446,698 |
| Stallion fees collected for the 2018 Super Stakes | 511,746 | 541,446 |
| Stallion fees collected for the 2019 Super Stakes | 379,400 | 366,600 |
| Stallion fees collected for the 2020 Super Stakes | 325,503 | 202,600 |
| Stallion fees collected for the 2021 Super Stakes | 129,997 | - |
| | <hr/> | <hr/> |
| Total stallion fees collected | 1,812,194 | 1,557,344 |
| Total advances to the Super Stakes | <u>(1,500,000)</u> | <u>(1,500,000)</u> |
| Net stallion fees | <hr/> 312,194 | <hr/> 57,344 |
| Foal fees collected for the 2015 Super Stakes | - | 591,950 |
| Foal fees collected for the 2016 Super Stakes | 599,800 | 598,300 |
| Foal fees collected for the 2017 Super Stakes | 541,650 | 454,350 |
| Foal fees collected for the 2018 Super Stakes | 483,010 | 139,360 |
| Foal fees collected for the 2019 Super Stakes | 26,400 | - |
| | <hr/> | <hr/> |
| Total foal fees collected | 1,650,860 | 1,783,960 |
| Deferred revenue for stallion/ foal fees | <u>\$ 1,963,054</u> | <u>\$ 1,841,304</u> |

At September 30, 2015, total advances from the general fund to the Super Stakes were as follows:

| | |
|------------------------------------|---------------------|
| Advance to the 2012 show | \$ 500,000 |
| Advance to the 2013 show | 500,000 |
| Advance to the 2014 show | <u>500,000</u> |
| Total advances to the Super Stakes | <u>\$ 1,500,000</u> |

See Note R for subsequent event disclosure relating to this program.

NATIONAL CUTTING HORSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS (continued)

L. Project, Promotional and Public Relations

Project, promotional and public relations expense were composed of the following:

| | Nine Months Ended September 30, 2015 | Year Ended December 31, 2014 |
|---|---|---|
| Affiliate software | \$ 47,550 | \$ 59,250 |
| Celebrity cutting | - | 66 |
| Daily chatter | 154 | 31,800 |
| Cutting academy clinics | 17,175 | 17,564 |
| NCHA blog | 12,600 | 18,450 |
| Other projects | 26,884 | 6,290 |
| Promotions | 48,133 | 63,334 |
| Public relations | 22,046 | 16,226 |
| Sponsor cutting | 4,054 | 12,245 |
| Television – Futurity | 1,540 | 700 |
| Television – other | 18,306 | 11,724 |
| Triple crown promotion | 15,296 | 88,244 |
| Youth projects | 3,406 | 30,052 |
| | <hr/> | <hr/> |
| Total project, promotional and public relations expense | <u>\$ 217,144</u> | <u>\$ 355,945</u> |

M. Concentrations

Entry fees, purse sponsorships, and other monies collected in advance of future shows are invested in short-term bond funds and various fixed income securities, which consist of liquid assets in various financial institutions.

At September 30, 2015 and December 31, 2014, approximately 97% and 80%, respectively, of the Association's accounts receivable was comprised of outstanding amounts due from the City of Fort Worth for the State of Texas incentives. All receivables are unsecured and are not pledged as collateral or limited in use.

N. Fund-Raising Events

The Association holds annual fund-raising events for the youth department and reports the revenue generated, net of any direct operating costs, as revenues in the accompanying statements of activities and changes in net assets which approximated \$124,000 and \$110,000 during the nine-months ended September 30, 2015 and year ended December 31, 2014, respectively. There were no direct costs relating to fund-raising events in 2015 or 2014.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (*continued*)

O. Unrestricted Non-Operating Activities

The Association incurred expenses of approximately \$111,000 and \$43,000, respectively, for the nine-months ended September 30, 2015 and year ended December 31, 2014 for planning costs associated with developing a new website. These expenses have been recorded as unrestricted non-operating activities as these activities do not fall with the Association's normal operations as discussed in Note A.

P. Related Party Transactions

NCHA Charities Foundation (the "Foundation") is a 501(c)(3) charitable organization that supports and benefits the Association by, among other things, maintaining scholarship funds, providing crisis funding in accordance with guidelines adopted by the board of directors of the Foundation, developing educational and animal welfare programs and otherwise assisting with the charitable purposes of the Association. At September 30, 2015 and December 31, 2014, the Association had a receivable of approximately \$30,000 and \$53,000, respectively, due from the Foundation relating to reimbursement of costs, which is included in accounts receivable in the accompanying statements of financial position. In addition, the Association's accounting department performs accounting functions for the Foundation at no cost.

The Association donated advertising in *The Cutting Horse Chatter* to the Foundation valued at approximately \$21,000 and \$24,000 for the nine-months ended September 30, 2015 and year ended December 31, 2014, respectively.

The Association receives a percentage of gross entry fees from national affiliates from their cutting horse contests. During the nine-months ended September 30, 2015 and year ended December 31, 2014, the Association received entry fees of approximately \$1,122,000 and \$1,346,000, respectively, from these affiliates.

Fees received from affiliates for use of the Association's show production software during the nine-months ended September 30, 2015 and year ended December 31, 2014 were approximately \$33,000 and \$51,000, respectively. Supplemental show software costs were reimbursed to affiliates meeting the requirements for partial reimbursement. During the nine-months ended September 30, 2015 and year ended December 31, 2014, show software costs of approximately \$48,000 and \$59,000, respectively, were reimbursed to affiliates.

The Association established the NCHA Texas Events PAC entity (the "PAC") in 2008 to promote and celebrate the cutting horse by making an effort to impact legislation that will positively affect the equine industry. At December 31, 2014, the Association had a receivable of approximately \$25,000 due from the PAC relating to reimbursement of costs. There was no such receivable at September 30, 2015. In addition, at September 30, 2015 and December 31, 2014, the Association had a payable of approximately \$34,000 and \$79,000, respectively, due to the PAC relating to donations collected from NCHA members on behalf of the PAC.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (*continued*)

Q. Commitments and Contingencies

From time to time, the Association is involved in various lawsuits and claims arising in the normal course of business. In management's opinion, the ultimate outcome of these items will not have a material adverse effect on the Association's financial position or results of operations.

The Association guarantees all entry fees paid by contestants to show management (affiliates) representing cutting horse contests. During the nine-months ended September 30, 2015 and year ended December 31, 2014, the contestants must be members of the Association in good standing and the show must remit 8% of all entry fees to the Association. At September 30, 2015 and December 31, 2014, approximately \$2,000 and \$300, respectively, was still receivable from the contestants. In the opinion of management, the amount of ultimate liability with respect to these entry fees will not materially affect the financial position or results of operations of the Association.

The Association leases certain office equipment, with annual rental payments of approximately \$19,000, which matures in January through March 2018. Rental expense under this lease approximated \$14,000 and \$19,000 for the nine-months ended September 30, 2015 and year ended December 31, 2014, respectively. Minimum annual lease payments approximate \$19,000 for 2016 through 2017 and \$7,000 for 2018.

The Association leases facilities from the City of Fort Worth under a five-year operating lease, which initially matured in May 2011, for the purpose of holding the Super Stakes, Summer Spectacular, World Championship Futurity, and World Finals events each year. On January 1 of each year beginning in 2008, one additional year will be automatically added to the end of the initial five-year term of this lease agreement unless written notice is given by either party prior to January 1. At September 30, 2015, the Association is obligated to continue under this lease until May 2017. The amount paid during the nine-months ended September 30, 2015 and year ended December 31, 2014 for the facilities rental under the lease was approximately \$199,000 and \$373,000, respectively. Minimum rentals, on an annual basis, are approximately \$304,000 for 2016 through 2017 and \$134,000 for 2018.

The Association entered into an operating lease for the rental of facilities in Jackson, Mississippi for the annual Eastern National Championships event which matured in March of 2013. The Association entered into an extension agreement for the 2014 and 2015 events. The amounts paid during the nine-months ended September 30, 2015 and year ended December 31, 2014 for the facilities rental was \$40,000 each year.

The Association entered into an operating lease for the facilities in Reno, Nevada for the annual Western National Championships in 2015. The amount paid during the nine-months ended September 30, 2015 was \$30,000. The Association leased facilities from the National Western Complex in Denver, Colorado for the annual Western National Championships event for 2016. The minimum annual lease payments are approximately \$25,000 for 2016.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS *(continued)*

Q. Commitments and Contingencies – continued

During 2011, the Association entered into an agreement with Western Bloodstock, Ltd (“WB”), which is in effect until January 1, 2016. WB will be the exclusive auction provider for all horse sales during events produced by the Association. In connection with the agreement, WB pays the Association the greater of 4% of annual gross sales, as defined by the agreement, or \$500,000, and also reimburses the Association for various expenses incurred in connection with the sale of horses. During the year ended December 31, 2014, the Association received approximately \$724,000 from WB in connection with the horse sales and these amounts are recorded in horse auction royalties in the accompanying statements of activities and changes in net assets. There was no such amount received during the nine-months ended September 30, 2015.

R. Subsequent Events

In preparing the accompanying financial statements, management has evaluated all subsequent events and transactions for potential recognition or disclosure through December 30, 2015, the date the financial statements were available for issuance.

In November 2015, the Association’s management communicated to the Executive Committee the various administrative issues associated with the Stallion/ Foal fees incentive program (see Note K). The issues occurred as a result of: (1) the volume of foals; (2) the multiple ways in which the nominations were allowed to be communicated (i.e. email, hand written notes, phone calls, etc.); (3) the fact that foals were not required to be named at the time of nomination, and; (4) a lack of timely follow up on missing or incomplete information on both foals and stallions.

An internal review of the program revealed that there was incomplete information on six horses that entered the 2015 Super Stakes. As a result, the Association’s Executive Committee has concluded that all penalties paid by stallion owners back to the 2012 breeding year and all foal nomination penalties paid to date will be refunded.

At September 30, 2015, the Association recorded \$155,950 in other accrued liabilities in the accompanying statement of financial position related to the refund of penalties associated with foal nominations for the 2015 Super Stakes. The expense associated with this refund has been recorded as stallion/foal fees refund in the accompanying statement of activities and changes in net assets for the nine months ended September 30, 2015.

NATIONAL CUTTING HORSE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS (continued)

R. Subsequent Events – continued

As set forth in the following table, all other refunds are associated with future Super Stakes events and will be deducted from the funds previously collected for the appropriate years which are recorded in deferred revenue for stallion/foal fees in the accompanying statements of financial position. The Association will refund the balances in fiscal 2016 which will result in a reduction of cash and deferred revenue for stallion/ foal fees and net assets will not be affected.

| | Deferred Revenue at September 30, 2015 | Estimated Fiscal 2016 Refunds | Adjusted Deferred Revenue after Refunds |
|---|---|--|--|
| Stallion fees collected for the 2017 Super Stakes | \$ 465,548 | \$ (26,344) | \$ 439,204 |
| Stallion fees collected for the 2018 Super Stakes | 511,746 | (18,500) | 493,246 |
| Stallion fees collected for the 2019 Super Stakes | 379,400 | (28,400) | 351,000 |
| Stallion fees collected for the 2020 Super Stakes | 325,503 | (22,000) | 303,503 |
| Stallion fees collected for the 2021 Super Stakes | 129,997 | (6,000) | 123,997 |
| Total stallion fees collected | 1,812,194 | <u>\$ (101,244)</u> | 1,710,950 |
| Total advances to the Super Stakes | <u>(1,500,000)</u> | | <u>(1,500,000)</u> |
| Net stallion fees | <u>312,194</u> | | <u>210,950</u> |
| Foal fees collected for the 2016 Super Stakes | 599,800 | (94,850) | 504,950 |
| Foal fees collected for the 2017 Super Stakes | 541,650 | (137,600) | 404,050 |
| Foal fees collected for the 2018 Super Stakes | 483,010 | (62,100) | 420,910 |
| Foal fees collected for the 2019 Super Stakes | 26,400 | - | 26,400 |
| Total foal fees collected | <u>1,650,860</u> | <u>\$ (294,550)</u> | <u>1,356,310</u> |
| Deferred revenue for stallion/ foal fees | <u>\$ 1,963,054</u> | | <u>\$ 1,567,260</u> |