# OPERATION GRATITUDE, INC.

**(A California Nonprofit Public Benefit Corporation)**

**FINANCIAL STATEMENTS**

**December 31, 2015**

Gursey | Schneider LLP
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

## C O N T E N T S

## Independent Auditor's Report

To the Board of Directors
Operation Gratitude, Inc.
Chatsworth, California

We have audited the accompanying financial statements of Operation Gratitude, Inc. (a California nonprofit public benefit corporation) which comprise the statement of financial position as of December 31, 2015, 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.



16633 Ventura Blvd, Suite 1320
Encino, CA 91436

310 552 0960 ph
310 557 3468 fx

www.gursey.com

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Operation Gratitude, Inc. as of December 31, 2015, 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.

Gursey | Schneider LLP

April 28, 2016
Los Angeles, California

**OPERATION GRATITUDE, INC.**
(A California Nonprofit Public Benefit Corporation)
Statement of Financial Position
December 31, 2015

## ASSETS

| | | |
|---|---|---|
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ | 2,031,915 |
| Restricted cash | | 84,368 |
| Investments, at fair value | | 209,926 |
| Contributions receivable, current portion | | 663,579 |
| Prepaid expenses | | 51,516 |
| Contributed inventory | | 2,720,087 |
| **Total Current Assets** | | 5,761,391 |
| **OTHER ASSETS** | | |
| Contributions receivable, long-term portion | | 1,500,000 |
| Property and equipment, net | | 29,279 |
| Deposits | | 60,150 |
| **Total Other Assets** | | 1,589,429 |
| **TOTAL ASSETS** | $ | 7,350,820 |

## LIABILITIES AND NET ASSETS

| | | |
|---|---|---|
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ | 22,344 |
| **NET ASSETS** | | |
| Unrestricted | | 5,244,108 |
| Temporary restricted | | 2,084,368 |
| **Total Net Assets** | | 7,328,476 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ | 7,350,820 |

**OPERATION GRATITUDE, INC.**
(A California Nonprofit Public Benefit Corporation)
Statement of Activities
For the Year Ended December 31, 2015

| | Unrestricted | Temporarily Restricted | Total |
|---|---|---|---|
| **REVENUES AND SUPPORT:** | | | |
| Contributions | $ 2,933,507 | $ 2,084,368 | $ 5,017,875 |
| Contributed goods for distribution | 3,066,819 | - | 3,066,819 |
| Contributed advertising and other in-kind goods | 1,165,933 | - | 1,165,933 |
| Contributed use of facilities | 350,000 | - | 350,000 |
| Contributed management and legal services | 95,623 | - | 95,623 |
| Subtotal - Contributions | 7,611,882 | 2,084,368 | 9,696,250 |
| Investment income (loss) | (9,254) | - | (9,254) |
| Interest income | 6,468 | - | 6,468 |
| Subtotal - Other support | (2,786) | - | (2,786) |
| **TOTAL REVENUES AND SUPPORT** | 7,609,096 | 2,084,368 | 9,693,464 |
| **FUNCTIONAL EXPENSES:** | | | |
| Program services | 9,440,289 | - | 9,440,289 |
| Management and general | 234,094 | - | 234,094 |
| Fundraising | 259,131 | - | 259,131 |
| **TOTAL FUNCTIONAL EXPENSES** | 9,933,514 | - | 9,933,514 |
| **CHANGES IN NET ASSETS** | (2,324,418) | 2,084,368 | (240,050) |
| **NET ASSETS, BEGINNING OF YEAR** | 7,568,526 | - | 7,568,526 |
| **NET ASSETS, END OF YEAR** | $ 5,244,108 | $ 2,084,368 | $ 7,328,476 |

**OPERATION GRATITUDE, INC.**
(A California Nonprofit Public Benefit Corporation)
Statement of Functional Expenses
For the Year Ended December 31, 2015

| | Program Services | Management and General | Fundraising | Total |
|---|---|---|---|---|
| Communications and marketing | $ 1,175,840 | $ 2,019 | $ 14,758 | $ 1,192,617 |
| Depreciation | 5,376 | 1,114 | 1,961 | 8,451 |
| Dues and subscriptions | 6,489 | 1,352 | 1,622 | 9,463 |
| Equipment rental | 12,452 | 2,605 | 3,362 | 18,419 |
| Goods delivered | 6,099,087 | - | - | 6,099,087 |
| Insurance | 25,818 | 5,501 | 6,382 | 37,701 |
| Merchant fees | 15,714 | 3,271 | 3,879 | 22,864 |
| Other | 4,935 | 1,416 | 1,734 | 8,085 |
| Payroll and payroll taxes | 690,057 | 144,077 | 174,136 | 1,008,270 |
| Postage and shipping supplies | 325,513 | 3,061 | 3,710 | 332,284 |
| Printing | 3,117 | 446 | 545 | 4,108 |
| Professional fees | 182,121 | 17,580 | 23,031 | 222,732 |
| Rent | 370,241 | 4,204 | 5,670 | 380,115 |
| Repairs and maintenance | 313 | 191 | 81 | 585 |
| Supplies | 464,402 | 29,391 | 3,518 | 497,311 |
| Taxes and licenses | - | 5,561 | - | 5,561 |
| Telephone and internet services | 816 | 174 | 220 | 1,210 |
| Travel | 30,484 | 6,322 | 7,706 | 44,512 |
| Website | 27,514 | 5,809 | 6,816 | 40,139 |
| **TOTAL FUNCTIONAL EXPENSES** | $ 9,440,289 | $ 234,094 | $ 259,131 | $ 9,933,514 |

See Accompanying Notes to Financial Statements

**OPERATION GRATITUDE, INC.**
(A California Nonprofit Public Benefit Corporation)
Statement of Cash Flows
For the Year Ended December 31, 2015

| | | |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Changes in net assets | $ | (240,050) |
| Adjustments to reconcile changes in net assets to net cash provided by operating activities: | | |
| Depreciation | | 8,451 |
| Net realized and unrealized investment loss | | 9,254 |
| Changes in assets and liabilities | | |
| Contributions receivable | | (2,103,161) |
| Prepaid expenses | | (11,514) |
| Contributed inventory | | 3,032,268 |
| Deposits | | (60,150) |
| Restricted cash | | (84,368) |
| Accounts payable | | (4,898) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | | 545,832 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Cash paid for purchases of investments | | (21,241) |
| Cash paid for purchases of property and equipment | | (6,430) |
| **NET CASH USED IN INVESTING ACTIVITIES** | | (27,671) |
| **NET INCREASE IN CASH AND CASH EQUIVALENT** | | 518,161 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | | 1,513,754 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | $ | 2,031,915 |

## NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

Operation Gratitude, Inc., a California non-profit public benefit corporation (the "Organization"), seeks to lift spirits and meet the evolving needs of our Active Duty and First Responder communities, and provide volunteer opportunities for all Americans to express their appreciation to all who serve our nation.

The Organization now sends approximately 150,000 care packages each year. These care packages are filled with food, hygiene products, entertainment and handmade items, plus personal letters of support, addressed to individual Soldiers, Sailors, Airmen and Marines deployed overseas, to their children left behind, and to Veterans, Recruits, First Responders, Wounded Warriors and their Caregivers. From its inception in 2003 through December 31, 2015, the Organization has distributed approximately 1,443,000 care packages.

During the year ended December 31, 2015, the Organization assembled and distributed approximately 257,000 care packages. This amount included approximately 113,340 care packages to Deployed Troops, New Recruits, and First Responders, 13,069 to Veterans, 7,637 to Military Families, 631 to Wounded Warriors and their Care Givers, 10,396 "Battalion Buddy" stuffed animals to military children, and 111,797 candy and disaster relief packages to military communities. Additionally, the Organization distributed goods in bulk quantities to U.S. military bases and to other military support charitable organizations. Occasionally, the Organization will distribute goods that do not conform to care package or other program requirements, or goods that are nearing their expiration date, to local community relief agencies.

The Organization is a 501(c)(3) not-for-profit corporation, funded entirely by private donations.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** – The accompanying 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. At December 31, 2015, the Organization had temporarily restricted net assets of $2,084,368 allocated for a specific care package distribution program and a capital campaign in progress.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)**

- 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. At December 31, 2015, there were no permanently restricted net assets.

**Cash and Cash Equivalents** – For financial statement purposes, the Organization considers cash on hand, cash held in checking accounts and highly liquid, short-term money market investments to be cash and cash equivalents.

**Restricted Cash** – Restricted cash includes all cash contributions received exclusively for the capital campaign. These funds will eventually be used to build a new home for the Organization.

**Investments** – The Organization accounts for its investments at fair value, determined by quoted market prices. Purchases and sales of investments are recorded on the trade date. Dividend income is recorded based on the record date. Interest income is recorded as earned on an accrual basis. Bond premiums and discounts are amortized to the first call date using a method that approximates the effective interest method. Realized gains and losses are recorded upon disposition of securities. Investment income and realized and unrealized gains and losses are recognized as unrestricted net assets, unless their use is temporary or permanently restricted by donors to a specified purpose or future period.

Investments, totaling $209,926 consist of various publicly traded common stock, exchange traded funds and mutual funds. These investments are valued at the closing price at the end of the year. This represents a Level 1 fair value measure.

**Contributions Receivable** – Unconditional contributions, including grants recorded at fair value, are recognized as revenues in the period received. The Organization reports unconditional contributions as restricted support if they are received with donor stipulations that limit the use of the donated assets. At December 31, 2015, the Organization evaluated the collectability of grants receivable and no allowance for uncollectible grants was considered necessary.

**Contributed Inventory** – The Organization receives most of the items it sends in care packages from private donations from corporations and individuals. Contributed inventory is recorded as unrestricted contributions when they are received and is valued at management's best estimate of fair value at the time they are received (a Level 3 fair value measure), net of inventory that is unusable for the Organization's purposes. Upon distribution, the inventory is recorded as a decrease in unrestricted net assets. Inventory that is unusable for the Organization's purposes is donated to other military support charities.

At December 31, 2015 inventory on hand 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 in Chatsworth, California.

**Property and Equipment —** Property and equipment are valued at cost or management's best estimate of fair value at the time of donation. Property and equipment are depreciated on a straight-line method over three or five years. Normal repairs and maintenance, as well as property and equipment purchases that are less than $1,000 are expensed as incurred.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

**Impairment of Long-Lived Assets —** Long-lived assets such as property and equipment are reviewed for events or changes in circumstances, which indicate that their carrying value may not recoverable. The Organization has determined that no events occurred during the year ended December 31, 2015 that would give rise to impairment of its long-lived assets.

**Contributed Management and Legal 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 $95,623 for the year ended December 31, 2015 (includes donated salaries, outside services and legal services).

Also included are individuals with specialized technical skills; individuals with whom the Organization would not be able to operate.

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 307,317 volunteer hours for solicitation, collection, staging, letter writing, knitting scarves, and package assembly were received during the year ended December 31, 2015 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.

**Contributed Advertising and Other In-Kind Goods** – The Organization receives donated advertisements including online advertisements, the production of a promotional video, public service announcements, and social media promotion on high-traffic websites. Management estimates the fair value of such services to be $1,165,933 for the year ended December 31, 2015.

**Contributed Use of Facilities** – During the year ended December 31, 2015, the Organization received rent-free use of its prior facility at the California Army National Guard facilities. This facility was used to receive, store and distribute inventory throughout the year and maintain an administrative office. This facility was also used to stage assembly operations during the Organization's monthly packaging events. Management estimates the fair value of contributed rent to be $350,000 for the year ended December 31, 2015.

**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.

**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 2012 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 2011 and subsequent.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

**Fair Value of Financial Instruments** – FASB ASC Topic No. 820. “Fair Value Measurements” (“ASC 820”), applies to all assets and liabilities that are recognized or disclosed at fair value on a recurring basis. ASC 820 defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in the orderly transactions between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. In addition to defining fair value, ASC 820 expands the disclosure requirement around fair value and established a fair value hierarchy for valuation inputs. The statement requires that assets and liabilities carried at fair value be classified and disclosed in one of the follow three categories:

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

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data

Level 3: Unobservable inputs that are not corroborated by market data

In general and where applicable, the Organization uses quoted prices in active markets for identical assets or liabilities to determine fair value. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then they use quoted prices for similar assets or inputs other than the quoted prices that are observable either directly or indirectly.

In accordance with ASC 820, the Organization has classified all of its cash and cash equivalents and investments in the Level 1 fair value hierarchy measured at fair value on a recurring basis at December 31, 2015. The carrying amounts of the Organization’s other financial instruments such as contributions receivable, and accounts payable approximate their fair value because of the short maturity of these instruments.

**Concentration of Credit Risks -** The Organization maintains its cash in bank deposit accounts which, at times may exceed federally insured limits. Bank accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. Investments in money market accounts are not insured by the FDIC.

As of December 31, 2015, one donor accounted for approximately 92% of contributions receivable.

**Recently Issued Accounting Standards –** In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, “Leases” (Topic 842). This ASU requires a lessee to recognize a right-of-use asset and a lease liability under most operating leases in its balance sheet. For non-public companies, the standard is effective for fiscal years beginning after December 15, 2019 and interim periods beginning the following year. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients during the period of adoption. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. Management is currently evaluating the impact this change in accounting standards will have on the Company’s consolidated financial statements and related disclosures.

**Subsequent Events -** Subsequent events have been evaluated through April 28, 2016, 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.

The most significant estimates relate to the valuation of contributed inventory, contributed labor and other services, and the valuation of inventory on hand. Contributed inventory, labor, and services accounted for approximately 48% of total revenue and support for the year ended December 31, 2015 and inventory on hand accounted for approximately 37% of total assets as of December 31, 2015.

The valuation of contributed inventory is based on management's best 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.

## NOTE 4 – INVESTMENTS

Investments are comprised of the following at December 31, 2015:

| | Cost or Value on Date of Receipt | Level 1 Fair Value |
|---|---|---|
| Equity securities | $ 21,504 | $ 21,579 |
| Exchange traded senior loan fund | 98,661 | 89,599 |
| Intermediate term bond mutual fund | 101,630 | 98,748 |
| | $ 221,795 | $ 209,926 |

All investments were classified by level within the level one fair value hierarchy.

**NOTE 5 – CONTRIBUTIONS RECEIVABLE**

As of December 31, 2015, the Organization's contributions receivable are expected to be received as follows:

| | |
|---|---|
| In one year or less | $ 663,579 |
| Between one year and five years | 1,500,000 |
| Total | $ 2,163,579 |

The Organization has not recorded a discount on multi-year contributions as of December 31, 2015 as the amount is not material to the financial statements.

**NOTE 6 – PROPERTY AND EQUIPMENT**

Property and equipment consists of the following at December 31, 2015:

| | |
|---|---|
| Furniture and fixtures | $ 75,615 |
| Automobiles | 33,770 |
| | 109,385 |
| Less accumulated depreciation | (80,106) |
| Net property and equipment | $ 29,279 |

Depreciation expense for the year ended December 31, 2015 was $8,451.

**NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS**

Changes in temporarily restricted net assets were as follows at December 31, 2015:

| | Available December 31, 2014 | Contributions | Released from Restriction | Available December 31, 2015 |
|---|---|---|---|---|
| Capital Campaign | $ - | $ 84,368 | $ - | $ 84,368 |
| "Package With Care" Program | - | 2,000,000 | - | 2,000,000 |
| Total | $ - | $ 2,084,368 | $ - | $ 2,084,368 |

*Capital Campaign* – During 2015, Operation Gratitude commenced a capital campaign with the goal of raising funds to purchase a commercial building. All contributions are reflected as temporarily restricted contributions until such time that a new facility is identified and acquired.

## NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS – (CONTINUED)

*"Package with Care" Program* – Operation Gratitude will work together with a corporate partner to develop and administer a care package delivery program for members of the military and first responders. Employees of the corporate partner will participate in the assembly and recommend the intended military members or first responders as recipients. The $2.0 million contribution reflects the corporate partner's minimum sponsorship commitment. This program is anticipated to run for two years.

## NOTE 8 – COMMITMENTS

As noted in Note 2 – Contributed Used of Facilities, during the year ended December 31, 2015, the Organization received rent-free use of its prior facility at the California Army National Guard facilities. In December 2015, the Organization moved into its new location in Chatsworth, California and entered into a non-cancelable operating lease agreement that expires on June 30, 2018. The future rental commitments under this operating lease is summarized as follows:

| Year ending December 31, | | |
|---|---|---|
| 2016 | $ | 315,000 |
| 2017 | | 324,444 |
| 2018 | | 167,268 |
| | $ | 806,712 |

In addition, the Organization leases industrial equipment for warehousing and distributing goods throughout the year. Such equipment, consisting of staging equipment, fork-lifts and other vehicles are rented on a month-to-month terms.

Total rent expense incurred for the year ended December 31, 2015 was $380,115.

## NOTE 9 – EMPLOYEE BENEFIT PLAN

The Organization sponsors a 401(k) profit sharing plan that covers full time employees meeting certain eligibility requirements. Employees may contribute a portion of their compensation to the plan, limited to the maximum annual amount as set forth in the adoption agreement. The Organization has elected to satisfy the safe harbor contribution requirements by making a non-elective deferral. In addition, the Organization elected to make an elective contribution to the plan. The Organization recognized contribution expenses of $11,557 for the year ended December 31, 2015.

## NOTE 9 – RELATED PARTY TRANSACTIONS

Some 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.