KPMG

# OPERATION SMILE, INC.
# AND AFFILIATE

Combined Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

**OPERATION SMILE, INC.**
**AND AFFILIATE**

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**KPMG LLP**
Suite 1900
440 Monticello Avenue
Norfolk, VA 23510

# Independent Auditors' Report

The Board of Directors
Operation Smile, Inc.

We have audited the accompanying combined statements of financial position of Operation Smile, Inc. and affiliate (the Organization) as of June 30, 2012 and 2011, and the related combined statements of activities, cash flows, and functional expenses for the years then ended. These combined financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these combined 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Operation Smile, Inc. and affiliate as of June 30, 2012 and 2011, and the results of their activities and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

December 4, 2012

**OPERATION SMILE, INC.**
**AND AFFILIATE**

Combined Statements of Financial Position

June 30, 2012 and 2011

| **Assets** | | **2012** | **2011** |
|---|---|---|---|
| Cash (note 11) | $ | 6,827,162 | 5,084,731 |
| Investments (note 3) | | 3,043,591 | 5,506,217 |
| Prepaid expenses | | 359,261 | 1,171,529 |
| Mission advances and other receivables | | 76,919 | 571,929 |
| Contributions receivable, net (note 2) | | 14,145,340 | 5,540,385 |
| Inventories | | 7,015,320 | 6,731,518 |
| Property and equipment, net (notes 4, 6 and 11) | | 16,345,662 | 6,072,224 |
| Total assets | $ | 47,813,255 | 30,678,533 |
| **Liabilities and Net Assets** | | | |
| Accounts payable and accrued expenses | $ | 7,013,698 | 4,891,210 |
| Deferred revenue | | 317,687 | 837,675 |
| Capital lease payable (notes 4 and 6) | | 33,276 | 45,947 |
| Long-term debt (note 11) | | 8,130,152 | — |
| Total liabilities | | 15,494,813 | 5,774,832 |
| Net assets: | | | |
| Unrestricted | | 14,573,810 | 16,475,827 |
| Temporarily restricted (note 7) | | 17,744,632 | 8,427,874 |
| Total net assets | | 32,318,442 | 24,903,701 |
| Commitments and contingencies (note 6) | | | |
| Total liabilities and net assets | $ | 47,813,255 | 30,678,533 |

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.**
**AND AFFILIATE**

Combined Statements of Activities

Years ended June 30, 2012 and 2011

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | **Unrestricted net assets** | **Temporarily restricted net assets** | **Total** | **Unrestricted net assets** | **Temporarily restricted net assets** | **Total** |
| Revenues: | | | | | | |
| Contributions (note 10) | $ 37,298,170 | 17,367,970 | 54,666,140 | 32,133,949 | 8,753,615 | 40,887,564 |
| Gifts-in-kind (note 5) | 3,356,591 | — | 3,356,591 | 3,104,913 | 3,050,000 | 6,154,913 |
| Contributed services (note 5) | 26,253,585 | — | 26,253,585 | 25,140,416 | — | 25,140,416 |
| Program service revenue | 1,277,336 | — | 1,277,336 | 858,386 | — | 858,386 |
| Foreign currency transaction gains (losses), net | (83,689) | — | (83,689) | 35,617 | — | 35,617 |
| Other income (expense), net | 12,650 | — | 12,650 | 31,308 | — | 31,308 |
| Net assets released from restrictions (note 8) | 8,051,212 | (8,051,212) | — | 7,739,480 | (7,739,480) | — |
| Total revenues | 76,165,855 | 9,316,758 | 85,482,613 | 69,044,069 | 4,064,135 | 73,108,204 |
| Expenses: | | | | | | |
| Program services : | | | | | | |
| Medical missions (note 5) | 38,963,786 | — | 38,963,786 | 37,624,927 | — | 37,624,927 |
| Education and sustainability | 18,174,955 | — | 18,174,955 | 12,366,934 | — | 12,366,934 |
| Total program services | 57,138,741 | — | 57,138,741 | 49,991,861 | — | 49,991,861 |
| Supporting services: | | | | | | |
| Fund-raising | 16,121,782 | — | 16,121,782 | 15,872,232 | — | 15,872,232 |
| Administration | 4,807,349 | — | 4,807,349 | 2,761,770 | — | 2,761,770 |
| Total supporting services | 20,929,131 | — | 20,929,131 | 18,634,002 | — | 18,634,002 |
| Total expenses | 78,067,872 | — | 78,067,872 | 68,625,863 | — | 68,625,863 |
| Change in net assets | (1,902,017) | 9,316,758 | 7,414,741 | 418,206 | 4,064,135 | 4,482,341 |
| Net assets at beginning of year | 16,475,827 | 8,427,874 | 24,903,701 | 16,057,621 | 4,363,739 | 20,421,360 |
| Net assets at end of year | $ 14,573,810 | 17,744,632 | 32,318,442 | 16,475,827 | 8,427,874 | 24,903,701 |

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.**
**AND AFFILIATE**

Combined Statements of Cash Flows

Years ended June 30, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Change in net assets | $ | 7,414,741 | 4,482,341 |
| Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities: | | | |
| Depreciation expense | | 331,397 | 370,616 |
| Loss on disposal of equipment | | 45,093 | — |
| Equipment donation to program countries | | 31,004 | 139,517 |
| Net realized and unrealized losses on investments | | 6,025 | (22,969) |
| In-kind donation of land | | — | (3,050,000) |
| In-kind donations of supplies and inventory | | (126,773) | (121,787) |
| In-kind donation of artwork | | (210,347) | — |
| Investment contributions received | | (268,874) | (150,157) |
| Changes in operating assets and liabilities: | | | |
| Prepaid expenses | | 812,268 | (1,080,822) |
| Mission advances and other receivables | | 495,010 | (221,123) |
| Contributions receivable | | (8,604,955) | (2,085,816) |
| Inventories | | (157,029) | (53,749) |
| Accounts payable and accrued expenses | | 2,122,488 | 106,473 |
| Deferred revenue | | (519,988) | 686,117 |
| Net cash provided by (used in) operating activities | | 1,370,060 | (1,001,359) |
| Cash flows from investing activities: | | | |
| Purchases of property and equipment | | (10,470,585) | (2,018,132) |
| Purchases of investments | | (2,720) | (27,053) |
| Proceeds from sales and maturities of investments | | 2,728,195 | 36,364 |
| Net cash used in investing activities | | (7,745,110) | (2,008,821) |
| Cash flows used in financing activities: | | | |
| Net borrowings on long-term debt | | 8,130,152 | — |
| Net borrowings (repayments) on capital leases | | (12,671) | 12,986 |
| Effect of exchange rate changes on cash | | — | 1,107 |
| Net cash provided by financing activities | | 8,117,481 | 14,093 |
| Net increase (decrease) in cash | | 1,742,431 | (2,996,087) |
| Cash at beginning of year | | 5,084,731 | 8,080,818 |
| Cash at end of year | $ | 6,827,162 | 5,084,731 |
| Supplemental cash flow information: | | | |
| Cash paid for interest, net of capitalized interest | $ | 8,696 | 7,747 |

See disclosure of noncash items in note 5.

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.**
**AND AFFILIATE**

Combined Statements of Functional Expenses

Years ended June 30, 2012 and 2011

**2012**

| | Program services | | | Supporting services | | | |
|---|---|---|---|---|---|---|---|
| | **Medical missions** | **Education and sustainability** | **Total** | **Fund-raising** | **Administration** | **Total** | **Total expenses** |
| Grants | $ 1,453,855 | 5,996,659 | 7,450,514 | — | — | — | 7,450,514 |
| Salaries and benefits | 2,107,670 | 2,001,486 | 4,109,156 | 2,245,308 | 1,985,873 | 4,231,181 | 8,340,337 |
| Professional services | 567,052 | 1,226,835 | 1,793,887 | 931,484 | 750,790 | 1,682,274 | 3,476,161 |
| Advertising and promotion | 57,986 | 344,624 | 402,610 | 932,337 | 161,743 | 1,094,080 | 1,496,690 |
| Supplies and equipment | 4,905,093 | 301,952 | 5,207,045 | 679,138 | 890,028 | 1,569,166 | 6,776,211 |
| Occupancy | 285,009 | 41,977 | 326,986 | 74,617 | 63,225 | 137,842 | 464,828 |
| Travel and conferences | 2,817,777 | 2,213,552 | 5,031,329 | 308,483 | 243,799 | 552,282 | 5,583,611 |
| Interest | 3,277 | 1,622 | 4,899 | 949 | 2,848 | 3,797 | 8,696 |
| Depreciation | 172,984 | — | 172,984 | — | 158,413 | 158,413 | 331,397 |
| Insurance | 48,243 | 4,722 | 52,965 | 1,909 | 29,784 | 31,693 | 84,658 |
| Other mission expense | 272,500 | 313 | 272,813 | — | 17 | 17 | 272,830 |
| Fundraising | — | — | — | 10,923,129 | — | 10,923,129 | 10,923,129 |
| Public education and awareness | — | 6,023,824 | 6,023,824 | — | 478,315 | 478,315 | 6,502,139 |
| Contributed services | 26,253,585 | — | 26,253,585 | — | — | — | 26,253,585 |
| Other | 18,755 | 17,389 | 36,144 | 24,428 | 42,514 | 66,942 | 103,086 |
| Total expenses | $ 38,963,786 | 18,174,955 | 57,138,741 | 16,121,782 | 4,807,349 | 20,929,131 | 78,067,872 |

**2011**

| | Program services | | | Supporting services | | | |
|---|---|---|---|---|---|---|---|
| | **Medical missions** | **Education and sustainability** | **Total** | **Fund-raising** | **Administration** | **Total** | **Total expenses** |
| Grants | $ 1,053,735 | 2,250,358 | 3,304,093 | — | — | — | 3,304,093 |
| Salaries and benefits | 2,004,707 | 1,815,289 | 3,819,996 | 3,043,114 | 978,350 | 4,021,464 | 7,841,460 |
| Professional services | 559,301 | 1,624,619 | 2,183,920 | 2,160,131 | 659,152 | 2,819,283 | 5,003,203 |
| Advertising and promotion | 69,008 | 248,787 | 317,795 | 715,854 | 96,129 | 811,983 | 1,129,778 |
| Supplies and equipment | 5,054,860 | 296,091 | 5,350,951 | 757,641 | 433,296 | 1,190,937 | 6,541,888 |
| Occupancy | 254,979 | 52,609 | 307,588 | 66,235 | 40,770 | 107,005 | 414,593 |
| Travel and conferences | 3,032,997 | 778,209 | 3,811,206 | 343,637 | 182,680 | 526,317 | 4,337,523 |
| Interest | 3,049 | 1,662 | 4,711 | 1,706 | 1,330 | 3,036 | 7,747 |
| Depreciation | 165,025 | 54,562 | 219,587 | 32,112 | 118,917 | 151,029 | 370,616 |
| Insurance | 58,409 | 9,130 | 67,539 | 12,364 | 18,156 | 30,520 | 98,059 |
| Other mission expense | 207,946 | 1,378 | 209,324 | 290 | 53 | 343 | 209,667 |
| Fundraising | — | — | — | 8,699,568 | — | 8,699,568 | 8,699,568 |
| Public education and awareness | — | 5,217,043 | 5,217,043 | — | 212,991 | 212,991 | 5,430,034 |
| Contributed services | 25,140,416 | — | 25,140,416 | — | — | — | 25,140,416 |
| Other | 20,495 | 17,197 | 37,692 | 39,580 | 19,946 | 59,526 | 97,218 |
| Total expenses | $ 37,624,927 | 12,366,934 | 49,991,861 | 15,872,232 | 2,761,770 | 18,634,002 | 68,625,863 |

See accompanying notes to combined financial statements.

## (1) Nature of Organization and Summary of Significant Accounting Policies

### *(a) Nature of Organization*

Operation Smile, Inc. (Operation Smile) is a 501 c(3) not-for-profit voluntary health and welfare organization whose principal purpose is to perform reconstructive surgery on children in developing countries and the United States. Additionally, the organization provides specialized training for medical professionals in developing countries to treat children with clefts at the local level. Focusing on the latest and safest surgical techniques and practices, Operation Smile offers a variety of hands-on training opportunities, fellowships, and formal mission and center-based education. Operation Smile was the first organization authorized by the American Heart Association to function as a mobile, global International Training Organization, providing Pediatric Advanced Life Support (PALS), Advanced Life Support (ACLS), and Basic Life Support (BLS) certification to medical professionals around the world.

In May 2010, OS HQ, LLC, a wholly owned subsidiary of Operation Smile, was formed to hold the assets and liabilities for a new global center located in Virginia Beach, Virginia. A groundbreaking was held in September 2010 with construction expected to be completed by Fall 2012.

In July 2003, Operation Smile Foundation, Inc. (the Foundation), also a 501 c(3) organization, became active. The purpose of the Foundation is to provide long-term financial support and fundraising capabilities to Operation Smile. The bylaws of the Foundation require that 85% of the earnings and other income, as defined, be disbursed to Operation Smile on a quarterly basis. The remaining 15% is to remain in the Foundation for the purpose of expanding and preserving the Foundation's asset base.

Operation Smile and the Foundation comprise the combined group collectively referred to as OSI. OSI currently has nine active chapter organizations throughout the United States and three representative offices in international countries, and their activities have been included in the accompanying financial statements. The accompanying combined financial statements do not include the accounts of OSI affiliates in international countries. OSI has international foundations that host mission teams, which are responsible for all in-country mission logistics. International foundations may also raise funds and awareness to support programs in international countries.

### *(b) Principles of Combination*

The accompanying combined financial statements include the accounts of Operation Smile (including its wholly owned subsidiary, OS HQ, LLC) and the Foundation. All significant intercompany balances and transactions have been eliminated in combination.

### *(c) Classification of Gifts*

OSI reports gifts of cash and other assets, including unconditional promises to give, as increases to unrestricted net assets, unless use of the related assets is limited by donor-imposed restrictions. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying combined statements of activities as net assets released from restrictions.

***(d) Unconditional Promises to Give***

Contributions are recognized as revenue when an unconditional promise to give has been made. Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises were received. Amortization of the discounts is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. Conditional promises to give are not included as revenue until the conditions are substantially met.

***(e) Cash***

Cash consists primarily of cash in banks. Cash in banks exceeded federally insured limits at both June 30, 2012 and 2011.

***(f) Investments***

Investment securities consist primarily of money market funds held in investment broker accounts, U.S. Treasury bills, and mutual funds. The net realized and unrealized gains and losses on investments are reflected in the accompanying combined statements of activities.

***(g) Prepaid Expenses***

Prepaid expenses are stated at cost less applicable amortization and include expenses prepaid for events that will occur in the next fiscal year and for insurance premiums, which are expensed over their estimated useful lives using the straight-line method.

***(h) Inventories***

Inventories consist primarily of supplies to be used for medical missions. Purchased inventory is valued at the lower of cost or fair value and donated inventory is valued at fair value, both on the first-in, first-out basis.

***(i) Property and Equipment***

Property and equipment are stated at cost except for donated equipment, artwork, and land, which are stated at fair value at the date of receipt. Medical equipment and furniture, fixtures, and office equipment are depreciated using the straight-line method over estimated useful lives ranging from 3 to 10 years. No provision for depreciation is made on land or artwork. No provision for depreciation is made on construction in process or work in process until such time as the relevant assets are completed and placed in service. Buildings and building improvements are depreciated using the straight-line method over their estimated useful lives of 40 years. Total depreciation expense for the years ended June 30, 2012 and 2011 was $331,397 and $370,616, respectively.

### *(j) Deferred Revenue*

Deferred revenue consists of cash collected for events that will occur in future periods.

### *(k) Classification of Net Assets*

OSI's net assets are grouped into the following three classes:

*Unrestricted Net Assets* – Unrestricted net assets generally result from contributions and other revenues not subject to donor-imposed restrictions.

*Temporarily Restricted Net Assets* – Temporarily restricted net assets generally result from contributions and other revenues whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of OSI pursuant to those stipulations.

*Permanently Restricted Net Assets* – Permanently restricted net assets result from contributions whose use by the organization is limited by donor stipulation that neither expire by passage of time nor can be fulfilled or otherwise removed by OSI. There were no permanently restricted net assets at June 30, 2012 or 2011.

### *(l) Functional Expenses*

OSI allocates its expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are allocated directly. Other expenses that are common to several functions are allocated based on various statistical bases, such as content, time, and purpose.

### *(m) Joint Cost Allocation*

OSI incurred expenses that were identifiable with a particular function but served joint purposes. Expenses related to certain events, donor communication and program materials jointly support medical missions, education and sustainability, fundraising, and administration and were allocated by their function classification as follows for the years ended June 30, 2012 and 2011:

| | **2012** | **2011** |
|---|---|---|
| Medical missions | $ 33,177 | 40,044 |
| Education and sustainability | 6,470,618 | 5,962,253 |
| Fund-raising | 9,148,512 | 8,181,236 |
| Administration | 867,295 | 441,451 |
| Total joint costs | $ 16,519,602 | 14,624,984 |

### *(n) Capitalized Interest*

OSI's policy is to capitalize interest cost incurred on debt during the construction of major projects exceeding one year. A reconciliation of total interest cost to "Interest" as reported in the combined statements of functional expenses for 2012 and 2011 is as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Interest cost capitalized | $ | 116,311 | — |
| Interest cost charged to income | | 8,696 | 7,747 |
| Total interest cost | $ | 125,007 | 7,747 |

### *(o) Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

### *(p) Fair Value Measurements*

OSI utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to OSI at the measurement date.
- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly.
- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

OSI's investments represent the financial assets that are accounted for at fair value on a recurring basis. At June 30, 2012 and 2011, the carrying value of all the investments was considered to be the fair value determined using Level 1 inputs in the fair value hierarchy.

***(q) Impairment of Long-Lived Assets***

Long-lived assets, such as property and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. As of June 30, 2012 and 2011, there was no indication of impairment. Any assets to be disposed of within the next fiscal year would be separately presented in the statements of financial position and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the statements of financial position.

***(r) Subsequent Events***

OSI has evaluated subsequent events from the statement of financial position date through December 4, 2012, the date these combined financial statements were available to be issued, and determined there are no other items to disclose.

**(2) Contributions Receivable**

Contributions receivable at June 30, 2012 and 2011 are expected to be received as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Within one year | $ | 2,391,262 | 3,796,892 |
| From one to five years | | 12,017,345 | 1,856,697 |
| | | 14,408,607 | 5,653,589 |
| Less discount to present value at rates, which range from 0.27% to 5.33% | | 263,267 | 113,204 |
| | $ | 14,145,340 | 5,540,385 |

**(3) Investments**

Investments consist of the following at June 30, 2012 and 2011:

| | | 2012 | 2011 |
|---|---|---|---|
| Money market funds | $ | 2,928,304 | 1,886,242 |
| U.S. Treasury bills | | — | 3,501,004 |
| Mutual funds | | 115,287 | 118,971 |
| Total investments | $ | 3,043,591 | 5,506,217 |



(Continued)

## (4) Property and Equipment

Property and equipment consist of the following at June 30, 2012 and 2011:

| | 2012 | 2011 |
|---|---|---|
| Construction in process (new global center) | $ 12,215,385 | — |
| Work in process | 76,316 | 1,968,540 |
| Medical equipment | 2,548,890 | 2,596,118 |
| Furniture, fixtures, and office equipment | 1,310,026 | 1,469,787 |
| Buildings | 240,555 | 240,555 |
| Building improvements | 362,448 | 362,448 |
| Land | 3,094,293 | 3,094,293 |
| Artwork | 210,347 | — |
| | 20,058,260 | 9,731,741 |
| Less accumulated depreciation | 3,712,598 | 3,659,517 |
| Property and equipment, net | $ 16,345,662 | 6,072,224 |

As of June 30, 2012 and 2011, furniture, fixtures, and office equipment recorded under capital leases have a cost basis of $88,909 and $84,317 and related accumulated amortization of $55,633 and $38,370 for a net book value of $33,276 and $45,947, respectively.

## (5) Contributed Services and Gifts-in-Kind

OSI's medical missions are staffed by volunteer surgical teams. In addition, when patients require treatment in the United States under the World Care Program, the hospital stay and related services are fully or partially donated by the hospitals and physicians. Services are also contributed within the United States for medical and dental care. These donated medical services are recorded at their estimated fair values and are classified as contributed services revenues and medical missions expenses in the accompanying combined statements of activities. Such services amounted to $26,253,585 and $25,140,416 in 2012 and 2011, respectively. OSI's medical missions are staffed by volunteer administrative support staff. These administrative personnel services are not recorded in the accompanying combined financial statements.

Donated mission supplies are received throughout the year for use in the overall Operation Smile mission, are recorded at their estimated fair values, and are classified as gifts-in-kind revenues in the accompanying statements of activities. Such donations amounted to $3,146,244 and $3,104,913 in 2012 and 2011, respectively. These supplies are expensed as they are used on missions and are classified as medical missions expenses in the accompanying statements of activities. Use of donated mission supplies amounted to $3,019,471 and $2,983,126 in 2012 and 2011, respectively.

The organization received a sculpture to be placed at the new global center. The estimated fair market value of the sculpture, $210,347, is included in gifts-in-kind revenues in the accompanying statements of activities for 2012.


(Continued)

The City of Virginia Beach, Virginia donated land to OS HQ, LLC to be used for the new global center. The estimated fair value of the land, $3,050,000, is included in gifts-in-kind revenues in the accompanying statements of activities for 2011. The deed of gift includes a provision that construction of improvements on the land must be completed within 24 months of the construction commencement date, or by September 19, 2013, otherwise the City of Virginia Beach will have the right and option to reacquire the land at no cost. As such, the land has been recorded as a temporarily restricted asset in the accompanying financial statements as of and for the year ended June 30, 2012.

## (6) Leases

OSI is obligated under capital and operating leases for its facility and certain equipment. The facility lease is an operating lease expiring in October 2012, but OSI has secured an extension allowing it to remain in its current facility through January 2013.

Future minimum lease payments under the operating lease and the present value of future minimum capital lease payments as of June 30, 2012 are as follows:

| | Capital lease | Operating lease |
|---|---|---|
| Year ending June 30: | | |
| 2013 | $ 20,681 | 77,847 |
| 2014 | 12,871 | 5,096 |
| 2015 | 12,599 | — |
| 2016 | 6,491 | — |
| Total minimum lease payments | 52,642 | $ 82,943 |
| Less amount representing interest | 19,366 | |
| Present value of net minimum lease payments | 33,276 | |
| Less current maturities of capital lease obligations | 14,532 | |
| Capital lease obligations, excluding current maturities | $ 18,744 | |

Total rent expense was $327,349 and $191,535 in 2012 and 2011, respectively.

## (7) Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following at June 30, 2012 and 2011:

| | 2012 | 2011 |
|---|---|---|
| Care centers | $ 448,255 | 211,583 |
| Domestic programs | 54,828 | 48,878 |
| Fellowships | 90,200 | — |
| Global education and sustainability | 67,097 | 162,086 |
| International programs | 1,124,931 | 873,045 |
| Land | 3,050,000 | 3,050,000 |
| Research | 141,414 | 107,259 |
| Other programs | 57,165 | — |
| Total purpose restricted | 5,033,890 | 4,452,851 |
| Total time restricted | 12,710,742 | 3,975,023 |
| Total temporarily restricted net assets | $ 17,744,632 | 8,427,874 |

## (8) Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by the donors. Total net assets released were $8,051,212 and $7,739,480 for the years ended June 30, 2012 and 2011, respectively.

## (9) Retirement Savings Plan

OSI has a 401(k) retirement savings plan. Employees are eligible the first of the quarter following four months of employment. OSI matches a portion of the employee contributions and makes a safe harbor contribution on behalf of each employee. OSI's contributions to the retirement savings plans for the years ended June 30, 2012 and 2011 were $488,521 and $430,863, respectively.

## (10) Related-Party Transactions

OSI received contributions from its Board of Directors and respective committee members of $216,894 and $113,426 for the years ended June 30, 2012 and 2011, respectively. Some board members may contribute directly to independent, affiliated Operation Smile international foundations.



(Continued)

## (11) Long-Term Debt

Long-term debt at June 30, 2012 consists of the following:

| | | 2012 |
|---|---|---|
| Non-revolving construction loan up to $8,500,000, 5.5% interest payable monthly for the first 36 months, followed by monthly installments of principal and interest through July 22, 2018 | $ | 7,130,152 |
| Non-interest bearing promissory note ($1,000,000 principal) payable annually beginning August 31, 2013. | | 1,000,000 |
| Total long-term debt | | 8,130,152 |
| Less current installments | | — |
| Long-term debt, excluding current installments | $ | 8,130,152 |

In July 2011, a donor pledged $10,000,000 and OSI entered into a construction loan agreement with a financial institution to complete construction of its new global center. The loan is guaranteed by the donor and is secured by a first priority lien on the property. The loan agreement requires OSI to maintain a minimum aggregate liquidity of $5,000,000, as defined, as well as a $1,000,000 compensating balance to be held by the financial institution until the loan is paid in full. Repayment terms are interest only due monthly for 36 months, followed by 47 consecutive, equal monthly installments of principal and interest based on a 20-year amortization and the then-current interest rate, as determined by the financial institution.

In September 2011, OSI obtained $1,000,000 cash and entered into an interest-free promissory note for the same amount for expansion of its global direct response program. No payments are required under the note until the later of August 31, 2013 or when OSI’s net proceeds, as defined, received from the related fund raising campaign, as defined, exceed $1,000,000. At that point, a payment schedule based on aggregate net proceeds under the fund raising campaign will apply.