

OPERATION GRATITUDE, INC.

(A California Nonprofit Public Benefit Corporation)

FINANCIAL STATEMENTS

December 31, 2012



Gurseley | Schneider LLP
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

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& ADVISORS

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- Gary L. Krausz, CPA†
- Keith S. Dolabson, CPA
- James M. Good, CPA†

DIRECTORS

- Brian J. Gray, CPA

FOUNDERS

- Donald L. Gursey, (1936-2007)
- Stanley B. Schneider, CPA



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Independent Auditors' Report

To the Board of Directors
Operation Gratitude, Inc.
Los Angeles, California

We have audited the accompanying financial statements of the Operation Gratitude, Inc., 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.

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.

*Accredited in Business Valuation
†Certified in Financial Forensics

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Operation Gratitude, Inc. as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Lussey | Schneider LLP

June 13, 2013
Los Angeles, California

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statements of Financial Position
December 31, 2012

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 1,553,570
Investments	9,256
Contributions receivable	7,112
Prepaid insurance	1,853
Donated inventory	<u>5,798,036</u>

TOTAL CURRENT ASSETS 7,369,827

PROPERTY AND EQUIPMENT, net 13,313

TOTAL ASSETS \$ 7,383,140

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable \$ 104,583

TOTAL CURRENT LIABILITIES 104,583

NET ASSETS

NET ASSETS - UNRESTRICTED 7,278,557

TOTAL LIABILITIES NET ASSETS \$ 7,383,140

See Accompanying Notes to Financial Statements

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statements of Activities
Year Ended December 31, 2012

SUPPORT AND REVENUES:	
Contributions	\$ 2,037,428
Net realized and unrealized investment gain	3,645
Interest income	<u>556</u>
SUBTOTAL	2,041,629
Donated goods for distribution	9,992,840
Donated advertising	766,809
Donated management services	433,407
Donated use of facilities	200,000
Donated legal and consulting services	<u>56,000</u>
TOTAL SUPPORT AND REVENUES	<u>13,490,685</u>
EXPENSES:	
Program services	13,118,599
Management and general	501,768
Fundraising	<u>293,464</u>
TOTAL EXPENSES	<u>13,913,831</u>
DECREASE IN NET ASSETS	(423,146)
NET ASSETS, BEGINNING OF YEAR	8,428,003
Adjustment to prior period	<u>(726,300)</u>
NET ASSETS, END OF YEAR	<u><u>\$ 7,278,557</u></u>

See Accompanying Notes to Financial Statements

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statement of Functional Expenses
Year Ended December 31, 2012

	Program Services	Management and General	Fundraising	TOTAL EXPENSES
Goods delivered	\$ 10,576,648	\$ -	\$ -	\$ 10,576,648
Salaries and outside services	830,897	226,451	136,939	1,194,287
Postage and shipping supplies	896,233	-	-	896,233
Advertising	469,576	156,525	156,525	782,626
Rent	200,000	-	-	200,000
Professional fees	-	84,850	-	84,850
Project and office administration	38,175	4,533	-	42,708
Supplies and donated food services	34,943	-	-	34,943
Travel	27,709	-	-	27,709
Equipment rental	24,439	-	-	24,439
Telephone and internet services	-	11,699	-	11,699
Repairs and maintenance	10,249	-	-	10,249
Depreciation	9,730	-	-	9,730
Merchant fees	-	8,233	-	8,233
Insurance	-	5,422	-	5,422
Taxes and licenses	-	4,055	-	4,055
TOTAL EXPENSES	\$ 13,118,599	\$ 501,768	\$ 293,464	\$ 13,913,831

The statement of functional expenses reflected above includes non-cash expenses for donated goods delivered (\$10,576,648), donated advertising and publicity (\$766,809), donated salaries and outside services (\$433,407), donated rent (\$200,000), donated legal services (\$6,000) and donated consulting services (\$50,000). These non-cash expenses comprise approximately 86% of total expenses during the year.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statement of Cash Flows
Year Ended December 31, 2012

CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	
Change in net assets	\$ (423,146)
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation expense	9,730
Non-cash contribution of investments	(108)
Non-cash contribution of fixed assets	(4,301)
Net realized and unrealized investment gain	(3,645)
Changes in assets and liabilities	
Contributions receivable	7,903
Prepaid expense	1,004
Donated inventory	306,192
Accounts payable	96,116
	<hr/>
CASH USED FOR OPERATING ACTIVITIES	(10,255)
 CASH FLOWS PROVIDED BY INVESTING ACTIVITIES	
Proceeds from sale of investments	5,050
	<hr/>
DECREASE IN CASH	(5,205)
 CASH AT BEGINNING OF YEAR	 1,558,775
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CASH AT END OF YEAR	\$ 1,553,570
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See Accompanying Notes to Financial Statements

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2012

NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

Operation Gratitude, Inc., a California non-profit public benefit corporation (the Organization), seeks to lift troops' morale by sending care packages to U.S. armed service members overseas. The care packages contain food, toiletries, clothing, entertainment items and personal letters of appreciation. The Organization also sends special care packages to the children of deployed or deploying Military and other family members and caregivers at home.

Through Collection Drives, Letter Writing Campaigns and Donations of requested items or funds for shipping expenses, the Organization provides civilians anywhere in America a way to express their respect and appreciation to the men and women of the U.S. military in an active, hands-on manner.

During the year ended December 31, 2012, the Organization distributed approximately 71,000 Troop care packages, 34,000 Battalion Buddies care package, 3,000 Wounded Warriors care packages, 22,000 Veterans care packages, 23,000 Military Families care packages, and 14,000 other care packages. Additionally, the Organization distributed goods in bulk quantities to military bases and other military support charitable organizations.

The Organization is a 501(c)(3) not-for-profit corporation, funded entirely by private donations. For safety and security, the assembling of all packages occurs at the Operation Gratitude headquarters located at the California Army National Guard armory located in Van Nuys, California.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP).

Net Assets – The Organization recognizes contributions, including unconditional promises to give, as revenue in the period received. Revenues, gains, expenses and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

- Unrestricted net assets - represent the portion of expendable funds that are available to support the operations and are not subject to donor-imposed restrictions
- Temporarily restricted net assets - consist of contributions that are restricted for use in specific programs or whose restrictions expire with the passage of time. The Organization records temporarily restricted cash contributions that are received and expended in the same year as temporarily restricted revenue. As the donor restrictions are satisfied, net assets are released from restrictions.
- Permanently restricted net assets - comprise funds that are subject to restrictions that the principal may be maintained in perpetuity and invested for the purpose of producing present and future income that may be expended by the Organization.

All net assets are unrestricted at December 31, 2012.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2012

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

Contributed Goods - The Organization receives most of the items it sends in care packages from private donations from corporations and individuals. Donated goods are recorded as unrestricted contributions when they are received. Donated goods are valued at management's estimate of fair value at the time they are received, net of goods that are unusable for the Organization's purposes. Upon distribution, the goods are recorded as a decrease in unrestricted net assets. Goods that are unusable for the Organization's purposes are donated to other military charities.

The Organization also receives rent-free use of the California Army National Guard facilities. This facility is used to receive, store and distribute inventory throughout the year and maintain an administrative office. This facility is also used to stage assembly operations during the Organization's bi-annual package drives. Management estimates the value of contributed rent at \$200,000 for the year ended December 31, 2012.

Contributed Services – Some management services provided to the Organization are donated. Contributed services are recognized by the Organization if the services received (a) increase or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Management estimates the fair value of such services to be \$433,407 for the year ended December 31, 2012.

These amounts include the services of the following individuals:

- Director of Development
- Mangers
- Forklift Operator
- Production Engineers
- Database Analysts
- Merchandising Manager
- Video Editors

Also included are individuals with specialized technical skills; individuals without whom the Organization would not be able to operate.

The Organization receives donated advertisements including online advertisements, the production of a promotional video, and social media promotion on high-traffic websites. Management estimates the fair value of such services to be \$766,809 for the year ended December 31, 2012. The Organization receives donated legal and consulting services valued at \$56,000 for the year ended December 31, 2012.

Additionally, the Organization receives a significant amount of contributed time from volunteers that does not meet the two recognition criteria described above. Accordingly, the value of this contributed time is not reflected in the accompanying financial statements. Management estimates that approximately 350,000 volunteer hours for solicitation, collection, staging, letter writing, knitting scarves, and package assembly were received last year by a support network of volunteers around the country. The purpose of the Organization could not be fulfilled without the significant contributions of volunteer time, which is not reflected in the accompanying financial statements.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2012

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

Functional Allocation of Expenses – The costs of providing the programs and other activities have been summarized on a functional basis in the statement of activities and detailed in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited based on management's estimates.

Inventory – Inventory is valued based on management's estimate of fair value (a Level 3 fair value measure) for each item received or actual cost for items that are purchased. Inventory consists primarily of home health products, consumer confectionary items, small electronic devices, music, movies, small dry grocery items, and other miscellaneous gifts. All inventories are warehoused at the California Army National Guard facilities.

Included in ending inventory are the following completed care packages and their values at year-end.

Troop care packages (includes troop, veteran, first responder, Wounded Warrior and special military family)	4,524
Battalion Buddies	821
Candy	3,145
Total value of completed boxes	<u>\$ 587,000</u>

Income Tax – The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, as amended. The Organization is also exempt from California Franchise taxes under Section 23701(d) of the State Revenue and Taxation Code. Therefore, no provision for federal or state income taxes is reflected in the accompanying financial statements.

The Organization's federal income tax and informational returns for tax years 2009 and subsequent remain subject to examination by the Internal Revenue Service. The returns for California remain subject to examination by the California Franchise Tax Board for years 2008 and subsequent.

Cash Equivalents – For the purposes of the statement of cash flows, cash equivalents consist of highly liquid, short-term money market investments.

Investments – Investments, totaling \$9,256 consist of various publicly traded equity securities. These investments are valued at the closing share trade price at the end of the year. This represents a Level 1 fair value measure.

Property and Equipment — Property and equipment consists of ten donated taping machines, ten portable storage containers, four forklifts, one pallet jack, and approximately 800 storage bins valued at cost or management's estimate of fair value at time of donation. The taping machines, fork lifts, storage containers, pallet jack are depreciated on a straight-line method over two to five years.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2012

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

Restatements – Prior year amounts have been restated to reflect a correction of an error. The following is a reconciliation of amounts reported as of and for the year ended December 31, 2011:

	<u>Change in Net Assets</u>	<u>Net Assets Unrestricted</u>
As reported	\$ 3,511,116	\$ 8,428,003
Adjustment to inventory values and cost of goods delivered	<u>(726,300)</u>	<u>(726,300)</u>
<i>As restated</i>	<u>\$ 2,784,816</u>	<u>\$ 7,701,703</u>

This adjustment is reflected in the accompanying financial statements as an adjustment to the opening amount net assets as of December 31, 2011.

Subsequent Events - The Company evaluated subsequent events through June 13, 2013, the date the financial statements were available to be issued.

NOTE 3 – USE OF ESTIMATES

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

As the operations of the Organization are conducted primarily by volunteers engaged to distribute donated goods, the most significant estimates related to the valuation of contributed goods, contributed labor and other services, and the valuation of inventory on hand. Contributed goods, labor, and services account for 85% of total revenues and contributed goods in inventory accounted for 79% of total assets for the year ended December 31, 2012.

The valuation of contributed goods is based on management's estimate of fair value for each item received. Items are valued upon receipt. Fair values are determined based on numerous factors which may include (a) amounts specified by the donor as being the wholesale selling price, (b) current retail or selling price of similar items, if known, or (c) management's own subjective appraisals based on research. Additionally, items of a unique or personal nature which do not have readily determinable fair values and goods which do not conform to the Organization's size or quality requirements for shipping are either assigned a nominal value or not assigned a value.

The valuation of donated salaries is based on prevailing labor costs of executive and supervisory employees engaged in non-profit and logistics management roles. The key roles of contributed service which meet the criteria for recognition discussed would include a minimum level of employed staffing required to run the Organization. Amounts recognized include a full-time development and communications manager, IT support personnel, and supervisors required to coordinate the efforts of all the volunteers at the bi-annual staging events.

OPERATION GRATITUDE, INC.
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Notes to Financial Statements
December 31, 2012

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

Taping machines	\$	35,500
Storage containers		28,626
Forklifts		5,600
Forklifts, held for sale		<u>3,700</u>
		73,426
Less accumulated depreciation		<u>(60,113)</u>
Total property and equipment	\$	<u><u>13,313</u></u>

Normal repairs and maintenance, as well as property and equipment purchases less than \$1,000 are expensed as incurred.

NOTE 5 – RELATED PARTY TRANSACTIONS

Administrative operations are conducted in the residences of the Directors and Executive Officers without cost. No provision for donated rent, utilities, and small office equipment is included in the accompanying financial statements.

NOTE 6 – COMMITMENTS

During campaign drive periods, the Organization will lease various industrial equipment for warehousing and distribution of goods. Such equipment, consisting of staging equipment, fork-lifts and other vehicles are rented on a month-to-month basis as needed.

NOTE 7 – CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Organization to concentrations of credit risk consist of cash deposits in checking accounts in excess of FDIC insured limits and money market accounts which are not FDIC insured. Until December 31, 2012, the FDIC provided unlimited protection on non-interest bearing bank deposits. After this date, FDIC insured amounts are limited to \$250,000.

At December 31, 2012, \$505,000 was held in one checking account (\$255,000 in excess of FDIC insured limits) and approximately \$1.1 million was held in one money market investment account.