

**Operation Gratitude, Inc.**

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

**FINANCIAL STATEMENTS**

**As of and for the Year Ended  
December 31, 2011**

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**Independent Auditors' Report**

To the Board of Directors  
Operation Gratitude, Inc.

We have audited the accompanying statement of financial position of Operation Gratitude, Inc. (a California nonprofit public benefit corporation) (the Organization) as of December 31, 2011, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of management. 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 of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of the Organization and the results of its activities, functional expenses and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 3 to the financial statements, 86% of total revenues are derived from donated goods and services and 81% of total assets are from donated inventory. The valuation of these donated goods is subject to estimation. The Organization estimates the value of donated goods by obtaining estimates of wholesale selling prices provided by the donors, or other indicators of value when donor estimated wholesale values are not provided. The Organization also undertakes its own research when practical in order to better ascertain fair values. Additionally, some items, due to their uniqueness in nature are assigned a nominal value when third-party information to ascertain value is not available. As a result, there is significant judgment and uncertainty in arriving at fair values of contributed goods, and such values materially enter into the determination of net assets and results of activities.

*Gursey | Schneider LLP*

July 9, 2012  
Los Angeles, California

**OPERATION GRATITUDE, INC.**  
(A California Nonprofit Public Benefit Corporation)  
Statement of Financial Position  
December 31, 2011

**ASSETS**

**CURRENT ASSETS**

Cash and cash equivalents	\$ 1,558,775
Investments	10,553
Contributions receivable	15,015
Prepaid insurance	2,857
Donated inventory	<u>6,830,528</u>

TOTAL CURRENT ASSETS 8,417,728

**PROPERTY AND EQUIPMENT, net** 18,742

**TOTAL ASSETS** \$ 8,436,470

**LIABILITIES AND NET ASSETS**

**CURRENT LIABILITIES**

Accounts payable \$ 8,467

TOTAL CURRENT LIABILITIES 8,467

**NET ASSETS**

NET ASSETS - UNRESTRICTED 8,428,003

**TOTAL LIABILITIES NET ASSETS** \$ 8,436,470

**OPERATION GRATITUDE, INC.**  
(A California Nonprofit Public Benefit Corporation)  
Statement of Activities  
For the Year Ended December 31, 2011

	<b>Unrestricted</b>
<b>SUPPORT AND REVENUES:</b>	
Contributions	\$ 2,004,470
Net realized and unrealized loss	(7,520)
Interest income	190
	1,997,140
<b>SUBTOTAL</b>	<b>1,997,140</b>
Donated goods for distribution	10,792,153
Donated advertising	985,371
Donated management services	564,143
Donated use of facilities	200,000
Donated food service for volunteers	25,960
	14,564,767
<b>TOTAL SUPPORT AND REVENUES</b>	<b>14,564,767</b>
<b>EXPENSES:</b>	
Program services	10,297,150
Management and general	440,864
Fundraising	315,637
	11,053,651
<b>TOTAL EXPENSES</b>	<b>11,053,651</b>
<b>INCREASE IN NET ASSETS - UNRESTRICTED</b>	<b>3,511,116</b>
<b>NET ASSETS, DECEMBER 31, 2010</b>	<b>4,916,887</b>
<b>NET ASSETS, DECEMBER 31, 2011</b>	<b>\$ 8,428,003</b>

See Accompanying Notes to Financial Statements

**OPERATION GRATITUDE, INC.**  
(A California Nonprofit Public Benefit Corporation)  
Statement of Functional Expenses  
For the Year Ended December 31, 2011

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>TOTAL EXPENSES</u>
Goods delivered	\$ 7,700,650	\$ -	\$ -	\$ 7,700,650
Advertising	603,716	201,238	201,238	1,006,192
Salaries and outside services	703,914	178,445	114,019	996,378
Postage and shipping supplies	954,906	-	-	954,906
Rent	200,000	-	-	200,000
Supplies and donated food services	65,708	-	-	65,708
Professional fees	-	34,858	380	35,238
Equipment rental	26,884	-	-	26,884
Repairs and maintenance	14,726	-	-	14,726
Depreciation	14,050	-	-	14,050
Project and office administration	3,274	7,579	-	10,853
Travel	9,322	-	-	9,322
Merchant fees	-	6,713	-	6,713
Insurance	-	5,949	-	5,949
Telephone and internet services	-	4,536	-	4,536
Taxes and licenses	-	1,546	-	1,546
<b>TOTAL EXPENSES</b>	<u>\$ 10,297,150</u>	<u>\$ 440,864</u>	<u>\$ 315,637</u>	<u>\$ 11,053,651</u>

The statement of functional expenses reflected above includes non-cash expenses for donated goods delivered (\$7,700,650), donated advertising and publicity (\$985,371), donated salaries and outside services (\$540,143), donated rent (\$200,000), donated volunteer food services (\$25,960), and donated legal services (\$24,000). These amounts comprise approximately 86% of total expenses during the year.

**OPERATION GRATITUDE, INC.**  
Statement of Cash Flows  
For the Year Ended December 31, 2011

<b>CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>	
Change in net assets	\$ 3,511,116
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:	
Depreciation expense	14,050
Non-cash contribution of investments	(5,491)
Non-cash contribution of fixed assets	-
Net realized and unrealized investment loss	7,520
Changes in assets and liabilities	
Contributions receivable	(15,015)
Prepaid expense	1,663
Donated inventory	(3,218,431)
Accounts payable	<u>(946)</u>
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>294,466</u>
<b>CASH FLOWS PROVIDED BY INVESTING ACTIVITIES</b>	
Proceeds from sale of investments	<u>153</u>
<b>CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u>153</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	294,619
<b>CASH AT BEGINNING OF YEAR</b>	<u>1,264,156</u>
<b>CASH AT END OF YEAR</b>	<u><u>\$ 1,558,775</u></u>

See Accompanying Notes to Financial Statements

**OPERATION GRATITUDE, INC.**  
**(A California Nonprofit Public Benefit Corporation)**

Notes to Financial Statements  
As of and For the Year Ended  
December 31, 2011

**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.

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, 2011, the Organization distributed approximately 82,000 Troop care packages, 37,000 Battalion Buddies care package, and 4,000 Wounded Warriors 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, 2011.



**OPERATION GRATITUDE, INC.**  
**(A California Nonprofit Public Benefit Corporation)**

Notes to Financial Statements  
As of and For the Year Ended  
December 31, 2011

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

**Contributed Goods** - The Organization receives all 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. In 2011, the Organization started a new program to send special care packages to the children of deployed or deploying Military. These packages include donated snacks and a stuffed animal called a "Battalion Buddy." More than half of the stuffed animals sent to children were donated by corporations and individuals and valued as per the process for all other donated items. Additional stuffed animals plus custom made jackets were purchased by the Organization and valued accordingly at cost.

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.

**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 \$564,143 for 2011 (includes donated salaries, outside services and legal services).

These amounts include the services of the following individuals that have donated significant amounts of time during 2011:

- Executive Director
- Director of Development
- Distribution and Logistics Managers
- Product Procurement Manager
- Production Engineers
- Database Analysts
- Video Editors

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

During 2011, the Organization received donated advertisements including online advertisements, the production of a promotional video, and social media promotion as well as donated food services. Management estimates the fair value of such services to be \$1,011,331 for 2011.

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.**  
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Notes to Financial Statements  
As of and For the Year Ended  
December 31, 2011

**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. At December 31, 2011, 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 8,157 completed troop care packages (this is a total of troop, Wounded Warrior and special military family packages), 6,918 Battalion Buddies care packages and 246 candy care packages which were assembled but not distributed at year-end. Management estimates these finished care packages on hand to be valued at \$1,032,000 (or approximately \$75, \$30, and \$35 per care package type, respectively) at December 31, 2011.

**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 2008 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 2007 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 \$10,553 consist of various publicly traded common stock. These shares 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, two forklifts, and approximately 800 storage bins valued at cost or management's estimate of fair value at time of donation. The taping machines, fork lifts and storage containers are depreciated on a straight-line method over two to five years.

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Notes to Financial Statements  
As of and For the Year Ended  
December 31, 2011

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

At December 31, 2011, property and equipment consists of the following:

Taping machines	\$	35,500
Storage containers		28,626
Forklifts		<u>4,999</u>
		69,125
Less accumulated depreciation		<u>(50,383)</u>
Total property and equipment	\$	<u><u>18,742</u></u>

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

**Subsequent Events** - The Company evaluated subsequent events through July 9, 2012, 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 86% of total revenues and contributed goods accounted for 81% of total assets.

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 executive director, 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.

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Notes to Financial Statements  
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**NOTE 4 – 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 5 – 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 6 – 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 limit of \$250,000. The FDIC has temporarily provided unlimited FDIC insurance on non-interest bearing deposits.

At December 31, 2011, approximately \$1,079,000 was held in one money market investment account and \$415,000 was held in one checking account.