

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

FINANCIAL STATEMENTS

As of and for the Year Ended

December 31, 2013



Gurseley | Schneider LLP
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

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Independent Auditors' Report

To the Board of Directors
Operation Gratitude, Inc.
Encino, 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, 2013, 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 Operation Gratitude, Inc. as of December 31, 2013, 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.

Other Matters

As disclosed in Note 3 to the financial statements, 83% of total revenues are derived from donated goods and services and 78% of total assets are from donated inventory on hand. 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 21, 2014
Los Angeles, California

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statement of Financial Position
December 31, 2013

CURRENT ASSETS	
Cash and cash equivalents	\$ 1,262,620
Investments	197,945
Contributions receivable	6,583
Prepaid insurance	4,968
Donated inventory	<u>5,248,549</u>
TOTAL CURRENT ASSETS	6,720,665
PROPERTY AND EQUIPMENT, net	<u>2,061</u>
TOTAL ASSETS	<u><u>\$ 6,722,726</u></u>
<u>LIABILITIES AND NET ASSETS</u>	
CURRENT LIABILITIES	
Accounts payable	\$ 25,854
NET ASSETS	
NET ASSETS - UNRESTRICTED	<u>6,696,872</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 6,722,726</u></u>

See Accompanying Notes to Financial Statements

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statement of Activities
Year Ended December 31, 2013

SUPPORT AND REVENUES:	
Contributions	\$ 1,921,644
Net realized and unrealized investment loss	(6,131)
Interest income	<u>7,105</u>
Subtotal - Contributions and investment income	<u>1,922,618</u>
Donated goods for distribution	7,545,789
Donated advertising and other in-kind goods	800,118
Donated management services	609,550
Donated use of facilities	200,000
Donated legal and consulting services	<u>65,253</u>
Subtotal - Donated goods and services	<u>9,220,710</u>
TOTAL SUPPORT AND REVENUES	<u><u>11,143,328</u></u>
EXPENSES:	
Program services	10,866,787
Management and general	559,754
Fundraising	<u>298,472</u>
TOTAL EXPENSES	<u>11,725,013</u>
DECREASE IN NET ASSETS	(581,685)
NET ASSETS, BEGINNING OF YEAR	<u>7,278,557</u>
NET ASSETS, END OF YEAR	<u><u>\$ 6,696,872</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, 2013

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>TOTAL EXPENSES</u>
Goods delivered	\$ 8,137,516	\$ -	\$ -	\$ 8,137,516
Advertising	481,987	160,663	160,663	803,313
Postage and shipping supplies	734,588	-	-	734,588
Outside services	509,281	128,634	89,735	727,650
Payroll and payroll taxes	529,538	99,720	48,074	677,332
Rent	200,000	-	-	200,000
Project and office administration	65,611	40,982	-	106,593
Professional fees	61,122	24,751	-	85,873
Supplies	85,168	-	-	85,168
Insurance	-	59,544	-	59,544
Equipment rental	25,781	-	-	25,781
Merchant fees	-	24,490	-	24,490
Travel	19,466	-	-	19,466
Taxes and licenses	-	10,787	-	10,787
Repairs and maintenance	10,477	-	-	10,477
Telephone and internet services	-	10,183	-	10,183
Depreciation	6,252	-	-	6,252
TOTAL EXPENSES	<u><u>\$ 10,866,787</u></u>	<u><u>\$ 559,754</u></u>	<u><u>\$ 298,472</u></u>	<u><u>\$ 11,725,013</u></u>

The statement of functional expenses reflected above includes non-cash expenses for donated goods delivered (\$8,137,516), donated advertising and publicity (\$800,118), donated salaries and outside services (\$609,550), donated rent (\$200,000), donated legal and consulting services (\$65,253). These non-cash expenses comprise approximately 84% of total expenses during the year.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Statement of Cash Flows
Year Ended December 31, 2013

CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	
Change in net assets	\$ (581,685)
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation expense	6,252
Non-cash contribution of investments	(314)
Net realized and unrealized investment loss (gain)	6,131
Changes in assets and liabilities	
Contributions receivable	529
Prepaid expense	(3,115)
Donated inventory	549,487
Accounts payable	(78,729)
	(101,444)
CASH USED FOR OPERATING ACTIVITIES	
CASH FLOWS PROVIDED BY INVESTING ACTIVITIES	
Proceeds from sale of investments	94,741
Cash paid for purchase of investments	(289,247)
Proceeds from sale of fixed assets	5,000
	(189,506)
CASH USED FOR FROM INVESTING ACTIVITIES	
DECREASE IN CASH	
	(290,950)
CASH AT BEGINNING OF YEAR	
	1,553,570
CASH AT END OF YEAR	
	\$ 1,262,620

See Accompanying Notes to Financial Statements

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2013

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 Veteran communities, and provide volunteer opportunities for all Americans to express their appreciation to our military.

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, 2013, the Organization distributed 1,067,897 care packages.

During the year ended December 31, 2013, the Organization assembled and distributed 159,200 care packages. This amount included approximately 60,000 care packages to deployed troops, 51,000 to veterans, 1,200 to military families, 1,700 to wounded warriors and their caregivers, 22,000 “Battalion Buddy” stuffed animals to military children, and 23,300 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.

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 California Army National Guard armory 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, 2013.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2013

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 support 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 monthly packaging events. 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 \$609,550 for the year ended December 31, 2013 (includes donated salaries, outside services and legal services).

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 with whom the Organization would not be able to operate.

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 \$800,118 for the year ended December 31, 2013. The Organization receives donated legal, management and consulting services valued at \$65,253 for the year ended December 31, 2013.

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
December 31, 2013

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 in Van Nuys, California.

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 2010 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 2009 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 \$197,945 consist of various publicly traded common stock, mutual funds and bonds. These investments are valued at the closing price at the end of the year. This represents a Level 1 fair value measure. The cost basis of these investments is \$200,863.

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

Subsequent Events - The Company evaluated subsequent events through July 21, 2014, 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 83% of total revenues and contributed goods in inventory accounted for 78% of total assets for the year 2013.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2013

NOTE 3 – USE OF ESTIMATES – (CONTINUED)

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.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

Taping machines	\$ 35,500
Storage containers	28,626
Forklifts	<u>3,100</u>
	67,226
Less accumulated depreciation	<u>(65,165)</u>
Total property and equipment	<u><u>\$ 2,061</u></u>

Depreciation expense for 2013 and 2012, was \$6,252 and \$9,730, respectively. Normal repairs and maintenance, as well as property and equipment purchases that are 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 leases industrial equipment for warehousing and distributing goods. Such equipment, consisting of staging equipment, fork-lifts and other vehicles are rented on a month-to-month basis as needed.

OPERATION GRATITUDE, INC.
(A California Nonprofit Public Benefit Corporation)
Notes to Financial Statements
December 31, 2013

NOTE 7 – CONCENTRATIONS OF CREDIT RISK

The Foundation maintains its cash in bank deposit accounts which, at times may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At December 31, 2013, the Organization had \$886,629 in money market accounts which are not insured by the FDIC.